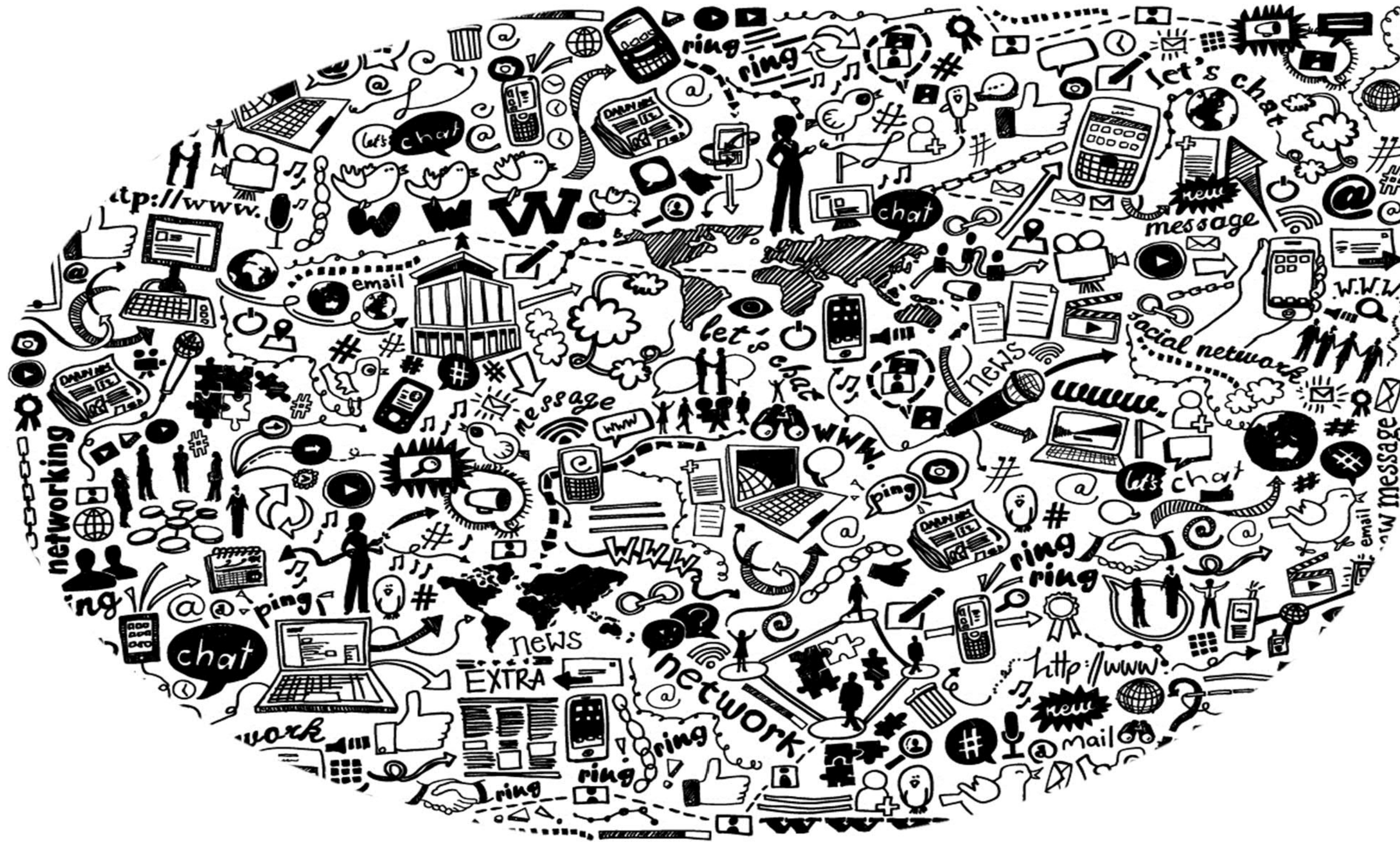
BUSINESS
WIRC
Ind AS – Impact on Media and Entertainment Industry including Practical Aspects
Govind Ahuja
October 6, 2018

Contents

- Industry overview – Emerging trends
- Ind AS – Impact on Accounting
  - Ind AS 115: Changes to revenue recognition
  - Ind AS 38: Intangibles (Rights: amortization, impairment)
  - Ind AS 103 & Ind AS 110: Business Combination & Consolidation-related topics
  - Others - Ind AS 102: ESOPs

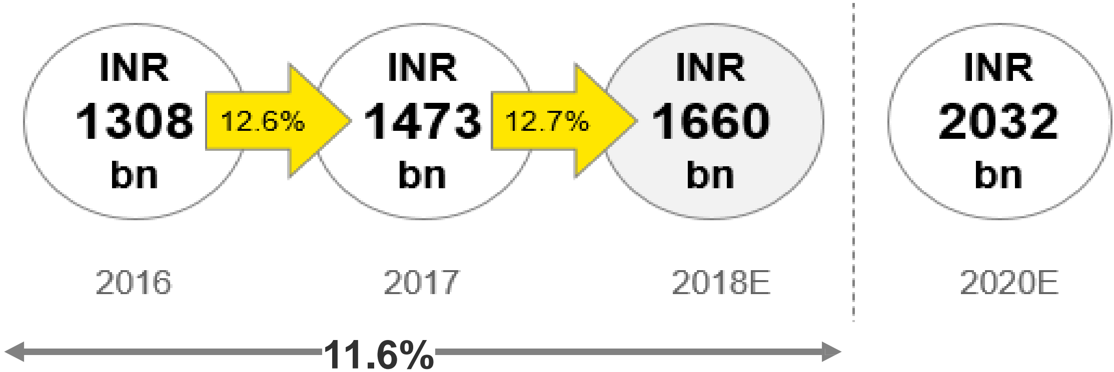
M&E Industry overview & Emerging trends



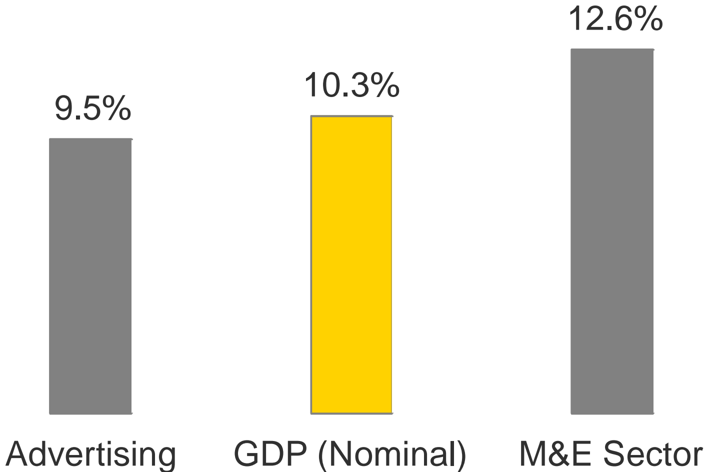
The Indian M&E sector- Growth story

(Amounts are gross of tax, for Jan to Dec of each year)

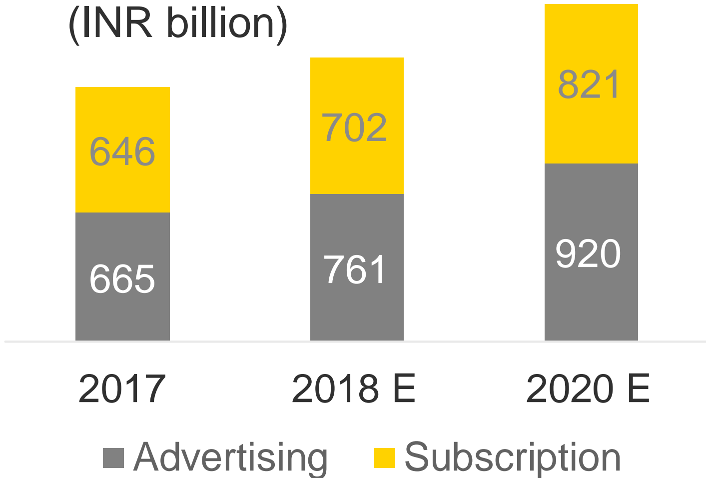
Looking ahead… to INR2 trillion by 2020



Indian M&E sector grew faster than GDP

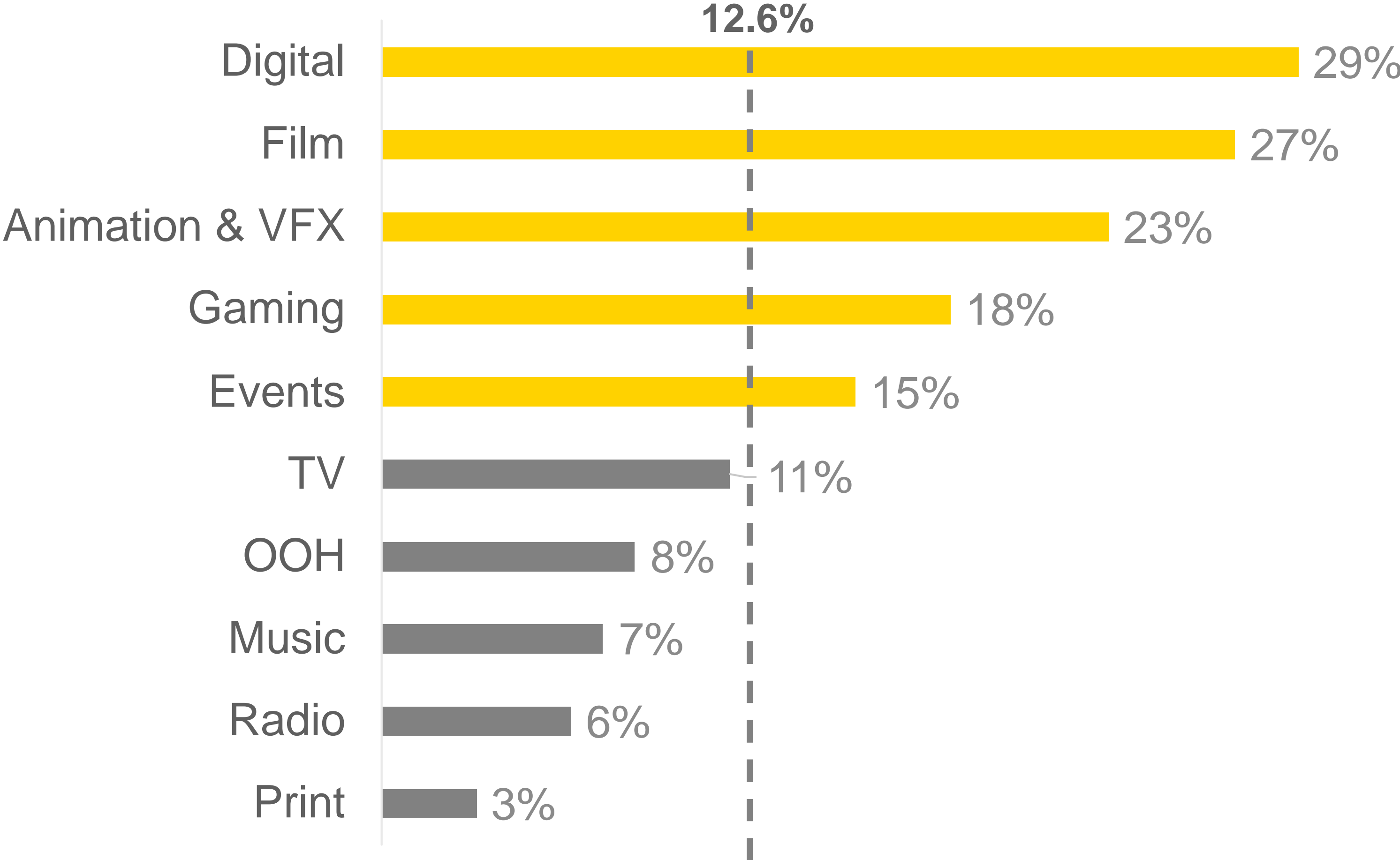


Subscription grew > advertising in 2017

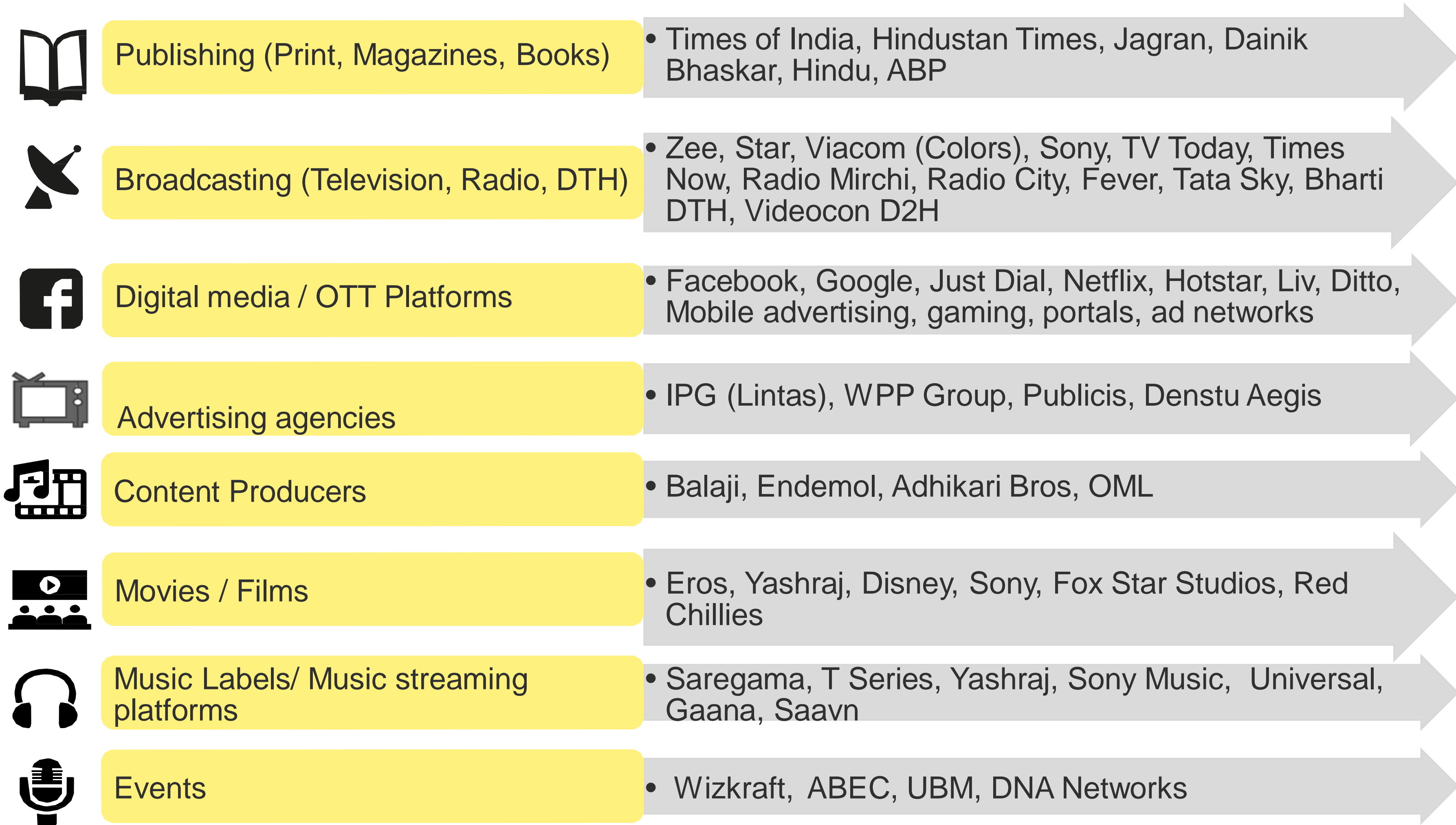


Source: Re-imagining India's M&E sector (FICCI-2018 report)

Digital tipping point - Emerging trends
Growth was led by digital, film, gaming



M&E key players



M&E revenue streams

GST impact on M&E

Positive | Neutral | Negative

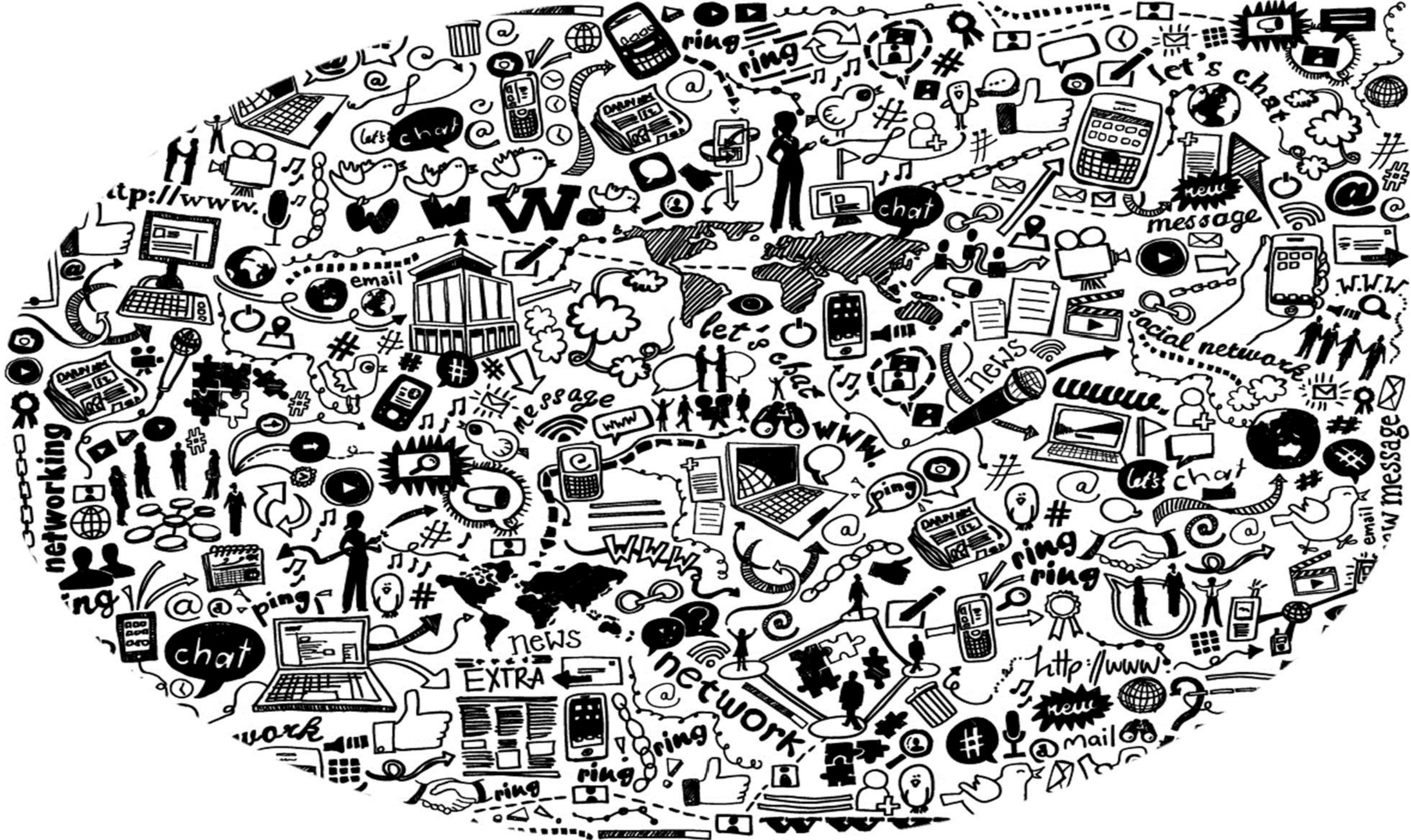
Sector	Input	Output	Implications
	• **Advertisement (In print media)** - 5% (with full ITC) • **Advertisement (other than print)** - 18% (with full ITC) • Supply of signage - 28% (with full ITC)	• **Procurement of:** • **Print media** - 5% (with full ITC) • **Other media** - 18% (with full ITC) • **Flex** - 12% (with full ITC) • **Signage** - 28% (with full ITC)	With trading sector being eligible for setoff of GST paid to Ad agencies, there seems to be effective increase in budgets for ad spends. Also, with advertisement in print media being brought to tax ambit under GST, there would be minimal credit reversal for the agencies resulting in slight positive impact on advertising agencies.
	• **Ad Sales and Distribution** - 18% (with full ITC) • **Syndication revenue** - 12% (with full ITC)	• **Content right (IPR)** - 12% (with full ITC) • **In- house prod (services)** - 18% (with full ITC) • **IRD boxes** - 28%(with full ITC) (No BCD)	With increase in rate of tax, the working capital requirement will increase which will be compensated with marginal increase in credit of VAT (which was not available under service tax regime).
	• **Production revenue** - 12% (with full ITC)	• **Production cost (line producer)** - 18% GST (with ITC)) • **Copyrights** - 12% (under RCM)	Credit of taxes will be fully available to film producers. However, due to fall in theatrical revenue collection from film exhibitors, the overall impact on producers is negative.

GST impact on M&E

Positive | Neutral | Negative

Sector	Input	Output	Implications
	• **Sale of movie tickets** - 28% (with full ITC) • **Ad revenue** - 18% (with full ITC) • **Food & beverage revenue** - 12%- 28% +applicable cess (if any)	• **Content Cost** - 12%/18% (with full ITC) • **Leased premises** - 18% (with full ITC) • **Leased infrastructure** - 28% (with full ITC)	GST rate of 28% on sale of tickets is an average increase of 18% on existing average entertainment tax rate (while the impact could differ from state to state). If state charges local body entertainment tax, GST will be significantly negative for film exhibition.
	• **Subscription revenue** - 18% (with full ITC) • **Advertisement revenue** - 18% (with full ITC)	• **Content Cost** - 12%/18% (with full ITC)	Digital companies are likely to have neutral negative impact under GST regime. With increase in rate of tax, the working capital requirement will increase.
	• **Advertisement in print media** - 5% (with full ITC) • **Circulation revenue (Newspaper)** - Nil rate	• **Newsprint** - 5% (with full ITC) • **Printing Job work (Newspaper)** - 5% (with full ITC)	Sale of newspaper is exempted while advertisements in newspapers are taxed at 5%. Proportionate credit of taxes paid on expenses will be available. However, this will be compensated by fall in business from exempted clients.

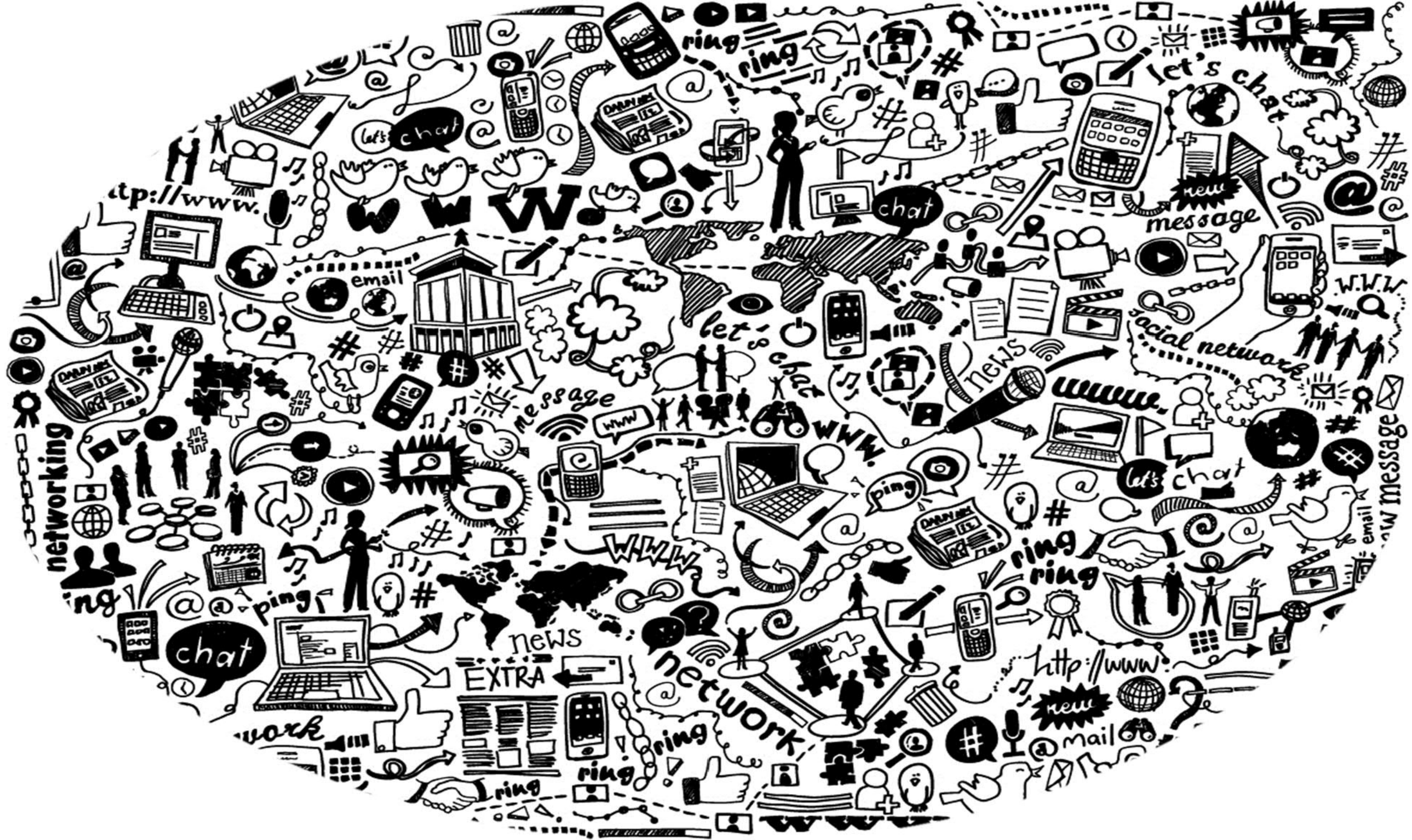
Ind AS: **Accounting Impact**



Ind AS : Practical examples

Revenue recognition	Intangible Assets	Business Combination/ Consolidation	Others
Subscription and Carriage fees	Accounting of Intangibles	Assessment of control	Share-based payment transactions
Bundled contracts	Amortisation of Rights	Potential voting rights	
Volume rebates	Impairment	Gain on dilution of stake	
Barter		Step up acquisition	
Gross vs Net		Common control	

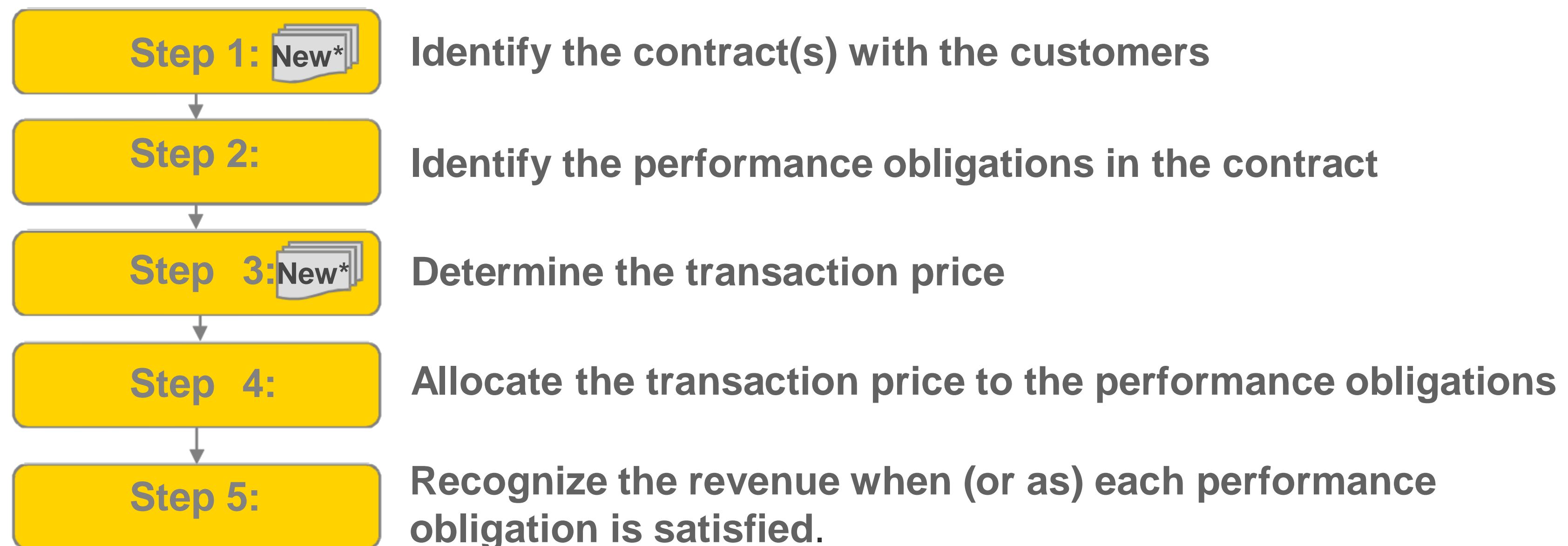
Ind AS 115- Revenue



Implementation of Ind AS 115

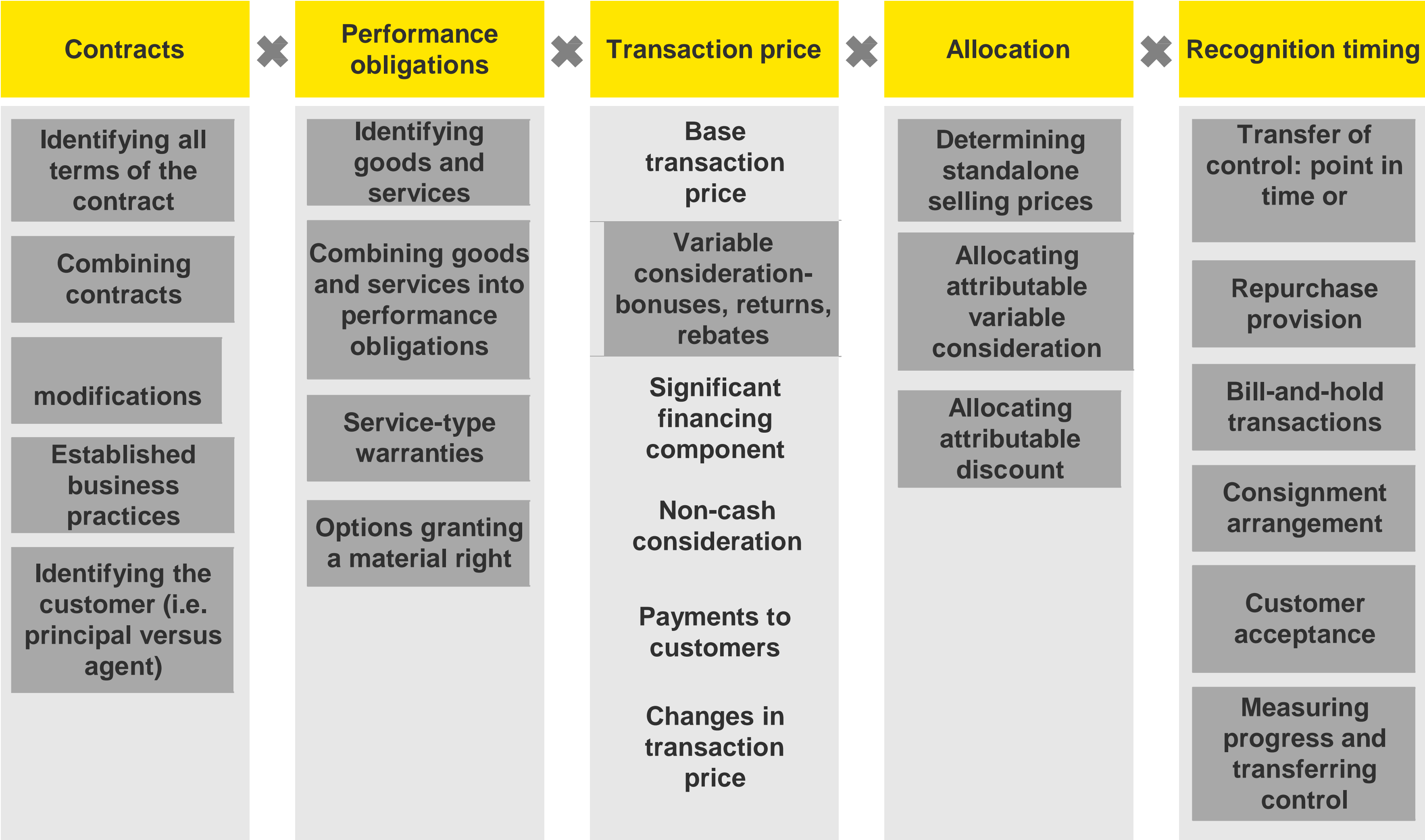
- Ind AS 115, Revenue from customer contracts which replaces existing revenue recognition requirements is applicable from April 1, 2018.

- Prescribes a five step model to decide timing and amount of revenue recognition from contracts with customer and also specifies how to account for the incremental costs of obtaining a contracts and the costs directly related to fulfilling a contract.



What should you consider?

Added complexities



Ind AS 115 - Transition Approach

Approach	Application	Comparatives
Full retrospective	The financial statements are presented as if Ind AS 115 had always been applied in accordance with Ind AS 8, Accounting policies, changes in accounting estimates and errors.	Comparatives (including the opening balance sheet) are restated.
Modified retrospective	Entities will recognise the cumulative effect of initially applying Ind AS 115 as an adjustment to the opening balance of equity at the date of initial application.	Comparatives are not restated and are presented using existing revenue standards (Ind AS 11, Construction Contracts and Ind AS 18, Revenue).

Irrespective of the transition approach elected, the 'date of initial application' is the start of the reporting period in which an entity first applies Ind AS 115 (i.e. 1 April 2018 for entities with years ending 31 March 2019).

New disclosure requirements

- Key principle of Ind AS 115 is to help financial statement users understand the
  - Nature, amount, timing
  - Uncertainty of revenue and cash flows arising from contracts with customers
- Entity must present qualitative and quantitative information about:
  - Contracts with customers-
    - Disaggregation of revenue
    - Changes in contract assets, liabilities and costs
    - Performance obligation
  - Significant judgments and changes in judgments made when applying the guidance to those contracts-
    - Determining the timing of satisfaction of performance obligations
    - Determining the transaction price
    - Determining amounts allocated to performance obligations
  - Assets recognized for costs to obtain or fulfill a contract

Accounting requirements and related examples

Ind AS 115 requirements	Practical examples
Identifying the contracts	Accounting for subscription revenue and carriage fees contracts with the same customer
Identifying the performance obligations in the contract	Valuation of free/ bonus spots
Determining transaction price	Volume rebates to advertising agencies
Allocate the transaction price to the performance obligations	Bundled contracts / Multiple element contracts
Gross / net reporting of revenue	Digital Print Fee in theatrical business

Pay channel subscription for carriage

- A television channel charges cable operators a per subscriber fee for its pay channel. The cable operator charge placement or carriage fees to television channel to carry their channel on its network.
- If a television channel and cable operator agree not to charge each other for pay channel and carriage respectively, is there a transaction involving barter?
- Under IGAAP- Cost and revenue was recorded separately basis the agreement

Ind As 18	Ind AS 115
► We have to understand the substance of the transaction of whether there is indeed a service involved for either party. ► In case the television channel is not popular and does not earn pay channel revenue from all cable operators, it could be possible to argue that there is no pay channel revenue ► Likewise, if the cable operator does not charge carriage to some other television channels, there could be no carriage fee involved. ► In both of the above situations, it will be important not to have conflicting documentation	► However, under Ind As 115, if it is concluded that the transaction has substance, given than the: ► Contracts are negotiated as a single commercial package and consideration in one contract depends on the other contract The contracts will be **accounted for as a single contract- hence net subscription revenue of carriage fees will be disclosed** (whichever is higher)

Multiple element contracts/ Bundled deals

Indian GAAP	Ind-AS 18	Ind-AS 115
► No specific guidance. ► Transactions recorded more basis the form of document rather than the substance	► Separate fair valuation of each element is required though Ind AS 18 does not prescribe an allocation method. ► Appendix B mentions two methods for allocation: 'relative fair values' or 'residual value method' (valuation of undelivered component). ► Hence judgement is required to select the most appropriate method	► Transaction price is allocated to each separate performance obligation in proportion of the stand alone selling prices, irrespective of whether they form a part of a single contract or a lump sum consideration. ► **Specific requirements to allocate discounts & variable consideration.** ► **Free spots**: Forms a part of performance obligation and revenue relating to the stand alone selling price of the bonus spots to be delivered post period end should be deferred
► Completed contract method allowed	► Revenue to be recognized basis percentage completion	► Five step revenue recognition model

Multiple element contracts / Bundled deals Composite contract for ad space and services

- Green FM is in the radio broadcasting business. Fragrant Co is a FMCG company which manufactures a beauty soap “Panache”
- Green FM also conducts events for music awards which are subsequently also telecast on a Hindi GEC. Fragrant Co has contracted with B for ‘Panache’ to be the title sponsors of the music awards events for a consideration of Rs.2 crores.
- Along with the title sponsorship of the event, Fragrant Co also receives other deliverables such as Panache standees in the on-ground event, Panache gift hampers to be given to the winners, etc.
- Besides this, Panache will be advertised as a title sponsor during the on-air radio promotions for the event, its logo will be displayed on hoarding promoting the event and during TV promos and advertisements of Panache will also be played during the telecast on TV
- The event was conducted on Mar 29th and has been telecast on 5th April.

Considering that the event was already held before Mar 31, Green FM has recognized Rs.1.5 crores of sponsorship revenue and has deferred Rs.50 lacs which is the value of the advertisements to be played during the telecast. Is this revenue recognition appropriate?

Multiple element contracts / Bundled deals Composite contract for ad space and services

- Transaction price is allocated to each separate performance obligation in the proportion of the "stand alone selling price" of each obligation. If stand alone selling price is not observable the transaction price is allocated based on the entity's estimation of the stand alone selling price.

- The estimation is dependent on the value perceived by the customer for each deliverable vis-à-vis the value for the entire contract value. Considering that Panache will be advertised the most during the telecast of the event which will have millions of viewers as opposed to the few thousands during the on-ground event, the perceived advertising value of the on-ground event is lesser.
- Green FM never sells the on ground standees/ gift hampers on a standalone basis, so it estimates the standalone selling price based on the underlying cost and the amount of margin the entity believes the market will bear (i.e. the expected cost plus a margin approach)

Deliverable	Year End Status	Stand-Alone selling price	% of stand alone price	Allocated values
On ground standees/ Gift hampers	Delivered	1,000,000	3.57%	714,000
Title sponsor logo on hoardings/ mentions during on-air spots	Delivered	7,000,000	25.00%	5,000,000
Advertisements on TV	Un-delivered	5,000,000	17.86%	3,572,000
Title sponsor name during telecast	Un-delivered	15,000,000	53.57%	10,714,000
		28,000,000		**20,000,000**

Free space/ Bonus advertisements

Composite contract for ad space across programmes / channels and sponsorships

- ► MediaCo is into publishing business and publishes various newspapers across the country and also conducts awards every year for recognize industry players.
- ► MediaCo has entered into a composite agreement customer whereby along with sponsorship of the awards to be held in Feb 2018, it will also provide free advertisement space in all publications from Mar 2018 to June 2018 for Rs.1 crore
- ► The advertisement space offered is otherwise sold for Rs.40 lacs to other customers.
- ► The Company would generally expect sponsorship of Rs.80 lacs and proposes to recognise Rs 80 lacs as revenue as sponsorship has been delivered

How does the Company record revenue for this arrangement for FY 2018?

How does it measure the fair value of each of the components in the composite contract?

Free space/ Bonus advertisements

- Under IGAAP, mixed practices were followed as there was no specific guidance and accounting was based more on documentation than substance.
- Ind AS 115 requires the transaction price to be allocated to the each performance obligation (this was also required under Ind AS 18). Free services provided are a part of the performance obligations.
- Further, paragraph 31 of Ind AS 115 requires that revenue shall be recognised when the entity satisfies a performance obligation by transferring a promised good or service to a customer.
- Thus, the revenue for the ads to be published in newspaper should be valued based on the rates at which the same space in the same publication is sold to an unrelated party and is recognised as and when the ads are actually published (Stand alone selling price). Balance portion of the agreement is assigned to the sponsorship revenues and recognised once the awards event is aired.

Deliverable	Year End Status at Mar 2018	Stand-Alone selling price	Allocated Value
Event sponsorship	Delivered	8,000,000	6,000,000 (i.e.10-4)
Advertisement	Undelivered	4,000,000	4,000,000
		12,000,000	10,000,000

Volume rebates

Media Co. sells each ad spot at Rs. 1,000/- and usually gives a volume discount at 10% to customers contracting for more than 100 spots on the entire contract value.

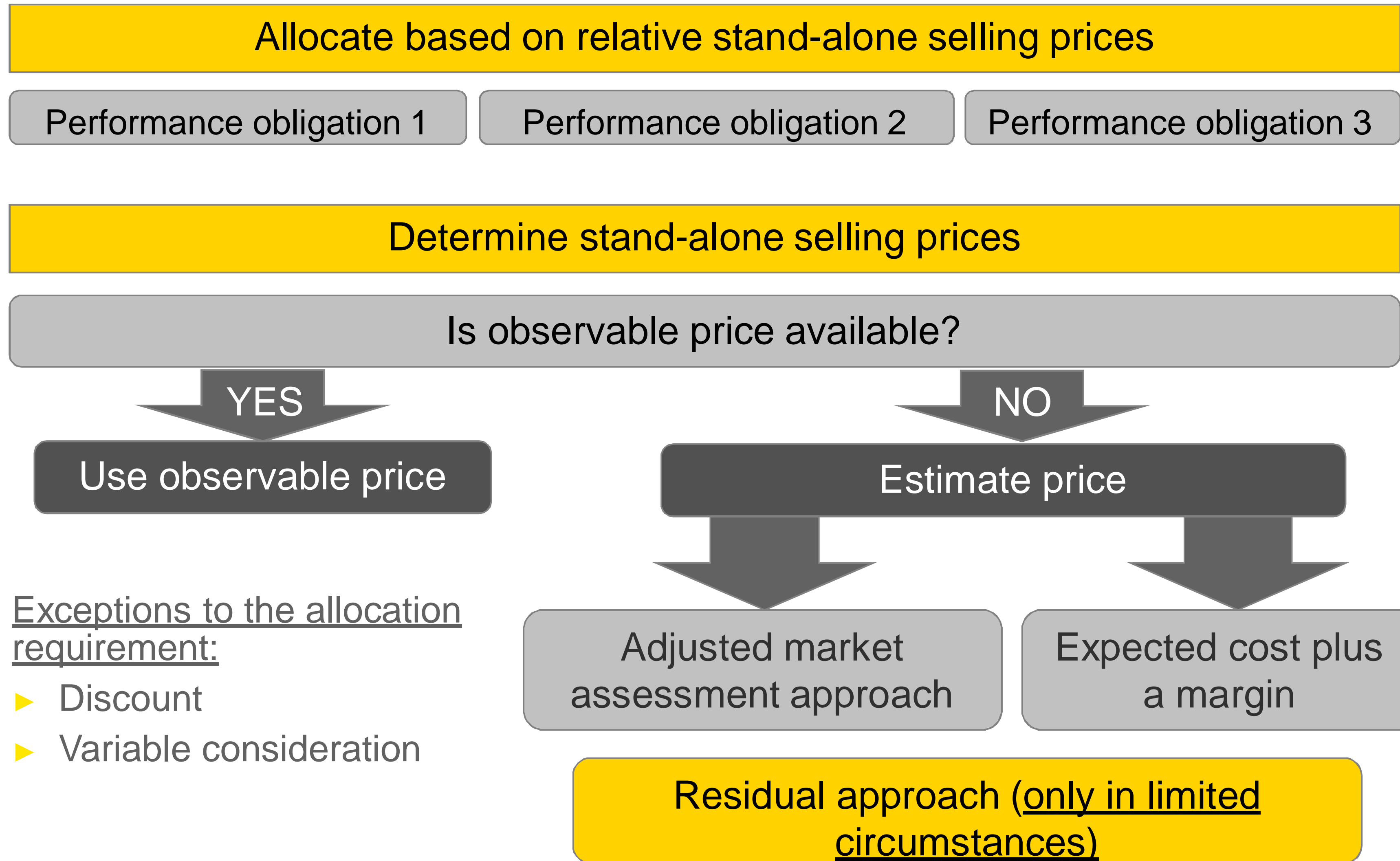
What is the revenue to be recognized when Media Co sells 450 spots to a customer?

Indian GAAP	Ind-AS 18	Ind-AS 115
No specific guidance	Revenue is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity	According to Ind AS 115.50, "if the consideration promised in the contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to the customer."

The revenue to be recognized by Media Co is to be netted off of the rebates given.

Particulars		Amount
Revenue derived (Rs.1000*450)	(A)	450,000
Volume Discount (>100 spot)…	(B)	10%
Volume Discount….	(C=A*B)	45,000
Net Revenue to be recognized…..	(D=A-C)	405,000

Allocation of the transaction price: Guidance
(Graphical representation of Paragraph 76-79 of Ind AS 115)



Barter transactions

IGAAP: No guidance under AS 9. Some insights available under the 'Guidance note for accounting for Dot-com companies' which is in line with IFRS

Ind AS 18	Ind AS 115
► Exchange of dissimilar goods and services, where revenue can be reliably measured is considered as 'Barter' ► Exchange of goods or services of a similar nature and value is not regarded as a sale ► Barter transaction to be recorded at the fair value of assets given up/ services delivered- based on 'similar, comparable' transaction. ► If the same is not identifiable- cost of services received/ asset received can be used for measurement. ► **Comparable & similar transactions imply transactions with third parties**, in the recent past for similar case facts (for example, similar duration, placement, timing of the advertisement)	► Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers ► An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. ► Paragraph 66 of Ind AS 115 provides that **to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of noncash consideration) at fair value** ► If one cannot reasonably estimate the fair value of the non-cash consideration, then measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration

► Barter transactions are **NOT** tax neutral since withholding tax, GST needs to be paid on the same

Barter transactions

Advertising services for goods:

- ► Entity AB Corp is in the creative advertising services business.
- ► Entity CD Corp is engaged in manufacturing and supplying of office lights, LED lamps, lighting fixtures etc.
- ► Both the entities have entered in to a contract whereby, AB Corp will produce a television advertisement (TVC) for advertising home lights of CD Corp and in turn CD Corp will supply the office lighting fixtures to AB Corp.
- ► AB Corp charges other customers- Rs.50 lacs for making a TVC and CD Corp has given a quote of Rs.85 lacs to provide similar fixtures to another office of a similar size
- ► Both the services are rendered in June 2018.

How should this transaction be recorded by AB Corp in June 2018?

Barter transactions
Ad space for goods and services

Recording of barter transactions:

- Given the transaction involves goods and services, revenue from barter can be recorded by both.
- The transaction is accounted by reference to the stand alone value of **advertising service provided**
- Therefore AB Corp recognises revenue of Rs.50 lacs and assets of Rs.50 lacs (and not Rs.85 lacs) in June 2018. Appropriate TDS and indirect tax to be recorded and paid both transactions.

Barter transactions

Ad space for services –

- ► Entity OOH is in the outdoor hoardings business.
- ► Entity FilmCo is mainly engaged in production of films and music videos and has recently produced a movie named “Super hit”.
- ► The entities have entered into an arrangement wherein OOH will provide outdoor hoardings to promote “Super hit” and in turn OOH will be named as the Outdoor promotion partner in the movie of “Super hit”. Both value the services at Rs.25 lacs.
- ► Super hit movie hoardings are displayed in the last week of June 2018 and the movie releases on July 3rd 2018

How should this transaction be recorded by OOH in June 2018?

Barter transactions
Ad space for goods and services

Recording of barter transactions:

- ► The medium of advertisement (Outdoor v/s film promotion) is dissimilar in nature and revenue can be reliably measured-hence this barter transaction will be recorded by both.
- ► Revenue is to be recognized only on the basis of actual services received and services provided, till the period end. Therefore OOH should recognise revenue at Rs.50 lacs in June 2018 and do the indirect tax compliance.
- ► The corresponding barter cost will be recognized only after the movie release which falls in July 2018.

Gross v/s Net reporting: Guidance

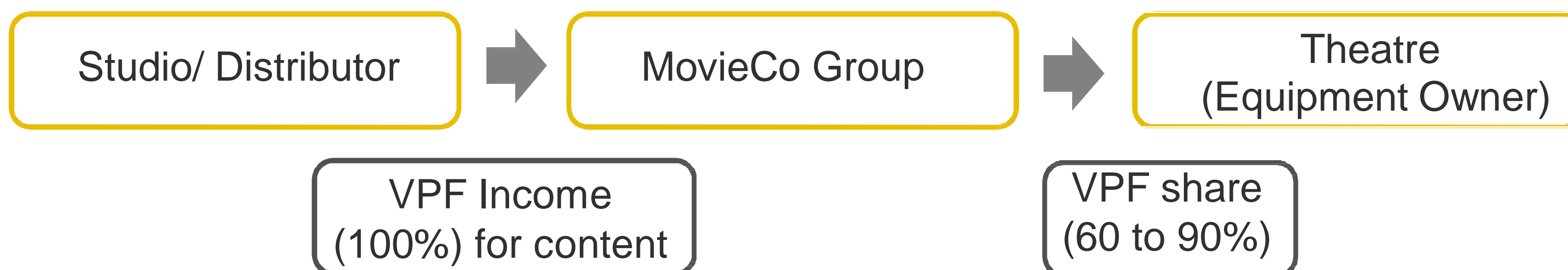
Indian GAAP	Ind-AS 18	Ind AS 115
No specific guidance	► Subjective matter requiring consideration of all facts and circumstances ► An entity is acting as a ‘principal’ when it has exposure to the **significant risks and rewards** associated with the sale of goods or rendering of services. ► Indicators include: ► **primary responsibility** for providing the goods or services to the customer or for fulfilling order, ► **inventory risk** before/after the customer order, during shipping/ on return; ► **latitude in establishing prices**, either directly or indirectly, for example by providing additional goods or services; and ► **customer's credit risk** on the receivable due from the customer	► An entity is a principal if the entity **controls a promised good or service before its transfer** to a customer ► An entity is an agent if the entity’s performance obligation is to arrange for the provision of goods or services by another party ► Indicators include: ► **Primary responsibility** for providing the goods or services to the customer or for fulfilling order, ► **Inventory risk** before the specified order has been transferred or after transfer of control (in case of right of return); ► **Latitude** in establishing prices, either directly or indirectly (agent may have some flexibility in setting prices to generate additional revenue)

Gross v/s Net reporting – Digital Print Fee

- Movie Co is a film exhibitor. It enters in to contract with distributors and studios to earn revenue (.i.e. digital print income) on account of display of movies in the theatres.
- The control of the 'movie' is transferred by the studio to MovieCo who then directly transmits the same to its equipment installed at the theatres.
- MovieCo shares 60-90% of the revenue with the theatre owners as digital print fee.

Will MovieCo account for this transaction on a gross or net basis?

Gross v/s Net reporting – Digital Print Fee



Condition of Gross V Net	Assessment for MovieCo Group
Control	► MovieCo **controls** the content once it receives the content from the studio
Responsibility	► Fulfilment of the contract is the primary responsibility of MovieCo
Pricing	► MovieCo **exercises its discretion** and latitude in establishing the VPF **prices** with the studio. ► The **theatre does not influence** prices in any manner whatsoever.
Agency Relationship	► MovieCo **does not** in any way, present itself to be an **agent** of the theatre or the studio
Credit Risk	► Though Ind As 115 does not include credit risk as a key indicator, it is essential to note that MovieCo is not liable to pay the theatre if it does not receive any revenue from the Studio.

- Accordingly, MovieCo is a principal in the above transaction, and the VPF income received from Studios and VPF share paid to the theatres should continue to be recorded on a gross basis.

Gross v/s Net
Broadcasting – presentation of agency incentives

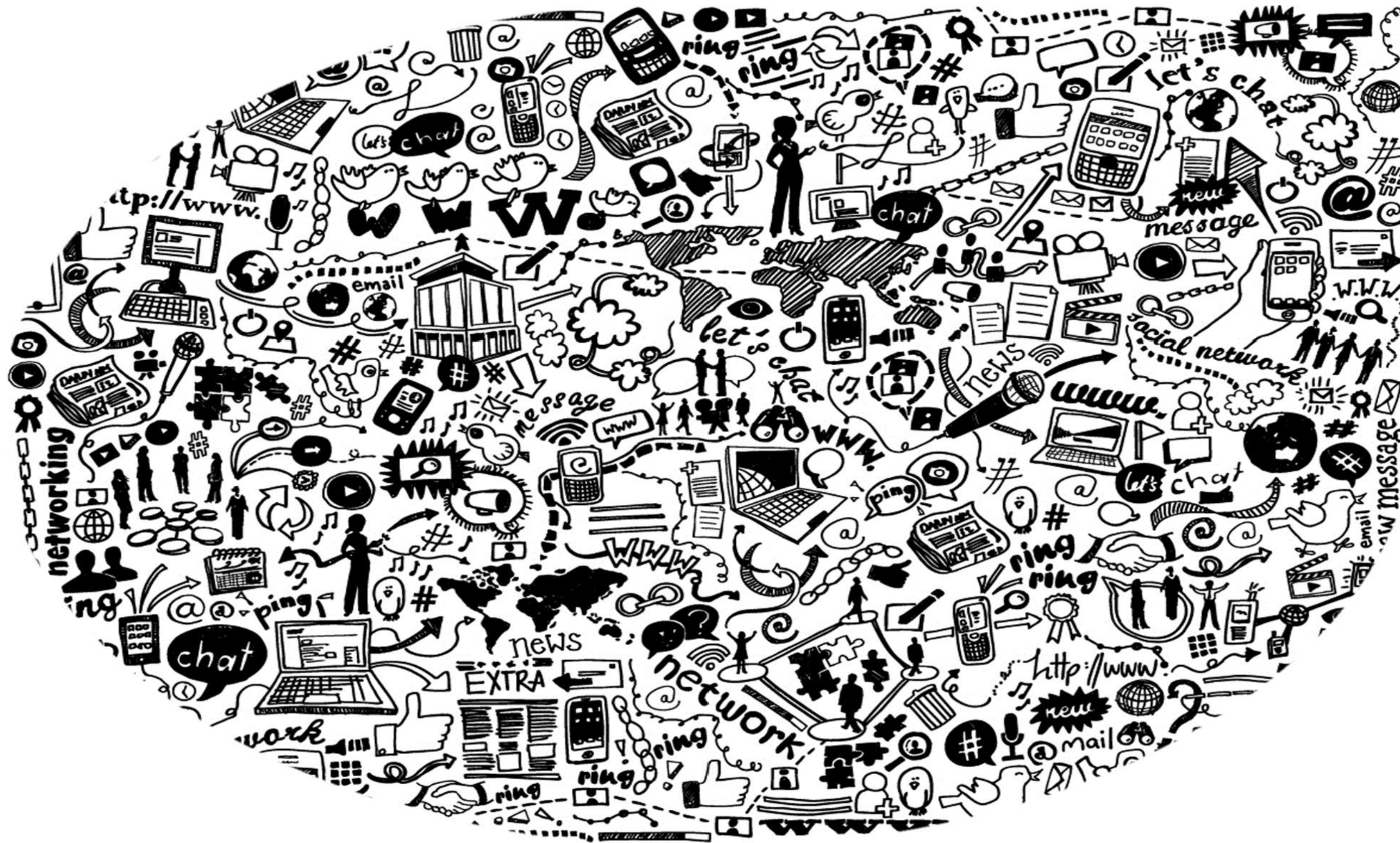
- Moon TV is into television broadcasting business and broadcasts 40+ channels across the country.
- It enters into ad sales agreements with various agencies fixing the ad rates and also the target incentives to be paid to these agencies at a certain pre-defined percentage on meeting the target sales.
- Incentives are paid in the form of cash and the same are paid only after all the dues are cleared by the agencies within the due date.

How will the Company account for the incentives to be paid to the agencies?

Gross v/s Net
Broadcasting – presentation of agency incentives

- The incentives are in the nature of discounts and are directly linked to the revenues
- Ind As 115 requires that ‘discount should be allocated entirely to one or more, but not all, performance obligations in the contract basis certain criteria being met.
- Since discounts are required to be allocated to the performance obligations, the revenue for the performance obligation will be reduced to the extent of the discount.
- Thus, the incentives are netted off from the revenues and disclosed on a net basis.

Intangible Rights



Intangible rights
Amortisation

Indian GAAP	Ind-AS
► Useful life is always finite. There is a rebuttable presumption that the useful life shall not exceed 10 years. ► Revaluation of intangible assets is prohibited.	► Useful life of an intangible asset can be finite or indefinite. No such rebuttable presumption ► Choose either cost model or revaluation model as its accounting policy. The revaluation model permitted only where there is an active market
Amortisation ► No specific literature- for amortisation of content in M&E. Generally, amortization is charged over the useful life of the asset.	► Finite life- Amortised over its useful life on a systematic basis. ► Indefinite life- Shall not be amortized but tested for impairment at least annually and whenever there is indication of impairment.
Revenue based amortisation ► For movie rights/ television program rights a revenue based amortisation is followed whereby generally higher amortisation is recorded in the initial years as rights are expected to realise higher revenues in the initial years, considering that usually highest value is realised on the first telecast/broadcast and dips thereafter.	► Ind As 38 contains a rebuttable presumption that **revenue-based amortisation method is inappropriate** and this presumption can be overcome only in the limited circumstances. This presumption can be overcome only of the revenue and consumption of the economic benefits of the intangible assets are **'highly co-related**'.

Intangible rights

- FilmCo is a film production studio and records the cost of the movies acquired/produced by is as ‘intangible assets’. It owns the intellectual property rights for the movies produced/co-produced/acquired by it.

- FilmCo may adopt a revenue based amortisation policy by adopting an ‘individual-movie forecast’ method by analysing whether revenue and consumption of the economic benefits of the intangible assets are ‘highly co-related’ under Ind AS 38.

- Though the standard does not define what is meant by ‘**highly correlated**’ it describes situations where the asset is ‘expressed as a measure of revenue’.

Intangible rights

- FilmCo is a production company and earns approximately 85-90% of its total estimated revenues from each movie in the year of release itself, in form of :
  - Theatrical revenues
  - Syndication of 1st run of the non-theatrical rights-music, cable and satellite rights, VOD rights.

- 2nd run of these non-theatrical rights will syndicated only after expiry of the first run, which could be approximately 10%-15% of the revenues from the first run.

- Since FilmCo has earned the most significant portion (85-90%) of the estimated lifetime revenues/ benefits in the 1st year of the release, it may be evident that the revenue and consumption of the economic benefits of the intangible asset are highly correlated and amortisation using revenue based model can be adopted. Using a straight lined method or other systematic method of amortization, may distort the profits for each of the years

- Alternatively, if FilmCo was an OTT platform which purchased movie rights for a 5 year license term for its library of content and earned revenues from subscription/ advertisements, one cannot say that the consumption of economic benefits are correlated to the revenue it earns. Hence the amortisation of the rights will be usually over a straight line method or any other systematic method.

Movie rights

Particulars		Total	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
FlimCo as Producer: Cost of production / /intangible asset on release		100	-	-	-	-	-
Estimated life time revenues	**(A)**	**200**	**180**	**-**	**-**	**15**	**5**
Theatrical		120	120	-	-	-	-
Non-theatrical revenues		80	60	-	-	15	5
Amortisation of cost in the ratio of revenues/economic benefits (Only if highly correlated under Ind AS 38)	(B)	100	90	-	-	8	2
Net Impact in PL- Producer of movies earning revenues from theatrical release or sale of non-theatrical rights	**(A)-(B)**	**100**	**90**	**-**	**-**	**7**	**3**
FlimCo as OTT Platform : Cost of purchase of rights as a library		100	-	-	-	-	-
Estimated revenue from subscription and advertisement (not co-related to specific movie rights)	**(A)**	**1500**	**300**	**500**	**200**	**300**	**200**
Amortisation of cost – straight line basis	(B)	100	20	20	20	20	20
Net Impact in PL- Not presented as there is no specific movie wise P&L							

Intangible rights
Impairment assessment –TV broadcasters

- Television broadcasters acquire high cost content (movies, sports, live event rights) which necessarily does not earn advertising revenue commensurate the cost of the right

- Generally, such programs are marketed individually and not in conjunction with other programs
  - If at the outset, the program cost is not recovered through advertising, is there a risk of impairment?

- To determine
  - Impact on subscription revenue
  - Revenue potential of a channel / network given that this channel / network has unique programing
  - the Cash Generating Unit

In practice, broadcasters review their business as a network of channels and not by an individual channel or program. As such, the CGU is generally the entire channel or network as the Company is able to earn pay channel revenue for the entire year – examples being sports channels where the sports events are not held evenly through the year

Intangible rights
Impairment assessment – film producers

- Film producers produce multiple films in a year which are exploited in theatres, television, digital, etc

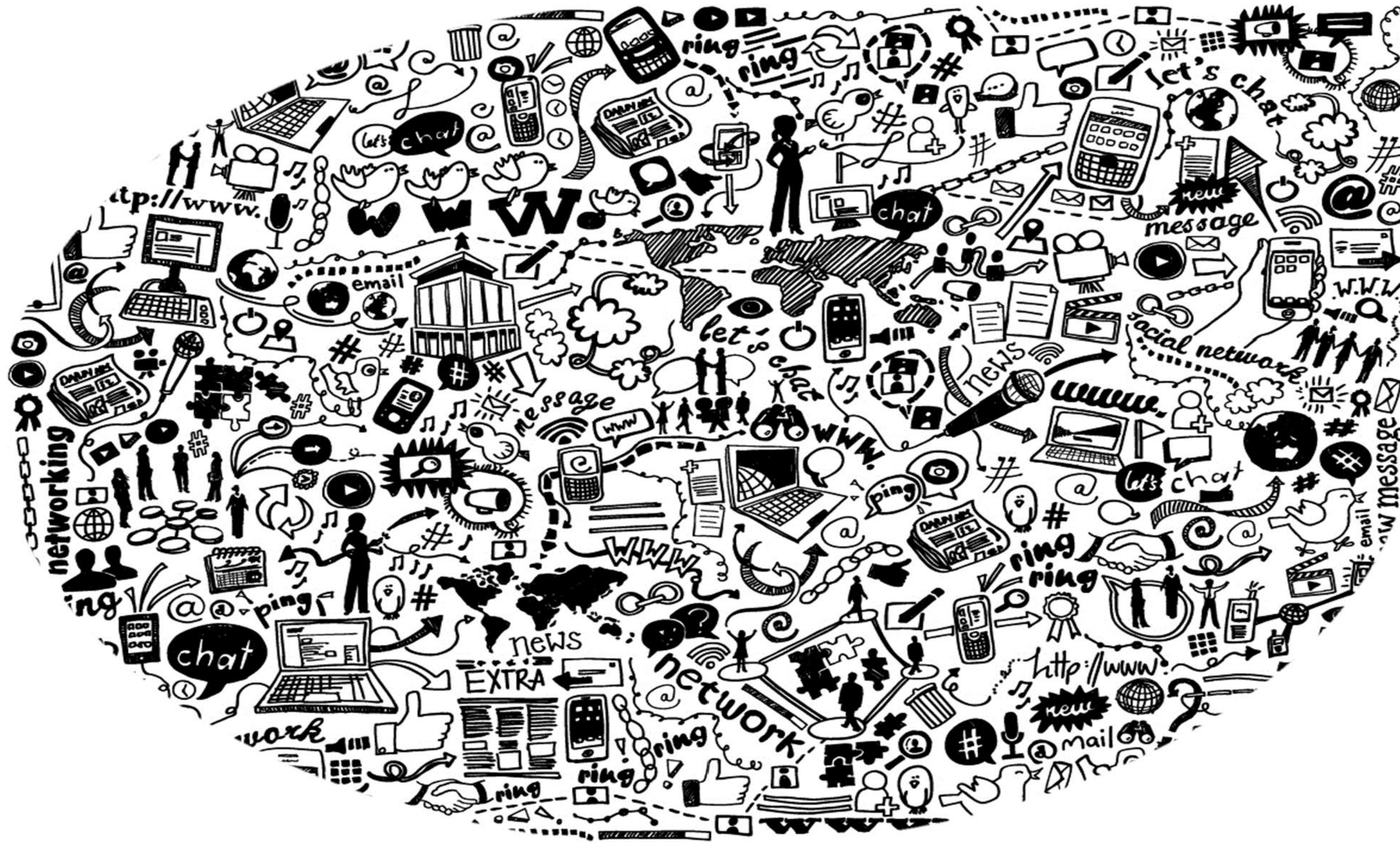
- New films are generally sold individually while old films are sold individually or as a package (bundled with other films). When sold as a bundle, there is specific value attributed to each film

- If at the outset, the film cost is not recovered as per plan, is there a risk of impairment?

- To determine
  - Performance of the film on the box office
  - Rights available with the film producer

In practice, film producers review the performance of each film separately. As such, the CGU is generally each film as the Company is able to track earnings from each exploitation by film.

Business combination & Consolidation



Assessment of control / significant influence

- Entity A acquired 10% stake in Entity B. Entity B is engaged into the business of developing, upgrading, maintaining and operating the software and monetizing such software. Entity A can nominate 1 out of the 3 directors. Certain policy making matters are reserved for specific approval by Entity A before Entity B can action them.

- In lieu of the investment by A , Entity B will design a software for A that provides holistic "Payable/Receivable Management Solutions", which will assist A to manage working capital and cash flows. Pursuant to mutual discussions between Entity A and the promoters of Entity B, it has been agreed that Entity B shall grant a perpetual license of this software to Entity A. It is also mentioned in the agreement that Entity B can sell the license to the software to other third party as well.

How will the investment in Entity B be classified under Ind AS?

- Per the definition of control as per Ind AS 110, "an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee".

- Thus, an investor controls an investee if and only if the investor has all the following:
  - Power over the investee;
  - Exposure, or rights, to variable returns from its involvement with the investee; and
  - The ability to use its power over the investee to affect the amount of the investor's returns.

Assessment of control / significant influence

Indicators of Control	Assessment
Power over the investee	A owns only 10% of the equity share capital of B. There are no other contractual arrangements which results in power, the reserved matters mentioned above are designed only to protect the interest of A without giving A any power over B or any decision making rights.
Exposure, or rights, to variable returns from its involvement with the investee.	A does not have the ability to affect its returns from its involvement with B and does not have any decision making rights which can affect the returns.
The ability to use its power over the investee to affect the amount of the investor's returns.	Though certain policy decisions are reserved for A , those decisions are not the ones that can affect the returns of A.

- Since Entity A does not control Entity B, B is not a subsidiary

- Per Ind AS 28, an associate is an entity over which the investor has significant influence. If the entity holds, directly or indirectly, less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated.
- Some of the significant influence indicators are met in this case are:
  - Representation on the board of directors or equivalent governing body of the investee
  - Material transactions between the entity and its investee
  - Participation in policy-making processes but it is not control or joint control over those policies

- **Thus, Entity B can be assessed to be an associate of Entity A**

Potential Voting Rights

- Hold Co Group's subsidiary Parent Co Ltd holds 100% equity share capital of Subs Co Ltd which was acquired for a consideration of Rs.250 crores.
- Another investor -Invest Co Ltd subscribed to 40% of freshly issued Non Cumulative Compulsorily Convertible Preference Shares (NCCPS) by Subs Co for a consideration of Rs.600 crores.
- Total Net worth of Subs Co as at date of issuance of NCCPS was Rs. 700 crores

Particulars	Equity held in Subs Co	Preference held in Subs Co	Diluted Stake in Subs Co
Parent Co	100.00%	-	60%
Invest Co	-	40%	40%

- What will be the accounting implications under Ind AS?
- What will be the proportion of Subs Co that will be consolidated by Hold Co Group?

Potential Voting Rights

Indian GAAP	Ind-AS
► No specific guidance	**Clause B47 Ind AS 110**: ► When assessing control, an investor shall consider its potential voting rights and potential voting rights held by other parties, to determine whether it has power. **Clause B89 & B90 Ind AS 110:** ► The proportion of profit or loss and changes in equity allocated to the parent and NCI in preparing consolidated financial statements (CFS) is determined solely on the basis of existing ownership interests and does not reflect possible exercise or conversion of potential voting rights. ► In some circumstances an entity has, in substance an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such cases, CFS shall be prepared taking into account the eventual exercise or conversion of potential voting rights.

- For assessing the control, Hold Co Group to consider the diluted stake in Subs Co as per Clause B47- Since Hold Co Group controls more than 50% of the voting power even on a diluted basis, Subs Co continues to be consolidated as a 'subsidiary'
- While preparing the CFS, Hold Co Group will however consider the **existing ownership** stake of 100% as per Clause B89 and **consolidate 100% of the assets** of Subs Co Ltd

Gain on partial dilution of ownership interest

Indian GAAP	Ind-AS
► No specific guidance	**Changes in Proportion held by NCI**: ► An entity shall adjust the carrying amounts of controlling and non controlling interests to reflect the changes in their relative interests in subsidiary. ► The entity shall **directly recognize in equity any difference between the amount by which NCI is adjusted and the fair value of consideration paid or received**, and attribute it to owners of parent

Particulars		Amount (in crore)
Total Networth of Subs Co Ltd	(A)	700
Invest Co's Diluted stake in Subs Co.	(B)	40%
Invest Co's Share of Net Assets	(C=A*B)	280
Investment in Subs Co by Invest Co	(D)	600
Difference	(E=C-D)	(320)
'Gain on Partial dilution of ownership interest' recognized in Other equity in the CFS of Hold Co Group		

Step up acquisition

- On 1st October 2017, MediaCorp increased its equity interest in Gem Media Limited (or ‘Fun’) from 50% to 51% by acquiring in cash 1% of the equity shares held by the other JV partner for Rs.10 crores and consequently obtained operational control over Gem.
- Accordingly, the Company consolidated Gem as subsidiary from 1st October 2017

Particulars	Amount (in crore)
Carrying value of existing investment in Gem (accounted as FVTPL)	100
FV of existing equity stake	500
Purchase consideration paid for additional 1% stake	10
Net assets of Gem as at Mar 1, 2018	200

What should be the accounting treatment in the consolidated financial statements of MediaCorp?

Step up acquisition

- Under Ind AS 103 – Business Combinations such transactions are considered as ‘step up acquisitions’ which require re-measurement of previously held equity interest at its acquisition date fair value and to recognise the resulting gain in the statement of profit and loss

- Further, excess of consideration transferred, non-controlling interest and the re-measured equity interest in the acquiree over fair value of identifiable assets acquired and liabilities assumed is recorded as goodwill.

Particulars	Amount (in crore)
Acquisition date FV of existing equity stake	500
Carrying value	100
Gain on dilution – P&L	**400**
Purchase consideration paid for additional 1% stake	10
New cost of 51% - Fair value of 50% stake on date of acquisition + cost of 1%	**510**
MediaCorp’s share of Net assets of Gem as at Mar 1, 2018	102
Goodwill as on the date of acquisition (Balance sheet)	**408**

Business combination- common control

Indian GAAP	Ind-AS
► The existing standard does not define 'identifiability', but states that an intangible asset could be distinguished clearly from goodwill if the asset was separable, but that separability was not a necessary condition for identifiability. ► The useful life of intangible asset may not be indefinite. ► Any difference between the fair value of asset acquired and purchase consideration paid is recognized as Goodwill. ► Goodwill is amortised over a period of 5 years from the acquisition date and is annually tested for impairment.	► Per Ind AS 103, if an entity has acquired only Assets, it is considered as Assets acquisition. If acquisition is in the nature of business, it should account for it as a business combination in accordance with Ind AS 103. ► Para 8: Business combinations involving entities or businesses under common control shall be accounted for using the **pooling of interests method.** ► If transferor is considered to be an entity under common control, then the difference in the carrying amount of assets acquired on the acquisition date and the consideration paid will be taken to **capital reserve.** ► The assets and liabilities of the combining entities are reflected at their carrying amounts**. No adjustments are made to reflect fair values, or recognise any new assets or liabilities.** The only adjustments that are made are to harmonise accounting policies.

Business Combination- common control

- XYZ Private Limited had acquired assets and customer contracts / relationships related to 'garment business' from ABC Incorporation Inc., holding company of the Company's parent company for Rs. 100 crores in FY 2015.
- The Company arrived at the purchase consideration on fair value basis and accounted assets of Rs. 20 crores as fixed assets and balance of Rs. 80 crores as goodwill under the Indian GAAP and was being amortized over a period of 5 years.

How will the assets acquired from ABC be accounted under Ind AS while transitioning to Ind AS in FY 2018?

- In the above example, XYZ has obtained identifiable assets worth Rs. 20 crores and other intangibles in the nature of customer contracts and relationships which are considered to have been in the nature of business acquisition and not in the nature of asset acquisition as in substance the garment business has been acquired on a going concern basis.

- Per Ind AS 103, the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in Ind AS 38, Intangible Assets) and liabilities assumed.

- As per para 8 to para 12, business combination involving entities or businesses under common control shall be accounted under 'pooling of interest method' and **values of identifiable assets are taken over at book value**

- Any difference between purchase consideration paid and book value of identifiable assets taken over is credited to **Capital Reserve**.

Business Combination- common control

- ► Reversal of goodwill and the related amortization
- ► Recording of assets and liabilities at book value
- ► Differential amount of to be debited to Capital Reserve under Ind AS

ESOP granted by parent to subsidiary’s employees

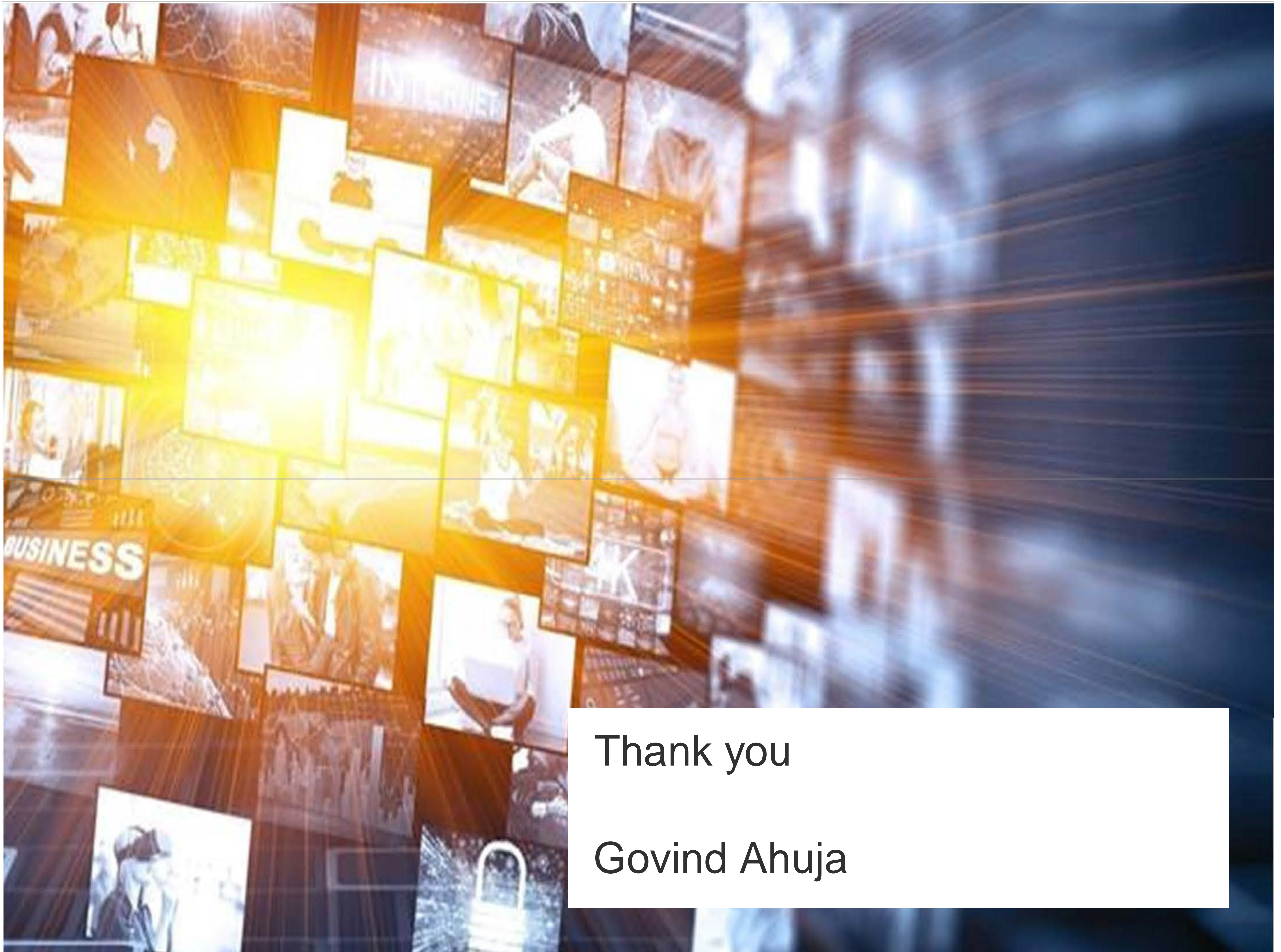
- Certain employees of the XYZ Private Limited are eligible to stock options granted by ABC Corporation Inc., ultimate parent company.
- Stock options were granted by the ultimate parent company at a price not less than its fair market value on the date of grant.
- The management of XYZ is of the opinion that XYZ does not have any settlement obligation nor has received any cross charge from the ultimate parent company for these stock options. Accordingly no cost was recorded in the books of the Company in Indian GAAP.

Ind-AS Guidance

- As per Ind AS 102 - Share based payments, where a parent grants rights to its equity instruments directly to the employees of its subsidiary: **the parent (not the subsidiary) has the obligation** to provide the employees of the subsidiary with the equity instruments
- B53 – Since the subsidiary does not have an obligation to provide its parent’s equity instruments to the employees, the subsidiary shall measure the services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions, and recognise a **corresponding increase in equity** as a contribution from the parent.

Resources

- ► Ind AS – Standards
- ► ICAI Publication – Educational material on Ind AS -115
- ► EY - FICCI Frames Report 2018 (Re-imaging India's M&E sector)



Thank you

Govind Ahuja