

Global vision backed by local knowledge



## IND AS – APPLICATION, ANALYSIS & MAT

Financial Year ended 31 March 2017

THE POWER OF BEING UNDERSTOOD





## RSM IN INDIA

- RSM India (comprising of RSM Astute Consulting Group and affiliates) is consistently ranked amongst India's top 6 tax, accounting and consulting groups [International Accounting Bulletin, September 2016]
- Nationwide presence through offices in 11 key cities across India
- Multi-disciplinary personnel strength of over 1,300
- International delivery capabilities

[rsmindia.in](http://rsmindia.in)

---

## RSM AROUND THE GLOBE

- Sixth largest audit, tax and consulting network across the globe
- Annual combined fee income of US\$ 4.87 billion
- Combined staff of over 41,400 in over 800 offices across 120 countries
- RSM is the fifth largest audit, tax and consulting group in the USA

[rsm.global](http://rsm.global)



Ind AS – Application, Analysis & MAT  
Financial Year ended 31 March 2017

# Foreword

With effect from financial year ended 31 March 2017, Indian companies are required to follow, Indian Accounting Standards (Ind AS)<sup>1</sup>, which represent the Indian converged globally followed International Financial Reporting Standards (IFRS). This will align Indian financial reporting with the globally followed financial reporting standards making it easier for Indian companies to access global investors and lenders as well as facilitate mergers and acquisitions. This is being implemented in phases with first phase, covering listed and unlisted companies with net worth in excess of Rs. 500 crores (phase I) from financial year ended 31 March 2017. As per the estimates, approximately 350<sup>2</sup> companies/groups, covered in phase I of Ind AS roadmap, have published their financial results under Ind AS. From 1 April 2017, approximately 8,500 Indian companies, i.e., balance listed companies and unlisted companies with net worth in excess of Rs. 250 crores, will be covered by Ind AS (phase II). As a result, the manner in which Ind AS has been applied by Phase I companies, its in-depth analysis and impact on different sectors as well as the MAT implications due to changes in book profits are of great relevance to Phase II companies. Towards this end, this publication provides an Ind AS technical analysis based the 31 March 2017 annual financial results of 104 companies across 18 sectors covered in Ind AS phase I. We discuss the sector-wise impact of the Ind AS requirements vis-à-vis the previous Indian GAAP accounting considering the key Ind AS impact areas that were reported by way of profit and equity (net worth) reconciliations by these companies as well as the MAT implications. This publication would help the phase II Ind AS companies to identify Ind AS requirements that are relevant to their industry sector and evaluate various accounting policy choices available under Ind AS.

In addition to the impact on the financial results of the companies, the transition caused significant far-reaching consequential business impact. For example, reclassification of redeemable preference shares from equity to debt impacted net worth, debt –equity and interest coverage ratios of several companies. Resultantly, many companies have had to re-negotiate the covenants in loan agreements with their lenders. Finance Act, 2017 introduced the tax provisions under minimum alternate tax (MAT) provisions for Ind AS companies. These provisions excluded fair value adjustments to Property, Plant & Equipments (PPE) as well as Investments from the levy of MAT which provided a lot of

1 Prescribed under section/133 of Companies Act, 2013 as notified under Companies (Indian Accounting Standards) Rules, 2015 as amended by Companies (Indian Accounting Standards Amendment) Rules, 2016  
2 These figures estimated by a report. We have not verified this figure.

flexibility to the asset based companies to revalue these assets which were carried at considerably lower historical costs (less depreciation). However, other than the above assets, these provisions resulted in most Ind AS adjustments, including transition impact, being taxed under MAT provisions. In many cases, there have been significant regulatory challenges, such as, power and infrastructure companies potentially meeting the criteria for NBFCs. The Ind AS assessment of existence of control over another entity is different from that under regulations, such as, Companies Act, IRDA and SEBI takeover code. This resulted in deconsolidation/ first-time consolidation of subsidiaries and other investee companies by many large Indian groups.

Recently, there have been Ind AS amendments notified by the Ministry of Corporate Affairs (MCA), as also, revisions in ICAI's interpretative pronouncements on Ind AS. These amendments, effective from 1 April 2017, were not part of Ind AS when phase I Ind AS companies adopted Ind AS. However, phase II Ind AS companies have to consider these amendments together with the overall transition to Ind AS. Furthermore, there are Ind AS exposure drafts issued by the ICAI proposing future Ind AS changes which may have to be considered by phase II Ind AS companies in FY 2017-18, if notified by the MCA in time. We have summarised the changes / proposals of the amendments / proposals in a separate chapter.

Ind AS contains several areas involving application of significant areas judgments and financial reporting is based on significant management estimates. Therefore, it is pertinent to examine the Ind AS application and implementation issues. Currently, there is limited literature of the Ind AS application and implementation issues. In this publication, we endeavor to bring out significant transition and first-time adoption related issues that are emerging in practice. In that context, we discuss various accounting options available under Ind AS, both upon transition on first-time adoption as well as those available on an ongoing basis. We discuss the sector-wise Ind AS transition adjustment analysis. This publication would also help Ind AS phase I companies to benchmark their Ind AS accounting with that of their industry peers as also with other leading companies.

This publication is not meant to deal with the quantitative impact that the shift to Ind AS may have caused from a capital markets or market capitalization perspective. Nor is it meant to examine, in detail, the differences between Indian GAAP and Ind AS. This publication aims to assess the accounting impact on the Ind AS transition for a wide cross-section of sectors with an objective to aid phase II companies leverage on the experiences, thereby, providing them with a head start for their Ind AS journey.

## Table of Contents

<b>Chapter 1</b>	<b>Introduction</b>	<b>1</b>
<b>Chapter 2</b>	<b>The Way Forward for Phase II Ind AS Companies</b>	<b>4</b>
<b>Chapter 3</b>	<b>Key Ind AS Adjustments – Overall Analysis</b>	<b>9</b>
<b>Chapter 4</b>	<b>Key Accounting Options Available under Ind AS</b>	<b>15</b>
<b>Chapter 5</b>	<b>Key Recent Ind AS Updates</b>	<b>31</b>
<b>Chapter 6</b>	<b>Minimum Alternate Tax for Ind AS Compliant Companies</b>	<b>38</b>
<b>Chapter 7</b>	<b>Methodology of Our analysis</b>	<b>51</b>
<b>Chapter 8</b>	<b>Summary of Ind AS Analysis</b>	<b>54</b>
<b>Chapter 9</b>	<b>Sector-wise Ind AS Analysis</b>	<b>68</b>
9.1	Automotive and auto components	69
9.2	Cement and allied products	76
9.3	Fast moving consumer goods	81
9.4	Hospitality and leisure	86
9.5	Industrial products and heavy engineering	90
9.6	Infrastructure	94
9.7	Iron and steel	101
9.8	Jewelry and gems	106
9.9	Media and entertainment	110
9.10	Mining and metals	114
9.11	Oil and gas	119
9.12	Power and utilities	124
9.13	Pharmaceuticals and life sciences	132
9.14	Real estate and construction	138
9.15	Retail	143
9.16	Technology and IT enabling services	146
9.17	Telecom operations and infrastructure	151
9.18	Transportation and logistics	155
	<b>Appendix – Key Changes in Indian GAAP</b>	<b>159</b>
	<b>Glossary</b>	<b>160</b>



International Financial Reporting Standards (IFRS) have become the de facto global standards for financial reporting prevalent in around 120 countries<sup>3</sup>. As a move towards IFRS convergence in India, the Ministry of Corporate Affairs (MCA) notified the roadmap for Indian Accounting Standards (Ind AS) implementation for corporates (companies other than banks, insurance companies and NBFCs) on 16 February 2015. Ind AS are largely based on IFRS, with a few differences (carve outs) intended to smoothen the transition to Ind AS for Indian companies.

With effect from financial year ended 31 March 2017, phase I companies i.e. listed and unlisted companies with net worth of Rs. 500 crores (about US\$ 75 million) or more have applied Ind AS, along with their group companies<sup>4</sup>. As a result, about 350 listed phase I companies have published their financial results for the financial year ended 31 March 2017.

With effect from financial year beginning 1 April 2017 (FY 2017–18), about 8,500 phase II companies i.e., the remaining listed companies and unlisted companies with net worth of Rs. 250 crores (about US\$ 38 million) or more have to apply Ind AS, along with their group companies<sup>4</sup>. This means that listed phase II companies will have to start publishing their financial results starting from June 2017 quarter. The next chapter deals with the timelines and the requirements more extensively.

Ind AS contains several significant differences in many areas compared to the erstwhile Indian generally accepted accounting principles (Indian GAAP<sup>5</sup>). The two fundamental differences in Ind AS as compared to Indian GAAP, are the requirements of fair valuation and accounting for time value of money under Ind AS. Ind AS contains new concepts of control and joint control, due to which a few Indian groups have had to reassess and consequently, in a few cases, change their holding–subsidiary or joint venture relations. Accounting for financial instruments is one of the major area of differences, such as, triggering reclassifications of equity into debt or vice versa, pervasive fair valuation and discounting contractual cash flows. Ind AS contains more elaborate guidance in areas of

3 Source: The Global Financial Reporting Language published by the International Accounting Standards Board.

4 Ind AS also applies to holding, subsidiary, joint ventures and associate companies of the covered companies.

5 Accounting Standards issued under section 133 read under Companies (Accounting Standards) Rules, 2006 of Companies Act, 2013



revenue recognition which has caused changes in reported revenue in many sectors. Deferred tax accounting under Ind AS contains many new requirements, including creating deferred tax liabilities on undistributed earnings of groups companies in certain cases. Our separate publication contains a detailed guidance and analysis of Ind AS requirement<sup>6</sup>.

As the impact varies from sector to sector based on the sector-specific issues, we have analysed Ind AS impact based on sectors, the categorization of which we have explained later in the publication. Company specific situations, such as, the group structure, financing structure and the extent of treasury activities would also differentiate the Ind AS impacts, for example, highly leveraged companies are likely to have more Ind AS adjustments. In subsequent chapters we have provided a sector-wise analysis of the key Ind AS transition adjustments.

The values and percentages referred to in this publication should be considered as suggestive and may vary if analysed differently and / or using different set of assumptions.

---

<sup>6</sup> *The New Axis of Financial Reporting – Ind AS and ICDS* ([Click here to read the publication](#))



Chapter 2

The Way Forward for Phase II  
Ind AS companies

It is clear from the experiences of the phase I companies, that converting to Ind AS is not merely an accounting exercise; it is a process of change management. Adopting Ind AS may affect many facets of an organization beyond financial reporting. Every consequential aspect of a company affected by financial information has the potential for change (for example, key performance indicators, profits, new worth, debt–equity composition, revenue recognition, employee compensation plans, tax on book profits and internal management information systems). Both the transition process and the implications of the conversion can vary widely among companies based on a number of variables, such as the sector specific accounting issues, accounting resources and levels of expertise available and data collection. Often, information and data not currently collected and/or warehoused may be needed to produce the required Ind AS information, for example, fair value measurement is pervasively required or permitted in Ind AS.

For listed phase II companies, the first occasion to publish Ind AS–based figures would be June 2017 financial results. Ind AS 101 requires the disclosure of the opening balance sheet in each interim financial period of the first reporting year under Ind AS. However, SEBI provided relaxations in terms of the reconciliations to be provided in the interim financial results. These relaxations are *mutatis mutandis* applicable to phase II companies. Following is a summary of the relaxations in reporting requirements for phase II companies.

Period ending	30 June 2017	30 September 2017	31 December 2017
Timelines up to	14 September 2017	14 December 2017	14 February 2018
Current quarter results as per Ind AS	Mandatory	Mandatory	Mandatory
Preceding quarter results as per Ind AS	Optional	Mandatory	Mandatory
Corresponding quarter in previous year as per Ind AS	Mandatory	Mandatory	Mandatory
Year to date period in current year as per Ind AS	Not Applicable	Mandatory	Mandatory

Period ending	30 June 2017	30 September 2017	31 December 2017
Year to date period in previous year as per Ind AS	Not Applicable	Mandatory	Mandatory
Previous year ended 31 March 2017 as per Ind AS	Optional	Optional	Optional
Audit/review of previous year comparative period as per Ind AS	Optional	Optional	Mandatory
Audit/review of year ended 31 March 2017 as per Ind AS	Optional	Optional	If presented, audit / review required
Disclosure of reserves (excluding revaluation reserve)	Optional	Optional	Optional

Converting to Ind AS is perhaps the most fundamental financial reporting change that Phase II companies would be dealing with during the current financial year. The complexity and quantum of the exercise, combined with the attention that financial statements attract from a broad range of stakeholders such as, the investor, tax and other regulatory authorities means effective project management and execution is critical. Understanding the key accounting issues, and ensuring they are properly applied and disclosed, will be essential.

Relative to Phase I companies, Phase II companies are medium-sized and do not have the same level of accounting resources and expertise, accessibility of data points and robust IT systems as compared to Phase I companies. While the changes around Ind AS would take place, there would pressure on account of: transition to GST; possible changes in direct taxes for example, due to MAT implications of Ind AS and due to ICDS; revisiting internal financial controls to ensure smooth transition to Ind AS; and modification of IT systems. To deal with such issues, companies would do well to plan appropriately and start their transition early. This will require a significant commitment from the company's top management.

An important point to note is that Indian GAAP was revised vide MCA circular dated 30

March 2016– Companies (Accounting Standards) Rules, 2016. These amendments are effective for financial year 2016–17 onwards<sup>7</sup>. Following are the key changes to Indian GAAP:

■ **Property, plant and equipment (PPE)**

- Spares part, service equipment and standby equipment that meet the definition of PPE i.e. which are intended to be used for a period of more than 12 months, should be treated as PPE and not inventory.
- The amended standard is based on unit of measure approach. This would enable capitalization of construction cost of approach roads on government land to facilitate construction of plant, which are otherwise available for the use general public, as a part of the project cost.
- Cost of an item of PPE purchased on a deferred payment basis, is the cash price equivalent. The difference between the cash price equivalent and the total payment treated as an interest cost.
- Initial estimated cost of dismantling/ retiring an asset and restoring the site is included in the cost of an item of PPE. The provision is measured at discounted amount.
- If revaluation model option is used for PPE, the entire class of assets should be revalued; revaluation is to be carried out with sufficient regularity.
- Useful lives and residual values of the items of PPE are reviewed periodically; change in depreciation method is to be accounted for as change in accounting estimate rather than change in accounting policy

■ **Investment property**

- Investment properties (properties held to earn rental income and/or capital

7 MCA general circular 4/2016 dated 27th April, 2016 clarified that the amended accounting standards should be used in preparation of accounts for accounting periods commencing on or after the date of notification i.e. 30 March, 2016.

appreciation) are required to be depreciated, using component approach, and tested for impairment, when there are impairment indicators

- Provision for proposed dividend:
- Dividends declared after the balance sheet date but before the financial statements are approved for issue are not recognized as a liability at the balance sheet date, but disclosed in the notes to accounts

## ■ Consolidation

- Where a company does not have a subsidiary, but has associate or joint venture company, it should prepare consolidated financial statements.

## ■ Mergers and amalgamations

- The disclosure in scenarios when the accounting as per the court schemes is different from that required in the accounting standards, does not apply to a scheme of amalgamation approved under Companies Act, 2013. Sections 230 and
- 232 of the Companies Act, require accounting treatment proposed in a scheme to be in conformity with the accounting standards.

These changes are by and large in lines with the Ind AS requirements. Due to these changes in Indian GAAP taking effect in FY 2016–17, the impact for phase II companies may be different from that experienced by phase I companies.



### ■ Revenue

- Change in timing of recognition of revenue (estimated sales return, dispatch vs. delivery)
- Incentive schemes– reduced from revenue
- Deferral of revenue due to multiple deliverable arrangements
- Fair valuation of consideration – time value of money to be considered
- Deferral of revenue due to linked transactions (to reflect the substance)
- Change in agency vs. principal assessment for customers
- Change in accounting for joint development agreements
- Differences in percentage of completion revenue recognition
- Change in gross vs. net presentation (excise duty, other charges)
- Accounting for service concession arrangements
- Accounting for customer loyalty schemes

### ■ Property, plant and equipment

- Provision and capitalization of asset retirement obligation (to consider time value of money)
- Use of fair value deemed cost exemption at transition
- Capitalization of eligible spare parts
- Capitalization of major overhaul
- Capitalization of eligible enabling assets

### ■ Intangible assets

- Restriction on revenue based amortization for new tolls roads
- Indefinite useful lives for certain intangibles



- De-capitalisation of non-eligible intangible assets

- **Borrowing cost**

- Eligible borrowing costs (debt vs. equity, stand-alone vs. consolidated)

- **Foreign exchange**

- Foreign exchange fluctuations to be immediately charged to the statement of profit and loss
- Functional currency assessment for all operations

- **Leases**

- Accounting for leases embedded in sale or service contracts
- Not straight-lining of the lease rentals on account of inflation
- Straight-lining of lease incentives

- **Deferred tax**

- Deferred tax on undistributed reserves on subsidiaries, joint venture, associate, unless certain criteria met
- Deferred tax on intercompany eliminations
- Deferred tax on capital loss

- **Financial instruments**

- Redeemable preference shares classified as liability and related 'dividend' recognised as interest expense
- Convertible bonds split into their liability and derivative components
- All costs related to the debt recognised through a periodic charge to the statement of profit and loss – cannot be adjusted against share premium

account under Ind AS

- Treasury shares are presented as a reduction from equity– no gain/loss on sale of treasury shares
- Compulsory convertible debentures at fixed ratio classified as equity
- Any obligation to issue variable number of shares may be classified as a liability.
- Classification of financial assets is based on an entity's business model for managing financial assets and the contractual cash flow characteristics of the financial asset
- Amortised cost based on effective interest rate
- Investments to be categorised – fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) and amortised cost
- Initial recognition of all financial assets and financial liabilities at fair value (interest –free security deposits, employee loans, etc.)
- Accounting for financial guarantees in favor of banks for borrowings by subsidiaries/other companies
- All investments, including unquoted equity shares, except investments in subsidiary / Joint venture/ associate measured at fair value
- All derivative instruments to be carried at fair value, unless hedge accounting requirements met
- Transfer of financial assets/liability with recourse – continue to be reported in the balance sheet
- Impairment of financial assets – expected loss model
- Separate accounting for embedded derivative in sale/ purchase contracts

■ **Share based payments**

- Mandatory use of fair value for share based payments
- Accelerated costs for options with graded vesting
- Consolidation of trusts administering employee share based payment
- Group share-based payments to be accounted for by the recipient company

■ **Employee benefits**

- Actuarial gains and loss recognized in equity through OCI rather than in P&L
- Long term employee benefits accrued on constructive obligation basis at discounted values
- Past service costs to be charged to P&L as incurred– cannot be deferred

■ **Business combinations and consolidation**

- Acquisition accounting based on fair values of assets including intangibles, such as customer relationships and contracts, etc., and liabilities, including, contingent liabilities
- Common control business combinations accounted for using pooling of interest method; cannot give rise to goodwill; restatement of comparative period mandatory
- Acquisition related costs charged to P&L as accrued
- Goodwill cannot be amortised, but should be tested for impairment at least annually
- Deferred and contingent consideration payable to the seller for business combination to be fair valued through P&L
- Detailed guidance for call/put option agreements / forward agreements to

buy / sell balance shares to non-controlling interest shareholders

- Gain/ loss on acquisition of further interest in a subsidiary from other shareholders or sale of shares to other shareholders without losing control cannot result in P&L gain/ loss; to be recognized directly in equity
- More elaborate guidance for aspects such as pre-existing relations between acquirer and acquire, share based payments, etc.
- Consolidation of joint ventures using equity method- 'one line consolidation'; proportionate consolidation not permitted
- Consolidation / deconsolidation based on new definition of control:
- Sale/dilution of stake without losing control not to be recognized in P&L
- Losses attributed to minority shareholders
- Fair valuation of contingent and deferred consideration
- Mandatory use of uniform accounting policies
- Non common control demerger accounted at fair value



Ind AS provides various accounting options. First set of options relate to optional exemptions from retrospective application of Ind AS standards upon first-time adoption of Ind AS transition. The other set of options are available under individual Ind AS standards, not necessarily available in the first year of Ind AS transition. In this chapter we discuss both these options available to a company.

#### **A. Accounting options available on first-time adoption of Ind AS**

Ind AS 101 contains the first-time adoption principles for all the transition related requirements when a company moves from accounting as per Indian GAAP to Ind AS. As a general principle, all the Ind AS requirements need to be applied retrospectively. However, to smoothen the transition, companies have the choice of electing certain optional exemptions from such retrospective application.

##### **■ Property, plant and equipment**

On transition to Ind AS, instead of retrospectively recomputing the carrying value of PPE under Ind AS 16, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. Specific choices include:

- a) Remeasure some or all items of PPE to their fair value as at the transition date; or
- b) In case assets have been previously revalued under Indian GAAP, then those revalued amounts can be considered as the deemed cost, provided that those revalued amounts are broadly comparable
  - (i) to the fair values as at the date of revaluation or
  - (ii) cost or depreciated cost in accordance with Ind AS adjusted to reflect, for instance, the changes in the general or specific price index; or

- c) Continue Indian GAAP carrying values of all items of PPE as at transition date without any modification, except for adjustments for decommissioning obligations to be included in the PPE. This exemption, if exercised, is required to be applied to all items of PPE without any exception. Following are the important points to be noted with regards to this option:
- The option is only available if there is no change in the company's functional currency on the transition date
  - The option is available to all PPE. Unlike option a) above, this option cannot be applied selectively
  - If the last Indian GAAP financial statements of the group was Indian GAAP consolidated financial statements, the Indian GAAP amount of the subsidiary should be the amounts used in the Indian GAAP consolidated financial statements
  - In case on a previously unconsolidated subsidiary, the amount required to be reported by the subsidiary as per the previous GAAP in its individual financial statements should be the previous GAAP amount
  - This option can be also availed for investment properties and intangible assets

This is an important option available to first time adopters of Ind AS due to the sheer size of fixed assets in many companies. It may have consequential impact on, for example; net worth; subsequent depreciation and impairment charge, it must be noted that additional depreciation cannot be recouped from reserves; deferred tax on transition and in subsequent period; and IT systems and records such as the fixed asset register.

It is important to note there is a possible change in exemption c) above. On 27 March, 2017, the Institute of Chartered Accountants of India (ICAI) issued an exposure draft (ED) of Amendments to Ind AS 101 with respect to PPE. The ED

provides more flexibility in the transition provisions, as compared to the current provisions of Ind AS 101.

The ED proposes to amend Ind AS 101.D7AA and makes the option more flexible for the first-time adopters of Ind AS. Following are the specific proposals:

- **Class of PPE rather than all PPE**

The ED proposes that the option can be exercised for a class of PPE rather than all PPE. Therefore, the proposal would allow a company to apply previous GAAP deemed cost option, for example, only to certain class of PPE, such as, plant & machinery and furniture & fixtures and not to apply this option, for example, to land and building. Land and building may be measured using, for example, the fair value option.

- **Transition adjustments due to other Ind AS requirements**

The ED proposes to remove the current restriction that no other adjustment to the previous GAAP deemed cost due to application of other Ind AS requirements is permitted, if the option under Ind AS 101.D7AA is used. In addition to the adjustments resulting from decommissioning obligation, the adjustments arising from other Ind AS standards would also be permitted to the previous GAAP deemed cost of the PPE under the proposal. For example, if a company had previously capitalized transaction cost or loan processing cost under previous GAAP, the transitional adjustment arising due to application of Ind AS 109 Financial Instruments would be made to the previous carrying amount.

### **Effective date proposed by the ED**

The ED states that an entity shall apply the amendments relating to paragraph D7AA for annual periods beginning on or after 1st April, 2017. Since these amendments to Ind AS will be notified by the Ministry of Corporate Affairs (MCA), the effective date proposed is subject to the notification of MCA with the same effective date.



## ■ Decommissioning obligations

Ind AS requires that the cost of dismantling or removal of the asset, or restoration of the site, should be included as part of the initial cost of the asset. Accordingly, a provision equivalent to the present value of such costs is recognised, with an equivalent amount capitalised as an additional cost component. Imputed interest would subsequently be recognised through the profit and loss account. Any changes in the obligation, other than that arising on efflux of time, are added or deducted from the cost of the asset and depreciated prospectively over balance useful life. This requirement may be difficult to apply retrospectively. A first time adopter of Ind AS is, therefore, provided with an exemption for such obligations incurred before the transition date. The exemption provides that a first time adopter:

- measures liability at the date of transition to Ind AS
- estimates the amount required that would have been capitalized in the past when the obligation first arose, by discounting the liability to that date using best estimate of the historical risk-adjusted discount rate(s) applicable during the intervening period
- Work out the accumulated depreciation on the above amount as at the transition date, on the basis of the current estimate of useful life of the asset

## ■ Assessment date for embedded leases

Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases. Under Ind AS, leasing would extend to arrangements which, in substance, meet the definition of a lease, even though not be structured as 'lease'. These arrangements convey a right to use an asset or assets for an

agreed period of time in return for a payment or series of payments.

The determination of whether an arrangement contains lease is made at the inception of the arrangement. For arrangements entered into several years back, this may pose practical challenge. Therefore, Ind AS 101 provides an option to first time adopter to make this assessment as of the date of transition based on the facts and circumstances as at that date, rather than at the inception of the arrangement.

It must be noted that this exemption is limited for the purpose of making assessment of whether the arrangement contains lease. If it is determined that the arrangement contains lease, accounting for operating or finance lease has to be done from the inception of the arrangement.

#### ■ Land lease

Ind AS provides guidance on accounting for leases of land, requiring a determination of whether the land lease would qualify as an operating lease or a finance lease. Where the land lease is for several decades, it may qualify as a finance lease even though the title of the land may not transfer at the end of the lease term (eg, a 99 year land lease arrangement). Ind AS also states that when a lease includes both land and building elements, an entity assesses the classification of each element as finance or an operating lease separately as per the criteria laid down.

Ind AS 101 provides an exemption when a lease contains both land and building element. A first time adopter may assess the classification of each element at the transition date based on the facts and circumstances existing at that date. If there is a land lease newly classified as finance lease under Ind AS at the transition date, then the first time adopter may recognize the asset and liability at fair value on that date with any difference between the fair values recognized in retained earnings.

#### ■ Business combinations

On transition to Ind AS, a company has the following three options in relation to the

business combination transactions before the transition date:

- Not to restate business combinations before the transition date and apply Ind AS only to subsequent business combinations; or
- Restate all past business combinations before the transition date; or
- Restate all past business combinations done after a chosen date, prior to the transition date.

Where the exemption for not restating past business combination is taken, usually no adjustments are made to the accounting as per Indian GAAP except certain specific matters, for example, where intangible assets that do not meet the definition of an asset under Ind AS have been recognised, then they would be derecognised with a corresponding adjustment to goodwill.

If the company elects not to restate past business combinations, the carrying value of goodwill as per Indian GAAP is required to be carried over to Ind AS without any modification. Under this approach, any previous goodwill amortisation under Indian GAAP is not required to be reversed. However, goodwill will need to be tested for impairment on transition date to Ind AS.

For subsidiaries which were not previously consolidated, goodwill can be computed as the difference, at the transition date, between parent's interest in carrying values of net assets of subsidiaries and the cost of investment in the parent's separate financial statements. This exemption is particularly relevant for unlisted Indian companies that may not have previously prepared consolidated financial statements under Indian GAAP.

Ind AS requires that any goodwill arising on acquisition of foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising of the acquisition to be treated as the assets and liabilities of the foreign operations. For first-time adopter, it may be impracticable, especially for old acquisitions, to determine the retrospective foreign currency exchange differences on goodwill and fair value adjustments. Towards this, Ind AS 101 provides a voluntary exemption

whereby a first-time adopter need not apply the requirement to retrospectively account for the foreign exchange differences on goodwill and fair value adjustments of foreign operations acquired. In other words, goodwill and fair value adjustments of foreign operations are treated as the assets and liabilities of the acquirer company and not the acquiree company. Therefore, those goodwill and fair value adjustments are either already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied under the Indian GAAP.

#### ■ **Investments in the separate financial statements of the parent**

On transition to Ind AS, a company is permitted to recognise an investment in the subsidiary either at the cost of the investment or at deemed cost. The deemed cost may be computed based on the fair value as at the transition date or based on the Indian GAAP carrying value. This deemed cost option may be applied selectively to each investment on a case-by-case basis.

#### ■ **Cumulative foreign currency translation reserve**

As at the transition date, the cumulative foreign currency translation reserve in relation to the foreign operation may be reset to zero. If a first-time adopter uses this exemption:

- the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind ASs; and
- the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind ASs and shall include later translation differences.

#### ■ **Managing different transition dates for group companies**

Where a subsidiary transitions to Ind AS later than its parent, the subsidiary has an option to measure its assets and liabilities at their carrying values based on either (i) the parent's transition date to Ind AS (if no adjustments were made for

consolidation procedures and for effects of business combination in which the parent acquired the subsidiary) or (ii) based on the subsidiary's own transition date to Ind AS.

Where a parent company transitions to Ind AS later than its subsidiary, the assets and liabilities of the subsidiary would be stated in the consolidated financial statements of the parent at the same values as appearing in the separate financial statements of the subsidiary company, after adjusting for the effects of business combination in which the company was acquired and consolidation adjustments.

The above principles in relation to the subsidiaries also apply in case of associates and joint ventures.

- **Employee stock option plans**

Employee stock options that have already vested as on the transition date need not be accounted for based on fair values.

- **Derecognition of financial instruments**

The transition requirements allow the application of the derecognition principles for financial assets and financial liabilities on a prospective basis from the transition date. Alternatively, these principles can be applied retrospectively from a date per the company's choice, if the information needed to apply the derecognition principles was obtained at the time of initially accounting those transactions.

- **Compound instruments**

Under Ind AS, an instrument may be compound instrument containing both equity element and debt element. For example, foreign currency convertible bond is treated as a compound instrument by the issuer containing an obligation towards interest and redemption payment i.e. a debt component and an equity conversion feature i.e. an equity element.

Ind AS 101 provides an exemption whereby a first-time adopter need not identify separately the two portions of equity if liability component of the instrument is no

longer outstanding at the date of transition to Ind AS.

### ■ **Classification of financial assets**

Under Ind AS all financial assets (eg, investments in equity shares, preference shares, mutual fund units, bonds, debentures, deposits, etc.) are classified into three main categories – amortised cost, fair value through P&L (FVPL) and fair value through OCI (OCI). The classification depends on the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

Under Ind AS 109, an entity may voluntarily designate a financial asset, which is a debt investment and otherwise meets amortised cost or FVOCI criteria, as FVPL. This designation is only allowed if the designation reduces or eliminates a measurement or recognition inconsistency. A first-time adopter is permitted to designate as FVPL based on the facts and circumstances at the transition date to Ind AS.

Ind AS 109 allows an entity to designate investment in equity instrument not held for trading as at FVOCI, instead of FVPL. Such an election has to be made on initial recognition and cannot subsequently be changed. A first-time adopter is allowed to make this designation based on the facts and circumstances at the transition date to Ind AS.

### ■ **Financial liabilities**

Under Ind AS financial liabilities (eg, borrowings, loans, debentures, etc.) are classified as at FVPL or amortised cost. Further, an entity permits an entity to designate a financial liability as at FVPL if the prescribed criteria are met at the time of initial recognition of the financial liability. A first-time adopter is permitted to designate a financial liability as at FVPL provided the liability meets the Ind AS 109 criteria at the date of transition to Ind AS.

### ■ **Measurement of financial asset and liability using effective interest method**

If it is impracticable for an entity to apply retrospectively the effective interest

method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind AS.

#### ■ Long term foreign currency monetary items

Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. If the long term foreign currency monetary item relates to other than acquisition of a depreciable capital asset, exchange differences are accumulated in the 'Foreign Currency Monetary Item Translation Difference Account' which is subsequently amortised through the P&L over the life of such long term asset or liability. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary items.

Ind AS 101 includes an optional exemption to continue the existing policy as per the previous GAAP, i.e., existing AS 11 in respect of the long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period. The exemption is only available for foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting periods. For example, for a phase II company, the first Ind AS reporting is applicable from FY 2017-18. Its date of transition is 1 April 2016 and its last Indian GAAP financial statements would be 31 March 2017. This option is only available for continuing deferral/ amortization for long term foreign currency monetary items recognized on or before 31 March 2017. For any long term

foreign currency monetary items recognized on or after 1 April 2017, deferral/ amortization of exchange differences would not be allowed.

#### ■ **Stripping costs in the production phase of a surface mine**

Mining operations involve overburden exercise necessary to remove waste materials to gain access to mineral ore deposits. This is referred to as stripping and it may go on during the production phase of a mine. Ind AS 16 Appendix B provides guidance on accounting for such stripping cost.

A first-time adopter may apply Ind AS 16 Appendix B from the date of transition to Ind AS. As at transition date to Ind AS, any previously recognised asset balance that resulted from stripping activity undertaken during the production phase should be reclassified as a part of an existing asset to which the stripping activity is related, however, only to the extent that there remains an identifiable component of the ore body with which the predecessor stripping asset can be associated.

The balance of the predecessor stripping asset should be depreciated or amortised over the remaining expected useful life of the identified component of the ore body to which each predecessor stripping asset balance relates. In case where there is no identifiable component of the ore body to which that predecessor stripping asset relates, it should be recognised in retained earnings at the transition date to Ind AS.

#### ■ **Non-current assets held for sale and discontinued operations**

Ind AS 105 requires non-current assets (or disposal groups) that meet the criteria laid down, to be measured at lower of its carrying amount and the fair value less cost to sell. Ind AS 105 requires that a non-current asset classified as held for sale or forming part of disposal group should not be depreciated. A first time adopter can:

- a)      measure such assets or operations at the lower of carrying value and fair value less cost to sell at the date of transition to Ind AS; and
- b)      recognise directly in retained earnings any difference between that amount



and the carrying amount of those assets at the date of transition to Ind AS.

- **Deemed cost for assets used in operations subject to rate regulation**

If the carrying amount of property, plant and equipment or intangible assets that are used in rate-regulated activities includes amounts under previous GAAP that do not qualify for capitalization in accordance with Ind ASs, a first-time adopter may elect to use the previous GAAP carrying amount of such items as deemed cost on the initial adoption of Ind ASs.

- **Service concessions**

Ind AS provides specific guidance for public-to-private service concession arrangements in which: the public sector entity controls or regulates the services provided with the infrastructure and their prices; and controls any significant residual interest in the infrastructure. The operator does not recognise the PPE constructed as a part of the service concession arrangement. As per the service concession agreement, the operator is considered to have a right to access, rather than a right to use/right of ownership over the infrastructure asset. This right is recognised either as an intangible asset or a financial asset based on terms of the arrangement.

For accounting purposes, service concession arrangements are normally divided into of two phases – construction phase and operations and maintenance phase. During construction phase, the operator recognises and measures revenue and costs related to the construction or upgrade of infrastructure, contracts. Hence, in the construction phase, the operator will generally recognise revenue as construction activity based on the value of the services performed (construction cost plus a fair margin).

If retrospective application of service concessions arrangement based on the above requirements is not practicable, Ind AS 101 gives first time adopters an exemption to

- Recognize financial and intangible asset that existed at the transition date

- Use the previous GAAP carrying amount, no matter how they were previously classified; and
- Test the financial and intangible assets recognized at that date for impairment

#### ■ **Revenue based depreciation for toll roads**

Indian GAAP allows revenue-based depreciation for toll roads created under a service concession arrangement. Ind AS prohibits use of revenue based depreciation. Ind AS 101 and Ind AS 38 provide an option to continue with revenue based amortization for toll roads recognized in financial statements for period immediately before the beginning of the first Ind AS financial statements. However, new toll roads constructed through subsequent service concessions would not be allowed to use revenue-based amortisation.

#### **B. Accounting options available on an ongoing basis under Ind AS**

Many Ind AS standards provide accounting policy choice related to measurement of assets and liabilities. Following is a list of the accounting policy choice available under various standards.

#### ■ **Property, plant and equipment**

Ind AS provides two alternative measurement models for subsequent measurement of property, plant and equipment:

- Cost model: PPE is carried at cost less accumulated depreciation and impairment.
- Revaluation model: PPE is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation and impairment, provided that fair value can be measured reliably. Under the revaluation model, revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date. If an item is revalued, the entire class of assets to which

- Use the previous GAAP carrying amount, no matter how they were previously classified; and
- Test the financial and intangible assets recognized at that date for impairment

#### ■ Revenue based depreciation for toll roads

Indian GAAP allows revenue-based depreciation for toll roads created under a service concession arrangement. Ind AS prohibits use of revenue based depreciation. Ind AS 101 and Ind AS 38 provide an option to continue with revenue based amortization for toll roads recognized in financial statements for period immediately before the beginning of the first Ind AS financial statements. However, new toll roads constructed through subsequent service concessions would not be allowed to use revenue-based amortisation.

#### B. Accounting options available on an ongoing basis under Ind AS

Many Ind AS standards provide accounting policy choice related to measurement of assets and liabilities. Following is a list of the accounting policy choice available under various standards.

#### ■ Property, plant and equipment

Ind AS provides two alternative measurement models for subsequent measurement of property, plant and equipment:

- Cost model: PPE is carried at cost less accumulated depreciation and impairment.
- Revaluation model: PPE is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation and impairment, provided that fair value can be measured reliably. Under the revaluation model, revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date. If an item is revalued, the entire class of assets to which

that asset belongs should be revalued. Revalued assets are depreciated in the same way as under the cost model, no recoupment of additional depreciation from reserves is permitted.

Similar accounting policy choice is available for intangible assets with quoted market price in an active market (which is uncommon).

- **Presentation of grants related to income**

Grants related to income may be presented as a credit in the statement of P&L, either separately or under a general heading such as 'other income'; alternatively, they are deducted in reporting the related expense.

- **Investments in subsidiaries, associates and joint venture in separate financial statements of parent or investor**

Investments in subsidiaries, associates and joint venture in separate financial statements of parent or investor are accounted for either at cost or at fair value as per Ind AS 109.

- **Financial instruments**

Ind AS requires investments in equity instruments to be fair valued. If an equity investment is not held for trading, an entity can make an irrevocable election at initial recognition to measure it fair value through other comprehensive income (FVOCI) rather than at FVPL. Under this option, all the fair value changes, realized or unrealized, are recognized in equity through OCI, with only dividend income recognized in P&L.

Ind AS provides three categories for classifying financial asset in debt instruments –amortised cost, FVOCI and FVPL. This classification of debt instruments is driven by the entity's business model for managing the financial assets and their contractual cash flow characteristics. Financial liabilities are classified as at FVPL or amortised cost. An entity is permitted to designate a financial asset or liability, otherwise to be measured at amortised cost, as at FVPL if the prescribed criteria are met at the time of initial recognition of the financial liability.



List of key recent Ind AS amendments, exposure drafts and other pronouncements:

Ind AS standard	Summary of the amendment	Effective date/ proposed effective date
<b>A. Ind AS amendments</b>		
Ind AS 102 <i>Share Based Payments</i>	<p>The amendments clarify that:</p> <ul style="list-style-type: none"> <li>– Market-based performance conditions and non-vesting conditions are reflected in the 'fair values', but non-market performance conditions and service vesting conditions are reflected in the estimate of the number of awards expected to vest.</li> <li>– If the terms and conditions of a cash-settled share-based payment transaction are modified with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as such from the date of the modification.</li> <li>– Fair value of cash-settled awards is determined on a basis consistent with that used for equity-settled awards.</li> <li>– Award that include a net settlement feature in respect of withholding taxes to be treated as equity-settled in its entirety. The cash payment to the tax authority is treated as if it was part of an equity settlement</li> </ul>	Annual periods beginning on or after 1 April 2017. However, due to the general requirements of Ind AS 101, a phase II Ind AS company would have to apply the amendment throughout in its first set of Ind AS financial statements i.e. since its Ind AS transition date i.e. 1 April 2016.
Ind AS 107 <i>Statement of Cash flows</i>	The amendment requires the entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes, suggesting inclusion of a reconciliation between the opening and closing balances	Annual periods beginning on or after 1 April 2017. However, due to the general requirements of Ind AS 101, a phase II Ind AS company would have to apply the amendment

Ind AS standard	Summary of the amendment	Effective date/ proposed effective date
	in the balance sheet for liabilities arising from financing activities, to meet the disclosure requirement.	throughout in its first set of Ind AS financial statements i.e. since its Ind AS transition date i.e. 1 April 2016.
<b>B. Revised ITFG Bulletins</b>		
Ind AS 1 <i>Presentation of Financial Statements</i>	<p><b>Background:</b> Security deposits collect by electricity companies at the time of issue of electricity connection which is refundable when the connection is surrendered.</p> <p><b>Issue:</b> Current/non-current classification of the deposits by the electricity company</p> <p><b>Previous clarification:</b> Although most customers would not surrender their connection, the electricity company does not have an unconditional right to defer the settlement of the deposit. Therefore, the electricity deposit is a current liability.</p> <p><b>Current status:</b> The clarification has been withdrawn since current/non-current classification requirement already existed under previous GAAP and this is not a transition issue.</p> <p><i>This interpretative guidance is clarificatory in nature and therefore there is no effective date.</i></p>	
Ind AS 101 <i>First time Adoption of Indian Accounting Standards (Ind AS)</i>	<p><b>Accounting for past loan processing fees when the previous GAAP carrying amount exemption is availed:</b></p> <p><b>Background:</b> A company had taken a loan prior to the date of transition to Ind AS and had capitalized the processing fees on the loan as a part of fixed asset cost. The company chose to avail the previous GAAP deemed cost exemption under Ind AS 101. D7AA (which allows the entity to carry forward the transition date previous GAAP carrying amount i.e., the net book value of the PPE, without any adjustments other than for decommissioning obligation). Ind AS 109 requires the processing fees to be included as a part of the loan liability and charged over the tenure of the loan as a part of effective interest method. This is required to be carried out retrospectively for all loans outstanding at the date of transition.</p> <p><b>Issue:</b> How to account for the adjustment arising out of the</p>	

Ind AS standard	Summary of the amendment	Effective date/ proposed effective date
	<p>retrospective deferral of the processing cost without adjusting the carrying amount of the PPE?</p> <p><b>Previous clarification:</b> No adjustment is made to the carrying amount of the PPE. Therefore, the adjustment to the loan amount is recognized in retained earnings (reserves).</p> <p><b>Revised clarification:</b> The processing fees should be adjusted in both the loan and the carrying amount of the PPE. This is a consequential adjustment to PPE and would reflect the correct economic reality and result in faithful representation of the effects of these transactions. Therefore, the carrying amount of the PPE is reduced by the amount of loan processing fees, net of the cumulative depreciation impact.</p> <p><i>This interpretative guidance is clarificatory in nature and therefore there is no effective date.</i></p>	
Ind AS 101 <i>First time Adoption of Indian Accounting Standards (Ind AS)</i>	<p><b>Accounting for past asset-related government grant when the previous GAAP carrying amount exemption is availed:</b></p> <p><b>Background:</b> A company had received an asset related government grant prior to the date of transition to Ind AS and had deducted the grant received from the carrying amount of the PPE as per previous GAAP. Ind AS 20 requires an asset-related grant to be presented as deferred revenue and prohibits netting from carrying amount of the PPE. This is required to be applied retrospectively for all the grants outstanding at the transition date. The company chose to avail the previous GAAP deemed cost exemption under Ind AS 101. D7AA (which allows the entity to carry forward the transition date previous GAAP carrying amount i.e., the net book value of the PPE, without any adjustments other than for decommissioning obligation).</p> <p><b>Issue:</b> How to account for the adjustment arising out of the retrospective setting up of deferred revenue of the grant without adjusting the carrying amount of the PPE?</p> <p><b>Previous clarification:</b> No adjustment is made to the carrying amount of the PPE. Therefore, the adjustment for setting up the deferred revenue grant is recognized in retained earnings (reserves).</p> <p><b>Revised clarification:</b> The accrual deferred revenue should be adjusted in the carrying amount of the PPE. This is a consequential adjustment to PPE and would reflect the correct economic reality and result in</p>	



Ind AS standard	Summary of the amendment	Effective date/ proposed effective date
	<p>faithful representation of the effects of these transactions. Therefore, the carrying amount of the PPE is increased by the amount of asset-related grant, net of the cumulative depreciation impact.</p>	
<b>C. ICAI Exposure drafts</b>		
<p>Ind AS 101 <i>First time Adoption of Indian Accounting Standards (Ind AS)</i></p>	<p><b>Current Ind AS:</b></p> <p>Ind AS 101 generally requires retrospective application of measurement requirements of Ind AS at the date of transition. Full retrospective restatement of PPE may practically prove quite onerous since these assets are generally long-lived and, therefore, the relevant accounting records may not be available and the past depreciation and capitalization accounting policies may not be compliant with the Ind AS requirements. Due to these practical difficulties, Ind AS 101 provides an exemption for deemed cost for measurement of PPE at the transition date that may not be a technically pure Ind AS basis, but can be considered as a surrogate Ind AS cost. As an alternative to retrospective restatement, the first-time adopter of Ind AS may select either of the options below as a deemed cost under Ind AS 101:</p> <p><i>Option 1: Fair valuation of revaluation as deemed cost (Ind AS 101. D5)</i></p> <p>Ind AS 101 permits a first-time adopter to measure individual items of PPE at deemed cost at the date of transition to Ind AS, if the revaluation was, at the date of the revaluation, broadly comparable to:</p> <ol style="list-style-type: none"> <li>Fair value, or</li> <li>Cost or depreciated value under Ind AS, adjusted to reflect, for example, changes in a general or specific price index.</li> </ol> <p>This option can be applied on an item-by-item basis i.e. it can be applied selectively to various items of PPE.</p> <p><i>Option 2: Event-driven fair value movement as deemed cost (Ind AS 101. D8)</i></p> <p>A first-time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at fair value at one particular date because of an event such as privatization or initial public offering. Ind AS 101 contains certain exemptions in respect of such event-driven fair values.</p>	

Ind AS standard	Summary of the amendment	Effective date/ proposed effective date
	<p><i>Option 3: Use previous GAAP carrying amount as deemed cost (Ind AS 101. D7AA)</i></p> <p>A first-time adopter may opt to continue with the carrying value for all of its PPE as recognized in its previous GAAP financial statements and use that as its deemed cost at the transition date. However, the entity is required to make appropriate adjustments for decommissioning liabilities to be included in the carrying amount of the PPE. This option involves following key requirements:</p> <ul style="list-style-type: none"> <li>– This option needs to be applied to all PPE. Unlike Option 1, above, this exemption cannot be applied on an item-by-item basis.</li> <li>– This provision allows the previous GAAP carrying amount to be adjusted only for decommissioning liabilities. No other adjustment due to application of other Ind AS requirements is allowed.</li> </ul> <p><b>Proposed amendments:</b></p> <p>The ED proposes to amend Ind AS 101.D7AA (option 3 above) and makes the option more flexible for the first-time adopters of Ind AS. Following are the proposals.</p> <p><i>Class of PPE rather than all PPE:</i></p> <p>The ED proposes that the option can be exercised for a class of PPE rather than all PPE. Therefore, the proposal would allow an entity to apply previous GAAP carrying amount deemed cost option, for example, only to certain class of PPE, such as, plant &amp; machinery and furniture &amp; fixtures and not to apply the option, for example, for land and building. Land and building may be measured using other options, for example, the fair value option (Option 1 above).</p> <p><i>Transition adjustments due to other Ind AS requirements:</i></p> <p>The ED proposes to remove the current restriction that no other adjustment to the previous GAAP deemed cost due to application of other Ind AS requirements is permitted, if the option under Ind AS 101.D7AA is used. In addition to the adjustments resulting from decommissioning obligation, the adjustments arising from other Ind AS standards would also be required to the previous GAAP deemed cost of the PPE as per the proposal. For example, if a company had previously capitalized transaction cost or loan processing cost under previous GAAP, the transitional adjustment arising due to application</p>	

Ind AS standard	Summary of the amendment	Effective date/ proposed effective date
	<p>of Ind AS 109 would be made to the previous GAAP carrying amount of the PPE net of past depreciation.</p> <p><b>Effective date</b></p> <p>The ED states that an entity shall apply the amendments relating to paragraph D7AA for annual periods beginning on or after 1st April, 2017. Since these amendments to Ind AS will be notified by the MCA, the effective date proposed is subject to the notification of MCA with the same effective date</p> <p><b>Next steps</b></p> <p>The amendments are required to be reviewed by the National Advisory Committee on Accounting Standards (NACAS) and recommended to the MCA. The MCA then notifies the amendments to Ind AS.</p>	

**MINIMUM ALTERNATE TAX FOR IND  
AS COMPLIANT COMPANIES**



Minimum Alternate Tax ('MAT') was effectively introduced in India by the Finance Act of 1987 to facilitate alternative tax mechanism for companies not paying taxes under normal provisions despite showing substantial profits in their books of accounts. MAT was thus introduced to levy minimum tax on such companies by deeming certain percentage of their book profits, computed under the Companies Act, as taxable income.

Section 115JB of the Income-tax Act ('IT Act') provides that in case of an assessee, being a company, the income-tax payable on the total income as computed under this Act is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of 18.5%. Section 115JB(2) provides that every assessee being a company, for the purpose of this section, shall prepare its profit and loss account for the relevant previous year in accordance with the provisions of Schedule III of the Companies Act, 2013 (18 of 2013).

Considering that the book profit based on Ind AS compliant financial statement is likely to be different from the book profit based on existing Indian GAAP, the Central Board of Direct Taxes (CBDT) constituted a committee in June, 2015 for suggesting the framework for computation of MAT liability under section 115JB for Ind AS compliant companies in the year of adoption and thereafter. After taking into account all the suggestions / comments received, the Committee submitted its final report on 22 December 2016. Based on the Committee report, section 115JB was amended vide Finance Act, 2017 to deal with the computation of book profit for Ind AS compliant companies.

Key features of the framework for computation of book profit for Ind AS compliant companies in the year of adoption and thereafter are as under.

### **A. MAT on Ind AS compliant financial statement**

- (i) No further adjustments to the net profits before other comprehensive income of Ind AS compliant companies, other than those already specified under section 115JB of the IT Act shall be made.

- (ii) The other comprehensive income includes certain items that will permanently be recorded in reserves and hence never be reclassified to the statement of profit and loss included in the computation of book profits. These items shall be included in book profits for MAT purposes at the point of time as specified below:

Sr. No.	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation / disposal / retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation / disposal / retirement or otherwise transferred
3	Remeasurement of defined benefit plans (Ind AS 19)	To be included in book profits every year as the remeasurements gains and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

- (iii) Appendix A of Ind AS 10 provides that any distribution of non-cash assets to shareholders (for example, in a demerger) shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the profit and loss account. Correspondingly, the reserves are debited at fair value to record the distribution as a 'deemed dividend' to the shareholders. As there is a corresponding adjustment in retained earnings, this difference arising on demerger shall be excluded from the book profits. However, in the case of a resulting company, where the property and liabilities of the undertaking or undertakings being

received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computing book profits of the resulting company.

**B. MAT on first time adoption**

- (i) The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. Several of these items would subsequently never be reclassified to the statement of profit and loss / included in the computation of book profits. Accordingly, the following treatment is to be provided.
- (i) Those adjustments recorded in other comprehensive income and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss.
- (ii) Those adjustments recorded in other comprehensive income and which would never be reclassified to the profit and loss shall be included in book profits as specified hereunder:

Sr. No.	Items	Point of time
1	Changes in revaluation surplus PPE and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation / disposal / retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation / disposal / retirement or otherwise transferred

Sr. No.	Items	Point of time
3	Remeasurement of defined benefit plans (Ind AS 19)	To be included in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS
4	Any other item	To be included in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS

- (III) All other adjustments recorded in Reserves and Surplus (excluding Capital Reserve and Securities Premium Reserve) as referred to in Division II of Schedule III of Companies Act, 2013 and which would otherwise never subsequently be reclassified to the profit and loss account, shall be included in the book profits, equally over a period of 5 years starting from the year of first time adoption of Ind AS subject to the following –

- (a) PPE and intangible assets at fair value as deemed cost

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE or and intangible asset as mentioned in paragraphs D5 and D7 of Ind AS 101. In such cases the treatment shall be as under –

- The existing provisions for computation of book profits under section 115JB of the IT Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits. Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and intangible asset shall be ignored for the purposes of computation of book profits.



- Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment.
  - Similarly, gain / loss on realisation / disposal / retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.
- (b) Investments in subsidiaries, joint ventures and associates at fair value as deemed cost

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for investment in subsidiary, joint venture or associate in its separate financial statements as mentioned in paragraph D15 of Ind AS 101. In such cases, retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.

- (c) Cumulative translation differences
- An entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition.
  - In such cases, to ensure that such Cumulative translation differences on the date of transition which have been transferred to retained earnings, are taken into account, these shall be included in the book profits at the time of disposal of foreign operations as mentioned in paragraph 48 of Ind AS 21.

- (ii) All other adjustments to retained earnings (part of other equity) at the time of transition (including for example, application of amortised cost measurement of financial assets and liabilities, asset retirement obligations, foreign exchange capitalisation / decapitalisation, borrowing costs adjustments, etc.) shall be included in book profits, equally over a period of 5 years starting from the year of first time adoption of Ind AS.
- (iii) Section 115JB of the IT Act already provides for adjustments on account of deferred tax and its provision. Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.

### C. Reference year for first time adoption adjustments

In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year. It is proposed that for the purposes of computation of book profits for the year of adoption and the proposed adjustments, the amounts adjusted as of the opening date of the first year of adoption shall be considered. For example, companies which adopt Ind AS with effect from 1 April 2016 are required to prepare their financial statements for the year 2016–17 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1 April 2015 and restate the financial statements for the comparative period 2015–16. In such a case, the first time adoption adjustments as of 31 March 2016 shall be considered for computation of MAT liability for previous year 2016–17 (Assessment Year 2017–18) and thereafter. Further, in this case, the period of 5 years proposed above shall be previous years 2016–17, 2017–18, 2018–19, 2019–2020 and 2020–21.

As the Ind AS is required to be adopted by certain companies for financial year

2016–17 mandatorily, these amendments will take effect from 1 April 2017 and will accordingly, apply in relation to the assessment year 2017–18 and subsequent assessment years.

Based on the above, an illustrative list of the MAT implications for Ind AS compliant financial statements is given hereunder:

### Illustrative list of MAT Implications for Ind AS Compliant Financial Statements

Sr. No.	Nature of Adjustment	Impact on Book Profit	
		First Time Adoption (FTA)	Subsequent Years
1	Changes in revaluation surplus of Property, Plant or Equipment and Intangible assets and consequential incremental depreciation	To be included in book profit at the time of realisation / disposal / retirement or otherwise	To be included in book profit at the time of realisation / disposal / retirement or otherwise
2	Gains and losses from investments in equity instruments designated at fair value through Other Comprehensive Income (OCI)	To be included in book profit at the time of realisation / disposal / retirement or otherwise	To be included in book profit at the time of realisation / disposal / retirement or otherwise
3	Gains and losses from investments in equity instruments measured at fair value through Profit & Loss Account	To be included in book profits equally over period of five (5) years starting from the year of FTA of Ind AS	To be included in book profits every year as the gains / losses arise <b>(Note 2)</b>
4	Remeasurement of defined benefit plans	To be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS	To be included in book profits every year as the remeasurement gains or losses arise
5	Remeasurement of retention money payable	To be included in book profits equally over a period of five	The unwinding interest cost will be expensed out in the

Sr. No.	Nature of Adjustment	Impact on Book Profit	
		First Time Adoption (FTA)	Subsequent Years
		(5) years starting from the year of FTA of Ind AS	Profit & Loss Statement and not under OCI and thus no further adjustment required
6	Reclassification of Financial Instruments by the issuers as Compound Financial Instrument, for example, Redeemable Preference Shares, Optionally / Compulsorily Convertible Debentures / Redeemable Debentures with mandatory interest payments	Equity Component of the Compound Financial Instrument to be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS <b>(Note 3)</b>	The unwinding interest cost on the financial liabilities will be expensed out in the Profit & Loss Statement and not under OCI and thus no further adjustment required
7	Remeasurement of Transaction cost on borrowings	To be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS	The transaction cost is spread over the tenure of the borrowed funds and each year the transaction cost would be expensed out in the Profit & Loss Account and not under OCI and thus no further adjustment required.
8	Impairment of Accounts Receivables (Provision for Doubtful Debts)	No impact as the amounts were already added back in earlier years pursuant to proviso in Explanation 1 to section 115JB(2)	No impact as the amounts is to be added back in the MAT computation pursuant to proviso in Explanation 1 to section 115JB(2)
9	Remeasurement of Security Deposits	The Difference between the carrying value and the fair	In subsequent years, unlikely impact, as the unwinding

Sr. No.	Nature of Adjustment	Impact on Book Profit	
		First Time Adoption (FTA)	Subsequent Years
		value is considered prepaid expenses and which is to be amortized over a period of agreement. The unwinding interest income / rent expenses for 2015-2016 appearing in other equity will be amortized / credited over period of 5 years	interest income would be off-set by the rent expenses
10	Remeasurement of corporate guarantee	Pre-transition period commission to be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS	The commission income for subsequent years would be accounted as income in the Profit & Loss Account resulting in increase in book profits
11	Deferred tax adjustments on Ind AS	To be ignored as the Deferred Tax adjustments are already given effect to in the MAT computation as per Explanation 1 to section 115JB(2)	To be ignored as the Deferred Tax adjustments are already given effect to in the MAT computation as per Explanation 1 to section 115JB(2)
12	Expenses incurred on Issue of Shares	To be ignored	Expenses on account of Issue of shares would not be directly adjusted against the Equity and not routed through Profit & Loss Statement thereby

Sr. No.	Nature of Adjustment	Impact on Book Profit	
		First Time Adoption (FTA)	Subsequent Years
			resulting in non deduction for the purpose of calculating book profit
13	Remeasurement of Government Grant	To be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS	Government Grant would be recognised as income in subsequent years in the Profit & Loss Statement resulting in increase in book profits
14	Reclassification / Remeasurement of Service Concession Agreement	To be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS	In subsequent years, until completion, construction margin will be recorded each year. On completion, interest income (erstwhile annuity income) will be recorded. Also, margin on Operation & Maintenance and Major Maintenance Repairs, if any, as part of the Concession Agreement; would be recognized as income in the Profit & Loss Statement
15	Remeasurement of Share Based Payments	To be included in book profits equally over a period of five (5) years starting from the year of FTA of Ind AS	To be included in book profits every year based on fair value based amortisation

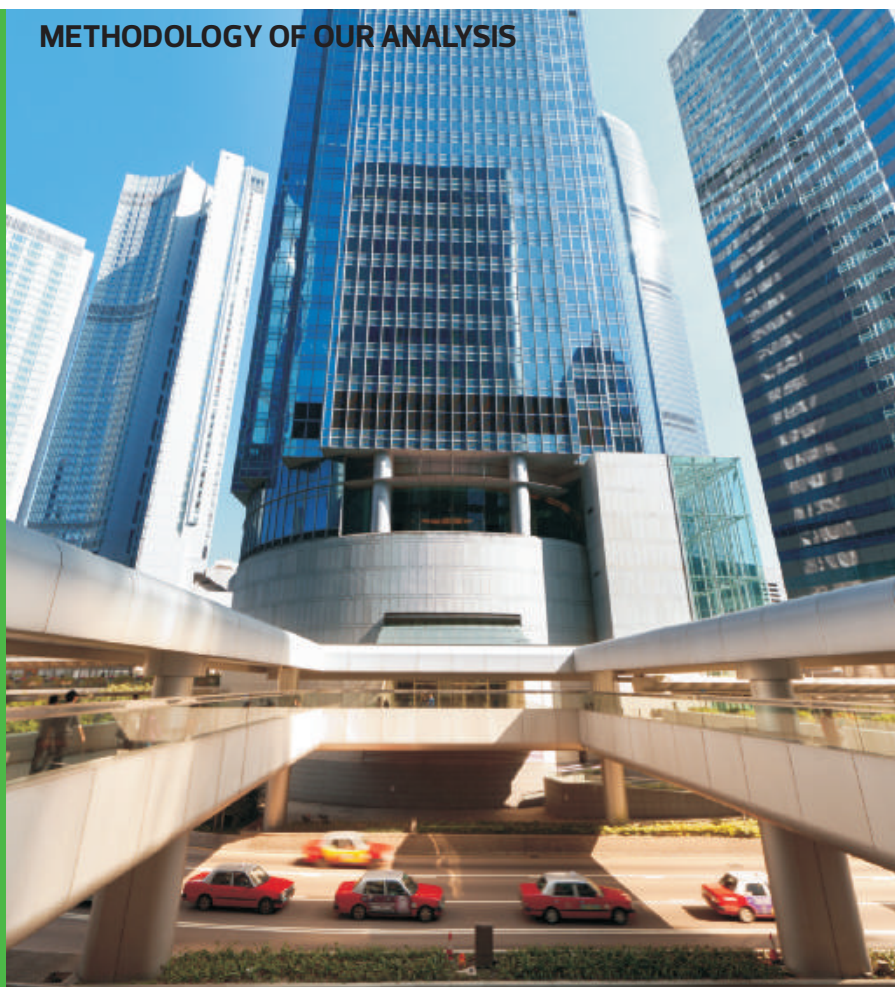
## Notes:

1. The above is an illustrative list of adjustments which would impact the book profit calculations for MAT purposes and each entity preparing its financial statements in compliance with the Indian Accounting Standards would need to consider the adjustment to book profit based on whether the adjustment would be subsequently reclassified to the Profit & Loss Statement or not. Where the adjustment would never be subsequently reclassified to the Profit & Loss Statement, in the year of First Time Adoption, the adjustment would be included in the book profits over a period of five (5) years and in subsequent years as and when the gains / losses arise. In case the adjustments would be subsequently reclassified, the impact of the adjustment would be considered in the book profits in the year in which such items would be reclassified to the Profit & Loss Statement.
2. It may be noted that under the proviso in Explanation 1 to Section 115JB(2), any diminution in value of assets is to be added back while computing the book profits. As such, where the losses on investments in equity is routed through Profit & Loss Statement, the tax authorities may not allow the same as deductible from book profit, although the gains would be added to book profits. .
3. The issue proceeds towards issue of instruments, viz, Redeemable / Optionally Convertible or Compulsorily Convertible Preference Shares / Debentures is considered as capital receipt and as such not subject to tax unless otherwise provided under the IT Act. However, pursuant to reclassification of the Financial Instruments as Compound Financial Instrument in accordance with Ind AS requirements; the equity component of such Compound Financial Instrument would be credited to Other Equity on First Time Adoption. As per the newly amended MAT provisions, any item appearing in Other Equity on First Time Adoption is to be included in the book profits over the period of five (5) years.

While the Equity Component is subjected to MAT, the issuer entity would also be entitled to deduction of the notional interest on a year on year basis and in this way, this adjustment seems to be a MAT neutral provision over a period of time.

However, this may not be always the case, given the limitation of MAT credit provisions and the possibility of a company paying tax under the normal provisions in later years. As such, inclusion of capital receipt in the computation of MAT would effectively result in levy of tax on receipt which is not in the nature of income at all and thus, to some extent it would defeat the fundamental principle of taxation.





Coverage

In this publication, we have analyzed the annual financial results announced by 104 companies across 18 sectors for the financial year ended 31 March 2017. These include the Ind AS phase I companies featuring in the Bombay Stock Exchange (BSE) 100 companies by market capitalization as at 30 June 2017. This list is based on market capitalization of the companies and does not find adequate representations of a few sectors, such as, real estate, retail, transportation and gems & jewelry. Therefore we have expanded our samples and included leading companies in respective sectors covered in Ind AS phase I, so as to have a sample size of at least 3 companies.

BSE 100 list includes many banks, insurance companies and NBFCs and companies with non-March year ends. We have excluded these companies since their annual Ind AS financial results are not available at the moment.

Sectors covered

Sr. No	Sector categorization	Number of companies covered
1	Automotive and auto components	12
2	Cement and allied products	4
3	Fast moving consumer goods	14
4	Hospitality and leisure	3
5	Industrial products and heavy equipment	5
6	Infrastructure	6
7	Iron and steel	3
8	Jewelry and gems	3
9	Media and entertainment	3
10	Metals and other commodities	6
11	Oil and gas	5
12	Power and utilities	8
13	Pharmaceuticals and life sciences	9
14	Real estate and construction	3
15	Retail	4
16	Technology and IT enabling services	8
17	Telecom operations and infrastructure	5
18	Transportation and logistics	3

**Basis of analysis**

The publication analysis the Ind AS transition adjustments on the performance of the companies based on the consolidated Indian GAAP versus Ind AS profit for financial year ending 31 March 2016 and equity reconciliations as at 31 March 2016 provided by the companies. We have also referred to the additional information and explanations provided by the companies by way of separate investor Ind AS presentations.



The table below summarises the area-wise Ind AS impact the aggregated profit and equity reconciliations and the number of sample companies that were affected by the Ind AS areas.

Description	P&L reconciliation (Rs. Crores)	Equity reconciliation (Rs. Crores)	Number of sample companies affected
FY 2015-16 Consolidated Profits/Equity as per Indian GAAP	250,325	2,393,110	
<b>Ind AS Impact:</b>			
Proposed Dividend	-	54,475	85
Financial instruments	(2,529)	51,870	101
Property, plant and equipment	18,975	121,473	79
Business combinations and consolidation	1,223	(282)	34
Foreign currency translation	(1,892)	1,851	38
Deferred taxes	8,820	(34,720)	104
Provisions	(676)	(5,957)	21
Revenue	(729)	(2,111)	19
Share- based payments	(175)	(655)	56
Leases	336	(1,457)	23
Employee benefits	(934)	(583)	98
Government grants	37	512	14
Intangible assets	16	67	9
Extractive / oil & gas activities	(23,208)	(80,224)	7
Real Estate Accounting	3	(6,572)	4
Service concessions	(191)	235	6
Others	(1,050)	(861)	
<b>Net Ind AS impact</b>	<b>(1,973)</b>	<b>97,061</b>	
<b>FY 2015-16 Consolidated Profits/ Equity as per Ind AS</b>	<b>248,352</b>	<b>2,490,172</b>	

The table below summarises the major area of impact, key reasons for the impact and the sectors impacted.

Major area of impact	Main reasons for pervasive impact	Main sectors impacted
Property, plant and equipment	<ul style="list-style-type: none"> <li>– Use of fair value deemed cost exemption at transition</li> <li>– Provision and capitalization of asset retirement obligation</li> <li>– Capitalization of eligible spare parts</li> <li>– Capitalization of major overhaul</li> </ul>	<ul style="list-style-type: none"> <li>– Oil &amp; gas</li> <li>– Metals &amp; mining</li> <li>– Cement</li> <li>– Iron &amp; steel</li> <li>– Power &amp; utilities</li> <li>– Industrial products &amp; heavy engineering</li> </ul>
Business combinations and consolidation	<ul style="list-style-type: none"> <li>– Purchase price allocation: acquisition accounting based on fair values of assets and liabilities</li> <li>– Common control: business combinations accounted for using pooling of interest method</li> <li>– Goodwill can not be amortised, but should be tested for impairment at least annually</li> <li>– Deferred and contingent consideration payable to be fair valued through P&amp;L</li> <li>– Allocation of loss to non-controlling shareholders</li> </ul>	<ul style="list-style-type: none"> <li>– Technology &amp; ITES,</li> <li>– Pharmaceuticals &amp; life sciences</li> <li>– Iron &amp; steel</li> </ul>
Financial instruments	<ul style="list-style-type: none"> <li>– Investments to be categorised: fair value through profit or loss (FVTPL), fair value through other comprehensive income (FVOCI) and amortised cost</li> <li>– All investments, including unquoted equity shares, except investments in subsidiary / Joint venture/ associate measured at fair value</li> <li>– All derivative instruments to be carried at fair value</li> </ul>	<i>Generally across all sectors</i>

Major area of impact	Main reasons for pervasive impact	Main sectors impacted
	<ul style="list-style-type: none"> <li>– Redeemable preference shares classified as liability and unwound through P&amp;L as interest expense</li> <li>– Amortised cost based on effective interest rate</li> <li>– Initial recognition of all financial assets and financial liabilities at fair value (interest –free security deposits, employee loans, etc.)</li> <li>– Impairment of financial assets: expected loss model</li> </ul>	
Share-based payments	<ul style="list-style-type: none"> <li>– Mandatory use of fair value for share based payments</li> <li>– Consolidation of trusts dealing with employee share based payment</li> </ul>	<ul style="list-style-type: none"> <li>– Fast moving consumer goods</li> <li>– Technology &amp; ITES</li> </ul>
Employee benefits	<ul style="list-style-type: none"> <li>– Actuarial gains and loss recognized in equity through OCI rather than in P&amp;L</li> </ul>	<i>Generally across all sectors</i>
Revenue	<ul style="list-style-type: none"> <li>– Gross vs. net presentation (excise duty, other charges)</li> <li>– Customer incentive schemes in some cases reduced from revenue</li> <li>– Timing of recognition of revenue (estimated sales return, dispatch vs. delivery)</li> <li>– Deferral of revenue due to multiple deliverable arrangements</li> <li>– Fair valuation of consideration: time value of money to be considered</li> <li>– Deferral of revenue due to linked transactions (to reflect the substance)</li> <li>– Customer loyalty schemes</li> </ul>	<ul style="list-style-type: none"> <li>– Excise duty presentation affected all the manufacturing companies</li> <li>– Adjustments on account for customer incentives presentation were evident in fast moving consumer goods, pharmaceutical &amp; life sciences and automotive</li> <li>– Revenue deferral due to multiple–element, estimated sale returns, linked transactions, etc. were evident in pharmaceutical &amp; life sciences and automotive</li> </ul>

Major area of impact	Main reasons for pervasive impact	Main sectors impacted
		<ul style="list-style-type: none"> <li>– Revenue deferral due to customer loyalty schemes were evident in retail and hospitality &amp; leisure</li> </ul>
Leases	<ul style="list-style-type: none"> <li>– Accounting for leases embedded in sale, purchase, other contracts</li> <li>– Not straight-lining of the lease escalations on account of inflation</li> </ul>	<ul style="list-style-type: none"> <li>– Power &amp; utilities</li> <li>– Automotive</li> <li>– Telecom &amp; related infrastructure</li> </ul>
Foreign currency	<ul style="list-style-type: none"> <li>– Foreign exchange fluctuations to be immediately charged to the statement of profit and loss</li> <li>– Functional currency assessment for all operations</li> </ul>	<ul style="list-style-type: none"> <li>– Mining &amp; metals</li> <li>– Oil &amp; gas</li> <li>– Automotive</li> <li>– Telecom &amp; related infrastructure</li> </ul>
Deferred tax	<ul style="list-style-type: none"> <li>– Deferred tax arising on temporary differences arising on Ind AS adjustments</li> <li>– Deferred tax on undistributed reserves on subsidiaries, joint venture, associate, unless certain criteria met</li> <li>– Deferred tax on intercompany eliminations</li> </ul>	<ul style="list-style-type: none"> <li>– Pharmaceutical &amp; life sciences</li> <li>– Technology &amp; ITES</li> <li>– Telecom &amp; related infrastructure</li> <li>– Mining &amp; metals</li> </ul>

## 8.1 Property, plant and equipment (PPE)

The biggest impact area with PPE accounting that we observed was with regards to the transition provisions that Ind AS 101 provides with regards to PPE. Ind AS 101 generally requires first-time adopters to retrospectively apply the requirements of Ind AS. Alternatively, the standard provides first-time adopters with exemptions allowing the Ind AS carrying amount of an item of PPE to be measured at the date of transition based on a deemed cost. Broadly, the deemed cost exemption may be based on either of the following:

- Selective fair valuation at the transition date



- Previous GAAP carrying values of the PPE at the transition date.

Whilst the use of previous GAAP carrying value deemed cost exemption is operationally most convenient, many companies opted for fair value deemed cost exemption, meaning they fair valued items of PPE at the transition date. Subsequent depreciation charge under Ind AS is based on the fair valued asset base. Based on the differential depreciation charge featuring in the profit reconciliations and fair valuation uplifts featuring in the equity reconciliations provided, at least 39 companies in our sample opted for the fair value deemed cost exemption.

Other widespread impact areas of differences included accounting for major overhaul and spares. This featured in the reconciliations of 16 sample companies, mostly in metals and mining, cement, iron & steel, power & utilities and industrial products & heavy engineering sectors.

## **8.2 Business combinations and consolidation**

Under Indian GAAP, there are separate standards that deal with amalgamation, consolidation and assets acquisition. Acquisitions through share acquisition are recorded at carrying values of assets and liabilities of the acquired company under AS 21. Under Ind AS 103, all assets and liabilities acquired are recognized at fair value. Additionally, contingent liabilities and intangible assets not recorded in the acquiree's balance sheet are likely to be recorded in the acquirer's balance sheet on acquisition date.

Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually. Indian GAAP, on the other hand, required amortization of goodwill in the case of amalgamations. This resulted in reversal of goodwill amortisation in 38 sample companies.

Upon first-time adoption of Ind AS, application of Ind AS 103 to past business combinations prior to the date of transition to Ind AS is optional under Ind AS 101. However, 22 sample companies in sectors such as, technology & ITES, pharmaceuticals & life sciences and iron & steel, opted to apply Ind AS business combinations accounting retrospectively, thereby resulting in increase in tangible/intangible assets (and resultant depreciation/ amortization) and

corresponding decrease in historical goodwill.

Indian GAAP does not differentiate between common control transactions and other acquisitions. Common control business combinations refer to a business combination involving companies or businesses in which all the combining companies or businesses are ultimately controlled by the same party or parties both before and after the business combination and such control is not transitory. In the case of common control business combinations Ind AS requires the assets, liabilities and reserves of the acquired company to be recognised at their carrying values (the only adjustment allowed is for harmonisation of policies). The difference between the consideration paid and share capital of the acquired company is recorded as capital reserve. Comparative information is restated. This treatment is similar to the pooling of interests method prescribed under Indian GAAP. 22 sample companies had adjustments on account of common control business combinations.

In addition, there were other widespread areas of differences such as, charging out of acquisition-related costs, accounting for put/call options with non-controlling shareholders and fair valuation of deferred and contingent considerations.

Under Ind AS, the assessment of control is not solely based on majority voting interest or ability to control the composition of the board of directors, but it is also based on existence of the investor's rights, exposure/rights to variable returns and ability to use rights over the investee to affect the amount of the investor's returns. For example, an investor with less than majority voting interest in a company may result in consolidation of the company as a subsidiary if the investor has substantive participative rights. Participative rights are rights to participate in the operating and financial policies of the company that go beyond just protecting the interests of the minority shareholder. 16 groups in our sample had a change in their erstwhile subsidiary/joint venture/associate relationship on account of Ind AS.

### 8.3 Financial Instruments

Apart from income taxes, accounting for financial instruments was the most widespread area of impact across all the sectors. Whilst, on an aggregated basis,

there was uplift in the equity as at 31 March 2016 on accounting for financial instruments, it caused the aggregated profits to decline.

Key widespread impact areas within financial instruments accounting included:

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI). If the FVOCI option is availed, fair value movement and gains/ losses on sale of the investments permanently escape P&L – all remeasurement changes other than dividend income are recognized in equity through OCI. Under Indian GAAP, they were generally classified as long term or current. Long term investments are measured at cost less other than temporary diminution in the value of investment. Current investments are measured at lower of cost or market price. This impacted companies across all the sectors.

Under Indian GAAP, there was no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments.

The impact of expected credit loss method based impairment is more pronounced in case automotive and industrial goods & heavy engineering sectors.

Debt instruments are treated as financial assets and liabilities under Ind AS and are accounted for at amortised cost using effective interest method. Indian GAAP did not contain any such requirement and interest was generally accrued based on the stated interest rates.

Under Ind AS, the liability and equity classifications of financial instruments may change substantially. Redeemable preference shares, classified as part of equity under Indian GAAP, are treated as, partly or entirely, a debt under Ind AS. This is due to the nature of the instrument giving rise to redemption obligation at a future date. Such debt instruments are initially measured at fair value and subsequently amortised through P&L by booking finance cost. Dividend distribution tax payable on such debt instruments are charged to P&L as finance cost.

Under Ind AS, financial guarantees issued in favour of bank on behalf of another company, for example, a subsidiary, are accounted for and are initially recognised and measured at fair value. Subsequently, the measurement is at the higher of: amount of loss allowance determined as per impairment requirements of Ind AS, and amount initially recognized less, where appropriate, cumulative amortization. The impact of this was evident in companies in infrastructure, power & utilities and real estate sectors.

All financial assets including assets such as interest-free lease deposits, low interest or interest-free loans, have to be fair valued at inception under Ind AS. The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the underlying transaction. For example, the initial difference on fair valuation of interest free lease deposits relating to an operating lease is considered as prepaid lease rent to be amortised as additional lease expense over the lease term. This impacted generally all sectors, however, the impact was predominant in retail, technology & ITES and fast moving consumer goods sectors.

## **8.4    Share based payments**

Under Indian GAAP, employee share based payment transactions can be accounted for either by the fair value method or the intrinsic value method. A company which uses the intrinsic value method is required to make fair value disclosures. In practice, most Indian companies used the intrinsic value method to measure the cost of share based payments. Under this approach, if the exercise price for the employee stock option is not less than the market price of the underlying shares on the date of the grant, no compensation cost is recorded. Under Ind AS, costs of

share based payments are recorded based on the fair value of the instrument, with rare exceptions. Under this approach, the instrument would have a value even if the exercise price is equal to the market price of the underlying shares on the date of grant. This value is generally measured using option pricing models, and, therefore, the employee costs for most employee stock options schemes increased under Ind AS, as can be seen in the table above. The impact was predominant in fast moving consumer goods sector and was also evident in technology sectors.

Ind AS 101 provides a transitional exemption to first-time adopters of Ind AS. Employee stock options that have already vested as at the transition date need not be accounted for based on fair values. Most companies in our sample availed this option and therefore there is no significant impact on equity.

In addition, in a few cases, we observed Ind AS adjustments on account of accounting for employee stock options with graded vesting schedule. Ind AS requires an accelerated method of employee benefit expense to be charged as against straight-line method, used by many Indian companies under Indian GAAP. Also, Ind AS requires ESOP trusts to be consolidated. These adjustments impacted sectors, such as technology & ITES. Ind AS requires accounting for the cost of any share based payments granted by a parent to employees of a subsidiary or vice versa. This change generally impacted multinational companies with overseas holding company/ subsidiaries. The Ind AS requirements have been further discussed in the respective sector sections.

## **8.5 Employee benefits**

Ind AS requires remeasurements, including actuarial gains and losses, to be accounted for in equity through OCI. Under Indian GAAP, such actuarial valuation was to be recognized in P&L. This adjustment impacted a vast majority of the sample companies across all sectors.

In certain cases, there was impact on account of early recording of constructive long term employee obligations at discounted values.

## **8.6 Revenue**

The most significant impact on revenue of manufacturing companies was on

account of grossing up of excise duty included in the sales price. Under Ind AS revenue is presented gross of excise duty, which is treated as a cost, as against Indian GAAP treatment of presentation of revenue net of excise duty. Whilst this did not have bottomline impact on profits, it did necessitate changes in key ratios based on revenue, such as, gross margin and net margin.

Under Ind AS, revenue is measured at the consideration received/receivable considering trade discounts, volume rebates, cash discounts and other incentives. Hence, under Ind AS, such customer incentives to achieve minimum threshold of purchase or early settlement of receivables (cash discounts), are recorded as a reduction from revenue rather than as expense. Under Indian GAAP, some of these costs were included in 'advertising and sales promotion' expenses. This impacted companies in fast moving consumer goods, pharmaceuticals and, in a few cases, automotive sectors.

A contract may include multiple components (for example, goods sold with subsequent free maintenance services). Indian GAAP did not have specific guidance on multiple element transactions. In practice, most companies accounted for such arrangements based on the invoiced values and the legal form of the transaction. Under Ind AS, when an arrangement includes more than one component, it is necessary to account for the revenue attributable to each component separately. In case of many sample companies, this caused deferral of revenue due to unsatisfied performance obligations. This impacted mostly companies in automotive, industrial goods & heavy engineering and technology sectors.

Under Ind AS, revenue from sale of goods is recognized when significant risks and rewards of ownership has been transferred to the buyer and the seller no longer retains control / managerial involvement. Further, Ind AS requires a careful assessment of principal–agency relations with the seller. Although, under Indian GAAP, revenue recognition has been on similar basis, there is no specific guidance. This caused deferral of revenue in companies in sectors such as pharmaceuticals and automotive. A company involved in manufacturing alcohol concluded its relationship with dealers as agent rather than principal for accounting purpose.

There were other sector specific adjustments, such as: revenue deferral on account of linked transactions and the requirement to estimate sales–returns and reduce from revenue in pharmaceuticals; fair valuation of joint development agreements in real estate sectors; separation of embedded derivatives in provisionally priced sale agreements in case of oil & gas and mining & metals sectors; difference in percentage of completion revenue method in transportation sector; accounting for service concessions arrangement in infrastructure sector; and accounting for customer loyalty schemes in retail, transportation and hospitality sectors. These have been discussed elaborately in subsequent chapters.

## 8.7 Leases

Indian GAAP requires lease rental escalations to be straight-lined over the lease term. In the Indian context, given the inflationary situation, Ind AS states that the straight lining of lease rentals may not be required in cases where periodic rent escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining. While this was a relaxation under Ind AS, very few companies had impact on account of this, probably, due to lack of application guidance as how and from which source should the inflation rates be benchmarked, at what point to assess whether lease rentals are in line with inflation, etc. However, one exception was that of the telecom & related infrastructure sector, which predominantly contributed to the equity reconciliation in the table above.

Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases. Under Ind AS, leasing would extend to arrangements which, in substance, meet the definition of a lease, even though not be structured as 'lease'. These arrangements convey a right to use an asset or assets for an agreed period of time in return for a payment or series of payments. Embedded leases exist in outsourcing job work arrangements, power purchase agreements, certain transportation arrangements, etc. Although, this impacted companies

across all sectors, this did not seem to have significant impact, probably on account of the arrangements being assessed as operating leases. Sectors that were impacted include power & utilities and iron & steel.

## 8.8 Foreign currency

Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. If the long term foreign currency monetary item relates to other than acquisition of a depreciable capital asset, exchange differences are accumulated in the 'Foreign Currency Monetary Item Translation Difference Account' which is subsequently amortised through the P&L over the life of such long term asset or liability. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. As a transitional relief, companies could elect to continue with their chosen Indian GAAP accounting policy to capitalize/defer exchange fluctuations on long term monetary items existing as of 31 March 2016. However, all subsequent long-term foreign currency monetary items are to be translated through P&L as per Ind AS 21. This impacted many companies, particularly, those in automotive, oil & gas and mining & metals sectors.

Accounting for exchange differences on translation of foreign operations under Indian GAAP was based on whether the operations are integral or non-integral. Ind AS does not have these concepts and requires determination of functional currency of the operations. This impacted oil & gas and mining & metals and telecom sectors.

## 8.9 Deferred taxes

Under Indian GAAP, deferred taxes are recognised on timing differences based on what is known as the income statement approach. Under Ind AS, deferred taxes are recognised on temporary differences based on what is known as the balance



sheet approach. Under this approach, additional deferred taxes may need to be recognised on revaluation of assets; indexation benefits for freehold land and investments; fair value changes for available for sale securities; and consolidation of undistributed profits of subsidiaries, joint ventures and associates. Under Ind AS, deferred tax impact of intragroup eliminations is also recorded. For example, when unrealised profits are eliminated on unsold inventory purchased by a subsidiary from a parent, deferred taxes are recognised for the temporary difference that arise between the tax base (normally, the transaction value) and the carrying value in the consolidated financial statements (after eliminating unrealised profits). All Ind AS transition adjustment that resulted in temporary differences also caused recognition of deferred taxes.

Deferred tax adjustments under Ind AS were seen in almost all sample companies. The impacts on account of deferred tax on undistributed profits of subsidiaries were significant in case of companies in technology & ITES, telecom and mining & metals sectors. Impacts of deferred tax on intragroup eliminations in consolidated financial statements were significant in pharmaceutical sector.

### 8.10 Proposed dividend

Under Indian GAAP, dividend proposed after the balance sheet date but prior to the approval of financial statements is considered as an adjusting event, and a provision for dividend payment is recognised in the financial statements of the period to which the dividend relates. Under Ind AS, dividend declaration is considered as a non-adjusting subsequent event and provision for dividends is recognised only in the period when the dividend is declared and approved. This impacted all the companies that had proposed dividend for FY 2015–16 or FY 2014–15.

It must be noted here that the accounting for proposed dividend under revised Indian GAAP effective in financial year 2016–17, notified under Companies (Accounting Standards Amendments) Rules, 2016 is similar to that under Ind AS (i.e. dividend obligation is only recognized after approval by the shareholders).



Chapter 9

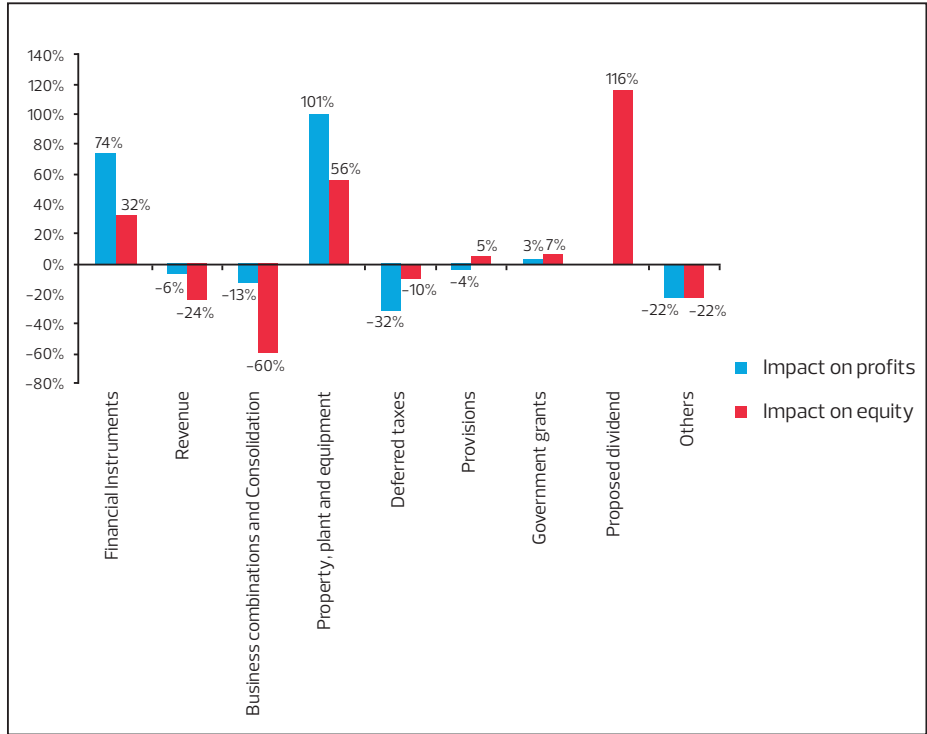
Sector-wise Ind AS Analysis

In this chapter, we take a closer look at the key Ind AS impact areas for each sector identified.

9.1 Automotive and ancillary companies

Sample size – 12 companies manufacturing commercial vehicles, passenger vehicles, including 2/3 wheelers, and automotive parts and equipment.

% of net impact on FY March 2016 profits and March 2016 equity (as a % of net Ind AS Impact)



■ Property, plant and equipment

– Capitalisation of Foreign currency exchange differences

Under Indian GAAP, exchange differences arising on translation of monetary

items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. If the long term foreign currency monetary item relates to other than acquisition of a depreciable capital asset, exchange differences are accumulated in the 'Foreign Currency Monetary Item Translation Difference Account' which is subsequently amortised through the P&L over the life of such long term asset or liability. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary items.

Many automotive companies had opted for this option under Indian GAAP (8 sample companies). Therefore, this difference was one of the major Ind AS adjustment in the sector. This adjustment constituted about 12 % of the Ind AS profit of one of the major automotive companies in our sample.

– **Fair valuation as deemed cost for property, plant and equipment**

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. One such choice is to revalue some or all items of PPE to their fair value as at the transition date with a corresponding adjustment in the retained earnings/ reserves.

The fair value uplift on account of the use of this option for PPE resulted in increase in equity and net worth of one major automotive group in our sample by 3% of the consolidated equity.

## ■ Financial instruments

### – Fair valuation of investments

Investments in equity shares of other companies (other than that in subsidiaries, joint venture and associates) and mutual fund units are required to be fair valued under Ind AS. Under Indian GAAP, they were generally classified as long term or current. Long term investments are measured at cost less other than temporary diminution in the value of investment. Current investments are measured at lower of cost or market price.

Many automotive companies invest their surplus funds in units of mutual funds as a part of their treasury operations. Fair valuation of such investments constituted a significant impact area- constituting about 55% of the overall net Ind AS impact on the aggregated net profits of our sample companies. Net profit of one passenger vehicle major had increased by 22% as a result of fair valuation under Ind AS, while the net profit of another sample company, an automotive equipment manufacturer increased by 19%.

### – Expected credit loss model

Under Indian GAAP, there was no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments.

One commercial vehicle major in our sample booked additional impairment provision based on ECL model to the tune of about 43% of its net Ind AS impact in absolute terms.

## ■ Revenue

### – **Multiple-element sales**

Automotive companies often provide after-sales services to its customers in the form of 'free' servicing/maintenance or extended warranties, etc. Ind AS requires an entity to identify all such components or elements within a sale contract with the customer. Consequently, the accounting would be as though the company has sold vehicle and an additional element (E.g. after sales maintenance) together. Revenue from sale of vehicle would be recognized when at the point when risks and rewards are transferred while revenue from after-sales maintenance is recognized over a period of time when the services are rendered. Indian GAAP does not explicitly require such accounting for multiple-element sales and therefore, generally, the entire revenue is recognized on sale of vehicles.

The Indian GAAP revenue for FY 2015–16 of one passenger vehicle major declined by 62% on account of this adjustment.

### – **Extended credit terms**

Under Indian GAAP, revenue is recognised at the contractual value of the consideration receivable. Ind AS requires measurement of revenue at fair value of the consideration receivable. If the company offers an extended credit period to customers, revenue is recognised at the present value of future cash inflows. Interest income is recognised over the credit period for the difference between the revenue recognised and the stated transaction value.

## ■ Business Combinations and Consolidation

### – **Restatement of past business combinations**

On transition to Ind AS, a company has the following three options in relation

to the business combination transactions before the transition date:

- Not to restate business combinations before the transition date and apply Ind AS only to subsequent business combinations; or
- Restate all past business combinations before the transition date; or
- Restate all past business combinations done after a chosen date, prior to the transition date.

If the company elects not to restate past business combinations, the carrying value of goodwill as per Indian GAAP is required to be carried over to Ind AS without any modification. Under this approach, any previous goodwill amortisation under Indian GAAP is not required to be reversed. However, goodwill will need to be tested for impairment on transition date to Ind AS.

Ind AS requires that any goodwill arising on acquisition of foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising of the acquisition to be treated as the assets and liabilities of the foreign operations. For first-time adopter, it may be impracticable, especially for old acquisitions, to determine the retrospective foreign currency exchange differences on goodwill and fair value adjustments. Towards this, Ind AS 101 provides a voluntary exemption whereby a first-time adopter need not apply the requirement to retrospectively account for the foreign exchange differences on goodwill and fair value adjustments of foreign operations acquired. In other words, goodwill and fair value adjustments of foreign operations are treated as the assets and liabilities of the acquirer company and not the acquiree company. Therefore, those goodwill and fair value adjustments are either already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied under the Indian GAAP.

#### – **Reversal of amortisation of goodwill**

Under Indian GAAP, there are separate standards that deal with

amalgamation, consolidation and assets acquisition. Acquisitions through share acquisition are recorded at carrying values of assets and liabilities of the acquired company under AS 21. Under Ind AS 103, all assets and liabilities acquired are recognized at fair value. Additionally, contingent liabilities and intangible assets not recorded in the acquiree's balance sheet are likely to be recorded in the acquirer's balance sheet on acquisition date. Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually. Indian GAAP, on the other hand, required amortization of goodwill in the case of amalgamations. Upon first-time adoption of Ind AS, application of Ind AS 103 to past business combinations prior to the date of transition to Ind AS is optional under Ind AS 101.

– **Consolidation**

Under Indian GAAP, the assessment of existence of control over a company and consolidation as a subsidiary is based on ownership of majority of the voting power or control over the composition of the board of directors. Under Ind AS, the assessment of control is not solely based on majority voting interest or ability to control the composition of the board of directors, but it is also based on existence of the investor's rights, exposure/rights to variable returns and ability to use rights over the investee to affect the amount of the investor's returns. For example, an investor with less than majority voting interest in a company may result in consolidation of the company as a subsidiary if the investor has substantive participative rights. Participative rights are rights to participate in the operating and financial policies of the company that go beyond just protecting the interests of the minority shareholder. Approval of budgets, veto rights, appointment and termination of key management personnel are examples of such participative rights, which may preclude consolidation by the majority shareholder.

Two automotive groups in our sample were impacted by this change in Ind AS and change their group composition.



## ■ **Government grant**

Under Indian GAAP, two broad approaches are followed for recognition of government grants – the capital approach or the income approach. Government grants in the nature of promoter's contribution are credited directly to the shareholders' funds (capital reserves). Grants related to depreciable assets are either treated as deferred income and transferred to the profit and loss account in proportion to the depreciation; or deducted from the cost of the asset. Ind AS does not permit recognition of grants directly in reserves. Therefore, government grants will be recognized as income, on a systematic basis, over the periods necessary to match them with the related cost, which they are intended to compensate. Further, government grants related to assets are presented in the balance sheet only by setting up the grant as deferred income and not as a reduction from PPE.

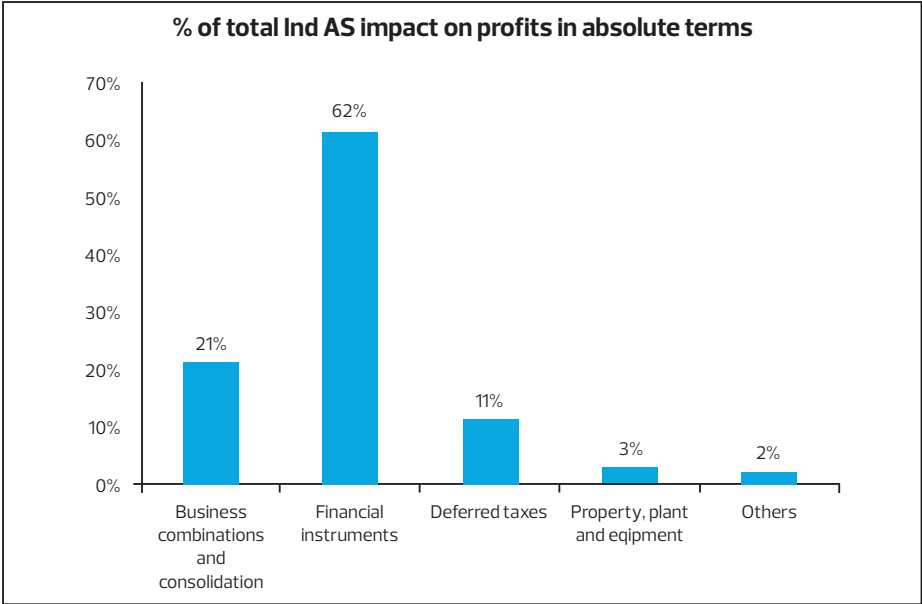
This adjustment to FY 2015-16 constituted about 78 % of the net Ind AS profit impact (in absolute terms) of one of the major auto component company in our sample and about 10% of another sample company.

## ■ **Other Ind AS adjustments**

- Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- Long term provisions (such as, warranties) are required to be initially measured at a discounted amount. Subsequently there is P&L charge on account of unwinding of the discount.
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI
- Revenue and expenses to be grossed up for excise duty.

9.2      Cement and allied products

Sample size– 4 cement companies. Following table provides an area wise contribution in % to the overall Ind AS FY March 2016 profit impact in absolute terms



■      Business Combinations and Consolidation

–      Common Control business combinations

Indian GAAP does not differentiate between common control transactions and other acquisitions. Common control business combinations refer to a business combination involving companies or businesses in which all the combining companies or businesses are ultimately controlled by the same party or parties both before and after the business combination and such control is not transitory. In the case of common control business combinations Ind AS requires the assets, liabilities and reserves of the acquired company to be recognised at their carrying values (the only adjustment allowed is for harmonisation of policies).

- **Acquisition related costs**

Acquisition related costs (for example, stamp duty) are treated as capital costs under Indian GAAP and included in the cost of the investment. Ind AS generally requires all such acquisition related costs to be charged to the profit and loss account as incurred. In case of a sample company, the additional charge due to acquisition related cost constituted 3% of its profit.

- **Acquisition accounting**

Currently, Indian GAAP does not mandatorily require fair valuation of assets and liabilities acquired on amalgamation/acquisition. However, with the introduction of Ind AS, fair valuation of all assets and liabilities would be mandatory, except for common control transactions. Accounting for amalgamation/ acquisition transactions in pharmaceutical sector under Ind AS would lead to recognition of several intangible assets by the acquirer/transferee companies.

This adjustment caused a 15% decrease in the 31 March 2016 net worth of a steel company in our sample.

- **Consolidation of joint venture and associates**

Under Indian GAAP, all joint ventures are classified into three types, jointly controlled assets, jointly controlled operations and jointly controlled entities. An entity's investments in joint controlled entities are accounted for using proportionate consolidation method. Ind AS classifies joint arrangements into two types, joint ventures and joint operations. An entity's interest in joint venture is accounted for by using equity method. Investments in associates are also accounted for using equity method. Consolidation of all the joint ventures and associates is based on their Ind AS financial statements.

- **Property plant and equipment (PPE)**

PPE was one of the main impact areas and all the sample companies had Ind AS

adjustments on this account.

- **Major spare parts**

Cement plants regularly require wear parts, resistance parts, mechanical and electrical spares for their normal operations. Major spares and stand-by equipment have been accounted for using divergent practices under Indian GAAP. Many cement companies treated them as inventory. Under Ind AS, all spare parts, stand-by and servicing equipment qualify as PPE if the company intends to use these for a period of more than 12 months. This capitalization constituted 19% of the total net IndAS P&L impact in case of one large cement company in our sample.

- **Decapitalisation of foreign exchange difference**

Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary items.

- **Government grant**

Many State governments in India provide sales tax deferral schemes to encourage and ensure development of underdeveloped areas. Ind AS 12 requires the benefit of a government loan at nil or below-market rate of interest to be treated as a government grant. Initially, the loan is measured at fair value. The difference between initial fair value of the loan and proceeds received is a government grant to be recognized over the future period depending on the nature of the grant, i.e.

asset-related or revenue grant. Going forward, the loan is measured at amortised cost using effective interest method. Indian GAAP does not require/allow fair valuation or discounting for such deferral schemes. The net profit of one large cement company increased by 16% on account of this adjustment.

#### ■ **Timing of revenue recognition**

Under Ind AS 18, revenue from sale of goods is recognized when an entity transfers the significant risks and rewards of ownership and gives up managerial involvement, usually associated with ownership or control, if economic benefits are likely to flow. This means that the accounting should reflect the economic substance of transactions and not merely their legal form, leading one cement company in our sample to defer its revenue recognition and related costs, in turn, causing decrease in net profit in excess of 100%.

#### ■ **Financial instruments**

Derivatives and investments in mutual fund units are required to be fair valued under Ind AS. This caused an increase in the net profits of two large cement companies by 11% and 14%.

#### ■ **Other adjustments**

None of the sample companies published FY March 2016 reconciliations and, therefore, the Ind AS issues discussed above may not be the only impact. Some of the other areas of Ind AS changes would be as follows:

- **Embedded leases:** Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases.

Under Ind AS, leasing would extend to arrangements which, in substance, meet the definition of a lease, even though not be structured as 'lease'.

These arrangements convey a right to use an asset or assets for an agreed

period of time in return for a payment or series of payments. Embedded leases exist in outsourcing job work arrangements, certain transportation arrangements, etc.

- All financial assets including assets such as interest free lease deposits, low interest or interest free loans, have to be fair valued at inception under Ind AS. The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the underlying transaction. For example, the initial difference on fair valuation of interest free lease deposits relating to an operating lease is considered as prepaid lease rent to be amortised as additional lease expense over the lease term.
- Long term provisions arising on site restoration obligation are required to be initially measured at a discounted amount. Subsequently there is P&L charge on account of unwinding of the discount.
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI.
- Measurement of financial liabilities such as loans and borrowings at effective interest method.
- Financial guarantees issued in favor of bank on behalf of another company, for example, a subsidiary, are accounted for and are initially recognised and measured at fair value. Subsequently, the measurement is at the higher of: amount of loss allowance determined as per impairment requirements of Ind AS 109, and amount initially recognized less, where appropriate, cumulative amortization.

### 9.3 Fast Moving Consumer Goods

Sample size – **14** companies.

Aggregated profit and equity reconciliations for the sample companies covered in the sector:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Indian GAAP</b>	<b>19,918</b>	<b>60,582</b>
<b>Ind AS Impact:</b>		
Financial instruments	(126)	1,045
Share based payments	(511)	(64)
Business combinations and consolidation	(270)	(814)
Revenue	(70)	(380)
Property, plant and equipment	12	3
Deferred taxes	(26)	(363)
Intangible assets	16	67
Proposed dividend	–	12,196
Others	70	22
<b>Net Ind AS impact</b>	<b>(905)</b>	<b>11,712</b>
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Ind AS</b>	<b>19,013</b>	<b>72,294</b>

#### ■ Share Based payments

##### – Group share-based payments

Many FMCG companies, particularly, multinationals, give stock based or share based compensation to their employees. Under Indian GAAP, companies could have used intrinsic value method or fair value method to measure their share based arrangements. Ind AS requires the use of fair value method to measure the employee costs over the vesting period. Also, where parent company provides share based compensation to employees

of the subsidiary, the subsidiary is required to recognize employee costs in its individual financial statements. This dented the profits of many FMCG companies.

- **Fair value measurement**

Under Indian GAAP, companies could have used intrinsic value method or fair value method to measure their share based arrangement. Ind AS requires the use of fair value method to measure the employee costs over the vesting period. This change in the measurement of employee share based payment caused a decrease in the net profits of the sample companies.

- **Financial instruments**

- **Fair valuation on investments**

As can be seen from above, the biggest impact area in the sample companies was financial instruments. Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI). If the FVOCI option is availed, fair value movement and gains/ losses on sale of the investments permanently escape P&L – all remeasurement changes other than dividend income are recognized in equity through OCI. Many FMCG companies in our sample opted for the FVOCI option.

Out of those who also disclosed their Ind AS vs Indian GAAP equity reconciliation as at 31 March 2016, fair valuation of financial instruments increased their reserves by 35%.

- **Redemption premium**

The other Ind AS requirement that caused impacts on the sample



companies was on account of redemption premium on debentures/ redeemable preference shares. Two companies in our sample were charging redemption premium to securities premium account under Indian GAAP. Under Ind AS, these instruments are required to be measured at effective interest rate through a charge in P&L. This change increased the finance cost of one of the sample companies by 50%.

### ■ Intangible assets

Under Indian GAAP intangible assets are amortised over their useful lives. There is a rebuttable presumption that the useful life can not 10 years. Under Ind AS, an intangible can be assessed to have an indefinite useful life if there is no predictable time period over which it is expected to generate economic benefits for the company. In practice, certain FMCG companies have assessed their brands with certain attributes to be having indefinite useful lives. This caused reversal of Indian GAAP amortization charge, increasing earnings of at least 3 sample companies.

### ■ Employee benefits

Under Indian GAAP, actuarial gains and losses on remeasurement of post-employment benefit plans are recognised immediately in the P&L. Under Ind AS, all such remeasurements are to be recognised in reserves through OCI. This increased the reported earnings of almost all the companies.

### ■ Revenue

Aggregated FY March 2016 revenue reconciliation for the companies covered in the sector:

Description	(Rs. Crores)
Revenue under Indian GAAP	<b>122,450</b>
Excise duty	18,386
Sales promotion and trade schemes and cash discount	(3,747)
Others	(399)
Revenue under Ind AS	<b>136,690</b>

Revenue is an important performance metric for FMCG sector. Under Indian GAAP revenue was reported net of excise duty, while under Ind AS, it has been clarified that revenue would be gross of excise duty and excise duty is recognized as an expense. This alone caused 15% increase in the reported revenue for our sample companies. Apart from this, following were the IndAS impact areas for revenue.

- **Timing of revenue recognition**

Under Ind AS 18, revenue from sale of goods is recognized when an entity transfers the significant risks and rewards of ownership and gives up managerial involvement, usually associated with ownership or control, if economic benefits are likely to flow. This means that the accounting should reflect the economic substance of transactions and not merely their legal form, leading one company in our sample to defer its revenue recognition and related costs, in turn, causing reduction of profits by 16%.

- **Trade promotion schemes**

FMCG companies often provide extensive sales incentives, discounts, rebates, consumer coupons and early settlement cash discounts to their customers, dealers, retailers or ultimate consumers in order to incentivize them to purchase the company's products. Under Indian GAAP, some of these costs were included in 'advertising and sales promotion' expenses. Under Ind AS, revenue is measured at the consideration received/receivable considering trade discounts, volume rebates, cash discounts and other incentives. Hence, under Ind AS, such customer incentives to achieve minimum threshold of purchase or early settlement of receivables, are recorded as a reduction from revenue rather than as expense. Since this is a reclassification, this would not affect the profits. However, key ratios such as gross margins, return on sales, etc, which are derived from revenue would be affected.

Although, on an aggregate basis, this impacted reported revenue by 3%, revenues of three companies declined by 6 -10%

## ■ **Deferred Tax**

### – **Balance sheet approach**

Under Indian GAAP, deferred taxes are recognised on timing differences based on what is known as the income statement approach. Under Ind AS, deferred taxes are recognised on temporary differences based on what is known as the balance sheet approach. Deferred tax is also recognized for the Ind AS transition adjustments giving rise to temporary differences. As can be seen from the above table, this impacted all the companies in the sample.

### – **Deferred taxes on unrealized profits on intra-group transactions**

Under Indian GAAP, deferred tax in the consolidated financial statements is the sum of the tax expense of the parent and the subsidiaries. Under Ind AS, deferred tax adjustments are made on account of this inter company elimination of unrealized profits. When unrealized profits are eliminated on unsold inventory purchased by a subsidiary from a parent, deferred taxes are recognized for the temporary difference arising between the tax base (normally the invoiced value) and the carrying amount in the consolidated financial statements (the group's cost after eliminating the unrealized profits).

## ■ **Other Ind AS impact areas**

- Under Ind AS 101 there is a first-time adoption exemption to selectively fair value the items of PPE as at the date of Ind AS transition. This is then treated as deemed cost of those items of PPE under Ind AS and forms the basis of subsequent depreciation charge.
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI
- Cash discount provided to customers to be estimated and deducted from revenue

## 9.4 Hospitality and leisure

Sample size– **3** companies including those involved in hotel operations and holiday management.

Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Indian GAAP</b>	<b>179</b>	<b>7,420</b>
<b>Ind AS Impact:</b>		
Financial instruments	(129)	(35)
Revenue	(19)	(32)
Business combinations and consolidation	(113)	(844)
Deferred taxes	43	(47)
Proposed dividend		96
Others	43	81
<b>Net Ind AS impact</b>	<b>(176)</b>	<b>(781)</b>
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Ind AS</b>	<b>3</b>	<b>6,639</b>

It is evident from the table that Ind AS had a substantial impact of the net profits of our sample companies. This is mainly driven by the increase in net loss on a large hotel group by about 1091%. Following are the key areas of Ind AS differences.

### ■ Financial instruments

#### – Accounting for redemption premium and measurement using effective interest method

Hotel companies have long term borrowings in the form of loans and debentures. Ind AS requires financial liabilities, such as loans and borrowing, to be initially fair valued, net of initial transaction costs, and subsequently to be measured at amortised cost with finance cost being recognized at

effective interest rates in P&L.

Many companies issue debentures or redeemable preference shares which are required to be redeemed with a back ended redemption premium. Under Indian GAAP, there was a practice of charging the redemption premium to securities premium account instead of P&L. Under Ind AS, these instruments are required to be measured at effective interest rate with a charge in P&L. Depending on the length of balance tenure of the debenture/ redeemable preference shares at the date of transition to Ind AS, this may have a significant impact.

This change increased the finance cost of one of the sample companies by and increased net loss by 210%.

– **Fair valuation of investments and derivative contracts**

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI). If the FVOCI option is availed, fair value movement and gains/ losses on sale of the investments permanently escape P&L – all remeasurement changes other than dividend income are recognized in equity through OCI.

A large hotel company opted to classify its investments in equity shares as FVOCI. As a result, there was a reversal of gain on sale of equity instruments that was earlier recognized in P&L. This increased its net loss by about 300%. Fair valuation of derivative instruments through P&L caused a further 152% increase in the net loss of the company.

■ **Consolidation**

Under Indian GAAP, the assessment of existence of control over a company and consolidation as a subsidiary is based on ownership of majority of the voting

power or control over the composition of the board of directors. Under Ind AS the assessment of control is not solely based on majority voting interest or ability to control the composition of the board of directors, but it is also based on existence of the investor's rights, exposure/rights to variable returns and ability to use rights over the investee to affect the amount of the investor's returns. For example, an investor with less than majority voting interest in a company may result in consolidation of the company as a subsidiary if the investor has substantive participative rights. Participative rights are rights to participate in the operating and financial policies of the company that go beyond just protecting the interests of the minority shareholder. Approval of budgets, veto rights, appointment and termination of key management personnel are examples of such participative rights, which may preclude consolidation by the majority shareholder.

One large hotel group in our sample was impacted by this change in Ind AS and had to consolidate entities that were not previously consolidated under Indian GAAP. This resulted in a 389% increase in the group's net loss.

#### ■ **Deferred tax**

All Ind AS transition adjustment that cause in temporary differences between book base and tax base of assets and liabilities result in recognition of deferred tax assets or liabilities. This was an adjustment in all the sample companies affecting the aggregated profits by 45%.

#### ■ **Revenue – customer loyalty award schemes**

Almost all hospitality and leisure companies provide loyalty incentives to their customers. Under Indian GAAP, there was no specific accounting standard dealing with accounting for award credits and loyalty point schemes. As a result, divergent practices emerged. Certain companies made provision towards redemption of the award credits based on the actual costs that will be incurred to honor the award credits. Under Ind AS, award credits and other loyalty schemes are considered as a separate component of the main service transaction. Under this approach, the fair value of the award credits/points is separated, based on a fair value allocation of the overall revenue, and deferred. Such deferred income is subsequently

recognised when the award credits/points are utilized by the customer or when the same lapse unutilized.

Atleast two hotel companies in our sample were affected by this change. The net loss of one company increased by 54%, while the net profit of the other company decreased by 11% as a result of accounting for customer loyalty and similar schemes. Also, the revenue from operations for half year ending 31 September 2015 of the first company reduced by 4%, while that of the later reduced by 3%.

### ■ Other Ind AS adjustments

In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- **Embedded leases:** Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases.
- Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on items.
- Under Indian GAAP, actuarial gains and losses on post-employment benefit plans and other long term employment plans are to be recognised

immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans and employment benefit plans are to be recognised in equity through other comprehensive income and permanently escape P&L.

- Indian GAAP requires lease rental escalations to be straight-lined over the lease term. Ind AS states that the straight lining of lease rentals may not be required in cases where periodic rent escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining.
- Employee share based payment charge to be based on fair value method instead of intrinsic value method.

## 9.5 Industrial products and heavy engineering

Sample size- **5** covering engineering companies including those manufacturing of industrial products such as power transformers and heavy equipment.

Aggregated profit and equity reconciliations of the sample companies are as

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015-16 Consolidated Profits/Equity as per Indian GAAP</b>	<b>6,960</b>	<b>93,017</b>
<b>Ind AS Impact:</b>		
Proposed dividend		2,708
Business combinations and consolidation	(275)	(1,011)
Financial instruments	(406)	(1,205)
Deferred taxes	(81)	(162)
Employee benefits	58	(488)
Revenue	87	88
Provision	(20)	(6)
Others	(23)	56
<b>Net Ind AS impact</b>	<b>(660)</b>	<b>(20)</b>
<b>FY 2015-16 Consolidated Profits/ Equity as per Ind AS</b>	<b>6,299</b>	<b>92,997</b>



## ■ Consolidation

Under Indian GAAP, there are separate standards that deal with amalgamation, consolidation and assets acquisition. Acquisitions through share acquisition are recorded at carrying values of assets and liabilities of the acquired company under AS 21. Under Ind AS 103, all assets and liabilities acquired are recognized at fair value. Additionally, contingent liabilities and intangible assets not recorded in the acquiree's balance sheet are likely to be recorded in the acquirer's balance sheet on acquisition date. Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually.

Due to these requirements, there would be difference between the gain/ loss arising on disposal of subsidiary. This change consisted of 33% of the net Ind AS P&L impact in a leading engineering company in our sample.

## ■ Financial instruments

### – Measurement at effective interest method

This sector is capital-intensive and has a fairly long operational cycle. Therefore, most companies borrow long term funds for projects and operations. Ind AS requires financial liabilities, such as loans and borrowing, to be initially fair valued, net of initial transaction costs, and subsequently to be measured at amortised cost using effective interest rates. This affected all the companies in our sample. The increase in the finance cost arising on account of this amounted to 8% of the net profit of a major engineering company in our sample.

### – Expected credit loss impairment provision

Under Indian GAAP, there is no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit

losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as historical loss trend for similar assets; current economic and trade conditions; and reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments. One major engineering group booked ECL based impairment provision to the tune of 3% of its Indian GAAP net worth as at 31 March 2016.

This sector consists of large companies. As can be seen from the above table, the magnitude of the consolidation-related adjustments and the impact on finance costs under Ind AS were the most significant adjustments. Whilst, the above adjustments were quantitatively dominant in the Ind AS reconciliations, there were other industry specific Ind AS issues that were also evident. Although the following Ind AS requirements may not be apparently significant in the overall context due to the sheer size of the companies in this sector, these did involve several deliberations and discussions.

## ■ **Deferred taxes**

### – **Deferred tax of Ind AS adjustments**

All Ind AS transition adjustment that cause in temporary differences between book base and tax base of assets and liabilities result in recognition of deferred tax assets or liabilities. This was an adjustment in all the sample companies

### – **Deferred tax on undistributed profits of subsidiaries, joint ventures and associates**

The differences in tax base and carrying amount of investments would arise due to the existence of undistributed profits of a subsidiary, joint venture or associate. Under Ind AS, deferred taxes are recognized on such temporary

differences, unless the parent or investor is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future. This exemption is generally available for undistributed profits of a subsidiary or a joint venture where the parent or investor controls distribution of dividends, and there is no current management intention to declare dividend from such undistributed profits. Deferred taxes are recognised on the portion of undistributed profits of a subsidiary, which have already been proposed for or are intended for distribution as dividend.

The adjustment for deferred taxes on undistributed earnings of joint ventures and associates constituted about 63% of the net Ind AS impact (in absolute terms) in case of a large engineering company in our sample.

#### ■ **Accounting for spare parts**

Historically, spares and stand-by equipment have been accounted for using divergent divergence practices under Indian GAAP. Many companies accounted them as fixed assets, while other treated them as inventory. Under Ind AS, all spare parts, stand-by and servicing equipment qualify as PPE if the company intends to use these for a period of more than 12 months.

#### ■ **Other Ind AS adjustments**

- Under Indian GAAP, performance linked remuneration schemes to employees are generally accounted on crystallization of the amount wherever there is no legal obligation to pay. Under Ind AS, provisions towards such schemes are required based on constructive obligation towards the employees.
- Long term provisions are required to be initially measured at a discounted amount. Subsequently there is P&L charge on account of unwinding of the discount.
- Employee share based payment charge to be based on fair value method

instead of intrinsic value method.

- Revenue from bundled sale contracts, e.g., turnkey projects involving subsequent operations and maintenance required to be separately recognized and measured on the basis of an allocated sale consideration.
- Redeemable preference share capital issued to be classified as financial liability rather than equity.
- Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- Cash discount provided to customers to be estimated and deducted from revenue.
- Certain foreign currency convertible bonds are split in equity element and debt portion, as against, being entirely treated as debt under Indian GAAP. The debt portion is subsequently measured using effective interest method, resulting in higher finance cost.
- Fair valuation of PPE on date of transition resulting in higher or lower subsequent depreciation.
- Fair value adjustments for assets and liabilities acquired in business combinations and acquisitions.
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI.
- Revenue and expenses to be grossed up for excise duty.

## 9.6 Infrastructure

Sample size – **6** companies representing BOT operator for road tolls, ports and airport.

This sector typically has a structure of holding company investing in special purpose subsidiaries which have the BOT and similar service concessions for infrastructure projects such as toll highway, ports or airport. An analysis of the first and second quarter results of these companies would not necessarily provide the entire story as four of them have opted to present only stand-alone financial results. None of the companies in our sample presented equity reconciliations, sticking to the minimum mandatory reconciliations explaining the variations between the profit reported under Indian GAAP for the June 2015 and September 2015 quarters.

Following table provides an aggregated profit and equity reconciliations.

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Indian GAAP</b>	<b>2,040</b>	<b>52,887</b>
<b>Ind AS Impact:</b>		
Financial instruments	(750)	(11,477)
Business combinations and consolidation	428	(545)
Property, plant and equipment	(951)	7,883
Deferred taxes	(107)	(2,272)
Leases	(176)	(380)
Service concession arrangements	38	(966)
Government grants	(72)	(882)
Others	70	(860)
<b>Net Ind AS impact</b>	<b>(1,520)</b>	<b>(9,499)</b>
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Ind AS</b>	<b>520</b>	<b>43,388</b>

## ■ Financial instruments

### – Interest free / subordinated loans

The holding company has to often provide what is known as subordinated loans to its subsidiaries which carry out the BOT agreements. These are

generally interest-free and have long tenure – ranging from 25–35 years.

All financial assets including assets such as interest free lease deposits, low interest or interest free loans, have to be fair valued at inception under Ind AS. The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the underlying transaction. For example, the initial difference on fair valuation of interest free loans to subsidiaries would be considered as equity contribution from the holding company to the subsidiary and added to the overall cost of investment in equity shares of the subsidiary. The loan is subsequently accounted at amortised cost using effective interest method – resulting in recognition of interest income in P&L of the holding company's separate financial statements.

This resulted in 1928% increase in the net profits of one large infrastructure company.

- **Financial guarantees**

Under Ind AS, financial guarantees issued in favour of bank on behalf of another company, for example, a subsidiary, are accounted for and are initially recognised and measured at fair value. Subsequently, the measurement is at the higher of: amount of loss allowance determined as per impairment requirements of Ind AS 109, and amount initially recognized less, where appropriate, cumulative amortization.

- **Preference shares**

Under Ind AS, the liability and equity classifications of financial instruments may change substantially. Redeemable preference shares, classified as part of equity under Indian GAAP, are treated as, partly or entirely, as debt under Ind AS. This is due to the nature of the instrument giving rise to redemption obligation at a future date. Such debt instruments are initially measured at fair value and subsequently amortised through P&L by booking finance cost. Dividend distribution tax payable on such debt instruments are

charged to P&L as finance cost.

This resulted in 7% decrease in the equity of a large infrastructure group in our sample.

- **Fair valuation of investments**

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates) at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI).

- **Expected credit loss model**

Under Indian GAAP, there was no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments.

The adjustment on account of additional impairment provision booked based on ECL model resulted in 22% decrease in profits of one of the major infrastructure group.

- **Service concession arrangements**

Service concession arrangements are arrangements between a public sector government agency and a private sector company /operator for construction of

infrastructure assets, such as highways, ports and airports, in which the government agency controls or regulates the services provided with the infrastructure, controls their price, and controls any significant residual interest in the infrastructure.

– **Service concession accounting**

There is no mandatory Indian GAAP standard dealing with service concession agreements and therefore, practice in this area varies significantly. Under Ind AS, the operator does not recognise the fixed asset constructed as a part of the service concession arrangement. The operator is considered to have a right to access, rather than a right to use/right of ownership control over the infrastructure asset. This right is recognised either as an intangible asset or a financial asset depending on the terms of the arrangement. Ind AS considers the arrangement to be in the nature of a barter, wherein the operator initially provides construction services to the government agency earning a right to collect consideration either from public or from a government agency or partly from both. Subsequently, the operator is also required to render operating & maintenance services. Consequently, the arrangements have two phases – construction phase and operations & maintenance phase. During construction phase, the operator is required to recognise revenue as construction activity progresses, based on the fair value of the services performed (cost of constructing the infrastructure plus fair margin).

One company in our sample operating highway concessions that presented consolidated financial results, has service concessions intangible assets constituting 783% of its net worth and 92% of total assets. The Company elected the Ind AS 101 first-time adoption exemption to continue with the previous GAAP carrying value of its toll collection rights intangible assets as at the date of Ind AS transition deemed cost. Therefore, the Ind AS impact on transition would have been significantly reduced.

None of financial results in our sample revealed significant measurement



impact visible in the financial results. However, this Ind AS requirement has been one of the main discussion points amongst the infrastructure companies. This is due to multiple business implication that the Ind AS accounting may potentially have. For example, reclassification of the infrastructure assets may impact debt covenants; recognition of construction phase revenue at fair value may attract MAT liability; reclassification as financial assets may possibly risk a company of being classified as NBFC under RBI regulations. In 2011, when Ind AS was to be originally introduced in India, this Ind AS requirement was deferred.

– **Accounting for Negative Grants/ NHAI premium**

Certain arrangements include the provision for negative grants, wherein the operator is required to make the payment to the grantor during the duration of the arrangement. Negative grant may be either in the form of fixed payment (upfront or annual throughout the SCA) or in the form of a percentage of revenue earned during the arrangement. Under Ind AS, a company is required to evaluate whether upfront fixed payment should be treated as an intangible asset given that it is paid towards getting the right to earn revenues by running the infrastructure and in case of annual fixed payment, whether to recognize intangible assets by crediting the liability with present value of the annual amounts payable during SCA.

Three companies in our sample had an impact on account of this requirement.

■ **Embedded leases**

Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases.

Under Ind AS, leasing would extend to arrangements which, in substance, meet the definition of a lease, even though not be structured as 'lease'. These arrangements convey a right to use an asset or assets for an agreed period of time in return for a payment or series of payments.

This accounting requirement under IndAS caused a 14% decrease in the net profit of one of the companies in our sample.

### ■ **Government grant**

Under Indian GAAP, government grants in the nature of promoter's contribution were to be credited directly to the shareholders' funds (reserves). Grants related to depreciable assets were either treated as deferred income and transferred to the P&L in proportion to the depreciation; or deducted from the cost of the asset. Ind AS does not permit recognition of grants directly in reserves. Therefore, government grants will be recognized as income, on a systematic basis, over the periods necessary to match them with the related cost, which they are intended to compensate. Further, asset-related government grants are presented in the balance sheet only by setting up the grant as deferred income and not as a reduction from PPE.

### ■ **Other Ind AS adjustments**

- **Broader concept of 'control':** Under Ind AS, the assessment of control is not solely based on majority voting interest or ability to control the composition of the board of directors, but it is also based on existence of the investor's rights, exposure/rights to variable returns and ability to use rights over the investee to affect the amount of the investor's returns. For example, an investor with less than majority voting interest in a company may result in consolidation of the company as a subsidiary if the investor has substantive participative rights. Participative rights are rights to participate in the operating and financial policies of the company that go beyond just protecting the interests of the minority shareholder.
- Long term provisions are required to be initially measured at a discounted

amount. Subsequently there is P&L charge on account of unwinding of the discount.

- Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- Fair valuation of property, plant and equipment on date of transition resulting in higher or lower subsequent depreciation.
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI.

## 9.7 Iron and steel

Sample size- **3** companies

Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015-16 Consolidated Profits/ 31 March 2016 Equity as per Indian GAAP</b>	<b>(8,087)</b>	<b>90,051</b>
<b>Ind AS Impact:</b>		
Financial instruments	(3,753)	6,085
Property, plant and equipment	7,397	21,070
Deferred taxes	1,063	(8,909)
Employee benefits	(1,707)	
Leases	(17)	(289)
Business combinations and consolidation	41	(7,368)
Proposed dividend		1,164
Others	1	1,749
<b>Net Ind AS impact</b>	<b>3,025</b>	<b>13,502</b>
<b>FY 2015-16 Consolidated Profits/ 31 March 2016 Equity as per Ind AS</b>	<b>(5,062)</b>	<b>103,553</b>

## ■ **Property, plant and equipment**

Steel industry is characterized by high capital intensity and therefore, expectedly, PPE was a major impact area.

### – **Fair valuation as deemed cost for PPE**

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. One such choice is to revalue some or all items of PPE to their fair value as at the transition date with a corresponding adjustment in the retained earnings/ reserves. Subsequent depreciation charge is based on the fair valued asset base.

One large steel company in our sample used this exemption. The fair valuation uplift increased the 31 March 2016 net worth of the company by 42% and impacted net loss by 246%.

### – **Accounting for major overhaul**

Mechanical and electrical equipment of power stations generally require regular overhauls, repair and refurbishment. Under Indian GAAP, generally, major overhaul expenses were charged off to P&L as incurred. Ind AS requires major repairs and overhaul expenditure to be capitalized as replacement costs, if they satisfy the recognition criteria.

### – **Accounting for spares**

Major spares and stand-by equipment were generally treated as inventory under Indian GAAP. Under Ind AS, all spare parts, stand-by and servicing equipment qualify as PPE if the company intends to use these for a period of more than 12 months.

The changes in accounting for major overhaul and spare resulted in 6%

impact in net loss of one of our sample company.

## ■ Financial instruments

### – Fair valuation of investments

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI). If the FVOCI option is availed, fair value movement and gains/ losses on sale of the investments permanently escape P&L – all re-measurement changes other than dividend income are recognized in equity through OCI.

One steel company opted for FVOCI for its investments. As a result of this the reversal of gain on sale of equity instruments in P&L amounted to 117% of its net loss.

### – Reclassification of perpetual bonds

Few companies issue perpetual non-redeemable callable bond with a fixed coupon rates. The bonds are normally redeemable only at the issuer's option. Coupon interest can be deferred in perpetuity at the issuer's option. Under Ind AS, if certain criteria are met, such instruments get classified as equity.

One company in our sample reclassified its perpetual bonds as equity causing 8% increase in its equity.

### – Measurement at effective interest method

Steel companies borrow long term funds for projects and operations. Ind AS requires financial liabilities, such as loans and borrowing, to be initially fair valued, net of initial transaction costs, and subsequently to be measured at amortised cost using effective interest rates. This affected all the

companies in our sample. Measurement of financial liabilities at amortised cost caused 10% increase in net loss of a major steel company in our sample.

- **Embedded derivatives– provisionally priced contracts**

Steel is traded on the London Metal Exchange (LME) or other exchanges. Many contracts in the industry are initially provisionally priced and subsequently finalized based on the on the future pricing observable on these exchanges. In many cases, these futures prices are not the same as expected future spot prices. Under Ind AS, at contract inception the entity is required to determine whether the provisional pricing mechanism represents an embedded derivative that needs to be separated from the host sales purchase/ sale contract.

- **Employee benefits**

Under Indian GAAP, actuarial gains and losses on post–employment benefit plans and other long term employment plans are to be recognised immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans employment benefit plans are to be recognised in equity through other comprehensive income and permanently escape P&L. The net loss of a large steel company was impacted by 56% on accounted of this adjustment.

- **Deferred tax**

Deferred tax is recognized for the Ind AS transition adjustments giving rise to temporary differences. This impacted all the sample companies.

- **Business combinations**

- **Acquisition accounting**

Currently, Indian GAAP does not mandatorily require fair valuation of assets and liabilities acquired on amalgamation/acquisition. However, with the introduction of Ind AS, fair valuation of all assets and liabilities would be mandatory, except for common control transactions. Accounting for

amalgamation/ acquisition transactions in pharmaceutical sector under Ind AS would lead to recognition of several intangible assets by the acquirer /transferee companies.

This adjustment caused a 15% decrease in the 31 March 2016 net worth of a steel company in our sample.

- **Consolidation of employee welfare trust**

The concept of "control" under Ind AS is broader than that under Indian GAAP, and goes beyond the shareholding and board nomination rights. Under Ind AS, such SPEs, such as employee welfare trusts, may be required to be consolidated.

- **Other Ind AS adjustments**

In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- **Decapitalisation of foreign exchange difference:** Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary
- Redeemable preference share capital issued to be classified as financial liability rather than equity.

- **Embedded leases:** Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases.

## 9.8 Jewelry & Gems

Sample size– **3** companies

Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/Equity as at 31 March 2016 as per Indian GAAP</b>	<b>913</b>	<b>8,693</b>
<b>Ind AS Impact:</b>		
Property, plant and equipment	(47)	1,346
Deferred taxes	15	(174)
Leases	4	47
Financial instruments	1	8
Employee Benefits	8	–
Others	–	4
<b>Net Ind AS impact</b>	<b>(18)</b>	<b>1,232</b>
<b>FY 2015–16 Consolidated Profits/Equity as at 31 March 2016 as per Indian GAAP</b>	<b>895</b>	<b>9,925</b>

### ■ Fair valuation as deemed cost for property, plant and equipment

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. One such choice is to revalue some



or all items of PPE to their fair value as at the transition date with a corresponding adjustment in the retained earnings/ reserves. Subsequent depreciation charge is based on the fair valued asset base.

Two sample companies opted for fair value deemed cost option. One of the sample company's net profit decreased by 35% on account of the additional depreciation charge

## ■ Financial instruments

### – **Measurement of financial asset and liability using effective interest method**

If it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind AS.

### – **Interest-free promoters' loans and lease deposits**

Under Ind AS, all financial instruments are recognized initially at their fair value plus directly attributable transaction costs (except those classified as fair value through profit or loss, where transaction costs are expensed as incurred). All financial assets including assets such as interest free lease deposits, low interest or interest-free loans from promoters or group companies will have to be fair valued at inception. The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the underlying transaction. For example, the initial difference on fair valuation of interest free lease deposits relating to an operating lease is considered as prepaid lease rent to be amortised as additional lease expense over the lease term.

- **Financial instruments– fair valuation of investments and derivative contracts**

Ind AS requires investments in equity shares (other than that of subsidiaries, joint ventures and associates) and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI).

- **Financial guarantees**

Under Ind AS, financial guarantees issued in favor of bank on behalf of another company, for example, a subsidiary, are accounted for and are initially recognised and measured at fair value. Subsequently, the measurement is at the higher of: amount of loss allowance determined as per impairment requirements of Ind AS 109, and amount initially recognized less, where appropriate, cumulative amortization.

- **Employee benefits**

Under Indian GAAP, actuarial gains and losses on post-employment benefit plans and other long term employment plans are to be recognised immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans employment benefit plans are to be recognised in equity through other comprehensive income.

- **Deferred tax**

All Ind AS transition adjustment that cause in temporary differences between book base and tax base of assets and liabilities result in recognition of deferred tax assets or liabilities. This was an adjustment in all the sample companies.

- **Leases**

Indian GAAP requires lease rental escalations to be straight-lined over the lease term. In the Indian context, given the inflationary situation, Ind AS states that the straight lining of lease rentals may not be required in cases where periodic rent

escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining.

### ■ Other Ind AS adjustments

In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- **Revenue:** Ind AS requires an entity to identify all the components or elements within a sale contract with the customer. Consequently, the accounting would be as though the company has sold vehicle and an additional element together. Revenue from sale of vehicle would be recognized when at the point when risks and rewards are transferred while revenue from after-sales maintenance is recognized over a period of time when the services are rendered. Indian GAAP does not explicitly require such accounting for multiple-element sales.
- **Hedge accounting:** Indian GAAP provides limited guidance on hedge accounting. Guidance was only there for forward exchange contracts that are entered into for hedging purposes. This guidance requires exchange differences based on changes in spot rates to be recognised in P&L (for the underlying foreign currency monetary items).

Under Ind AS, there are three hedge accounting models under Ind AS. One of them is cash flow hedge accounting model – this applies in a hedge of the cash flow exposure relating to a recognised asset/ liability, firm commitment or a highly probable forecast transaction. For example, a forward contract taken for a highly probable forecast export transaction would qualify for consideration as a cash flow hedge. One company in our sample used this option and had cash flow hedge reserve.

## 9.9 Media and entertainment

Sample size– **3** companies, including companies involved in broadcasting.

Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/Equity as at 31 March 2016 as per Indian GAAP</b>	<b>1,906</b>	<b>9,040</b>
<b>Ind AS Impact:</b>		
Proposed Dividend		259
Financial instruments	(173)	177
Business combinations and consolidation	25	392
Property, plant and equipment	5	(5)
Deferred taxes	5	4
Revenue	1	(3)
Others	3	1
<b>Net Ind AS impact</b>	<b>(135)</b>	<b>825</b>
<b>FY 2015–16 Consolidated Profits/Equity as at 31 March 2016 as per Indian GAAP</b>	<b>1,771</b>	<b>9,866</b>

### Financial instruments

#### – Preference shares

Under Ind AS, the liability and equity classifications of financial instruments may change substantially. Redeemable preference shares, classified as part of equity under Indian GAAP, are treated as, partly or entirely, as debt under Ind AS. This is due to the nature of the instrument giving rise to redemption obligation at a future date. Such debt instruments are initially measured at fair value and subsequently amortised through P&L by booking finance cost. Dividend distribution tax payable on such debt instruments are charged to P&L as finance cost.

This resulted in 20% decrease in the net profits of a large media company in our sample.

- **Fair valuation of investments**

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates) at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI).

Fair valuation through P&L constituted 55% of the net Ind AS impact of one of the broadcasting company in our sample.

- **Initial fair valuation of refundable deposits**

All financial assets including assets such as interest free lease deposits, have to be fair valued at inception under Ind AS. The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the underlying transaction. For example, the initial difference on fair valuation of interest free lease deposits relating to an operating lease is considered as prepaid lease rent to be amortised as additional lease expense over the lease term.

- **Impairment provision based on expected credit loss model**

Under Indian GAAP, there was no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and

supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments.

## ■ Revenue

### – **Sale contracts with extended credit period**

Under Indian GAAP, revenue is recognised at the contractual value of the consideration receivable. Ind AS requires measurement of revenue at fair value of the consideration receivable. If the seller offers an extended credit period to customers, revenue is recognised at the present value of future cash inflows. Subsequently, interest income is recognised over the credit period for the difference between the revenue recognised and the stated transaction value.

### – **Non-cash consideration (barter advertising transactions)**

Arrangements in the sector at times involve non-cash consideration in the form of barter advertising. For example, a media company may provide advertisement to an advertiser (generally a startup) for a period of 2–3 years, partly or fully, in exchange of right to subscribe for the equity shares of the advertiser. There are several variations of such arrangements amongst the media companies. Ind AS requires entities to measure the consideration at fair value whenever the arrangement includes non-cash consideration. This would require estimation of fair value of the non-cash consideration, i.e. the equity shares of the advertiser and recognize revenue over the period as and when the advertisement services are rendered.

## ■ Business combinations and consolidation

### – **Common Control business combinations**

Indian GAAP does not differentiate between common control transactions and other acquisitions. Common control business combinations refer to a business combination involving companies or businesses in which all the combining companies or businesses are ultimately controlled by the same

party or parties both before and after the business combination and such control is not transitory. In the case of common control business combinations Ind AS requires the assets, liabilities and reserves of the acquired company to be recognised at their carrying values (the only adjustment allowed is for harmonisation of policies). The difference between the consideration paid and share capital of the acquired company is recorded as capital reserve. Comparative information is restated.

- **Loss allocation to non-controlling interest**

Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. This adjustments constituted about 77% of the net profit in case of a sample company.

- **Other impact areas**

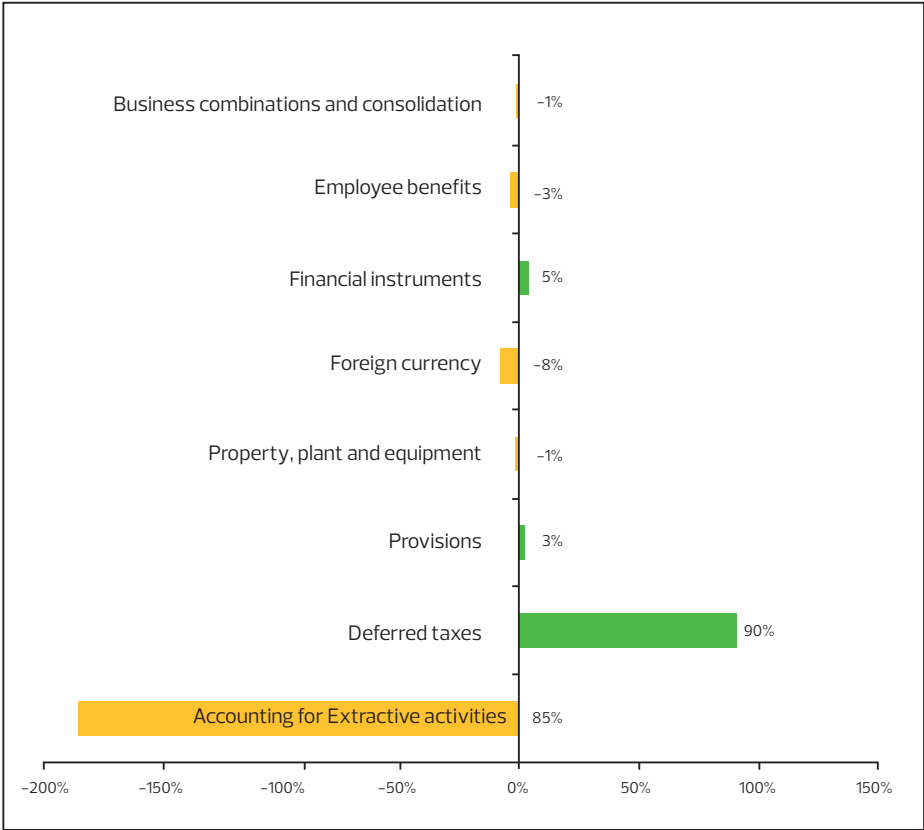
Apart from the aforementioned adjustments following Ind AS differences were also evident, although quantitatively they did not have significant P&L impact.

- Employee share based payment charge to be based on fair value method instead of intrinsic value method
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI
- Deferred tax resulting from all the Ind AS transition adjustment
- Adjustments in revenue due to providing non-cash incentives to customer/distributors

9.10    Mining and metals

Sample size– **6** companies involved in metal mining and trading operations.

The diagram below depicts the impact wise contribution to the net impact on the aggregated FY March 2016 profits of sample companies.



–      **Upstream accounting– stripping costs**

In surface mining operations, entities may find it necessary to remove mine waste materials (‘overburden’) to gain access to mineral ore deposits. This waste removal activity is known as ‘stripping’. Ind AS set out the principles



for recognition of stripping costs incurred during production phase and acknowledges that some of these costs will benefit production in future and sets out the criteria for capitalizing such costs. Indian GAAP did not specifically deal with such costs. Many companies used to either expense such costs as incurred or allocate them to inventory produced in the period.

Capitalisation of stripping cost under Ind AS caused 4% increase in the net profit of one large group in our sample.

- **Impairment of extractive/mining assets**

Under Ind AS, companies have to identify and account for pre-exploratory expenditure, exploration and evaluation (E&E) expenditure and development expenditure separately. E&E expenditure can either be expensed as incurred or capitalised in accordance with the company's selected accounting policy. Capitalised E&E costs are segregated into tangible and intangible assets, according to their nature.

Extractive / mining asset are subjected to an impairment test under Ind AS 36 to ensure that they are not overstated on the balance sheet. The basic principle of impairment is that an asset may not be carried on the balance sheet above its recoverable amount. Recoverable amount is defined as the higher of the asset's fair value less costs of disposal and its value in use.

- **Deferred tax**

As can be seen from the above, Ind AS adjustment on account of deferred tax has been one of the main impact areas in the sector. In aggregate, deferred tax resulted in 3% decrease in the aggregated net profit of our sample companies. In case of one of the companies, the deferred tax adjustment was as high as 18% of net profit.

- **Deferred tax of Ind AS adjustments**

All Ind AS transition adjustment that cause in temporary differences between book base and tax base of assets and liabilities result in

recognition of deferred tax assets or liabilities. This was an adjustment in all the sample companies.

- **Deferred tax on undistributed profits of subsidiaries, joint ventures and associates**

The differences in tax base and carrying amount of investments would arise due to the existence of undistributed profits of a subsidiary, joint venture or associate. Under Ind AS, deferred taxes are recognized on such temporary differences, unless the parent or investor is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future. This exemption is generally available for undistributed profits of a subsidiary or a joint venture where the parent or investor controls distribution of dividends, and there is no current management intention to declare dividend from such undistributed profits. Deferred taxes are recognised on the portion of undistributed profits of a subsidiary, which have already been proposed for or are intended for distribution as dividend.

The net profit of one large mining and metals group in our sample decreased by 10% on account of the Ind AS deferred tax adjustment on undistributed profits of subsidiaries.

- **Financial instruments– fair valuation of investments and derivative contracts**

Ind AS requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI).

Fair valuation of investments caused 33% increase in the net profit of a large metal and commodities group in our sample. While the 31 March 2016 net worth of another large commodities company increased by 8% in our sample.

## ■ Foreign currency exchange differences

Given the international nature of metals market, mining entities often enter directly into transactions that are denominated in foreign currencies; and conduct foreign operations through a subsidiary, an equity interest, a joint venture or a directly owned operation.

Under Indian GAAP, companies prepared their financial statements using Indian rupees. Under Ind AS, a company needs to determine its functional currency, which may not necessarily be the currency of the country in which it is domiciled. Thus, it is possible that the functional currency of an Indian company may be a foreign currency. Each within the group financial statements should undertake its own determination of functional currency based on its primary economic environment. Factors used for determining the functional currency include the currency that determines the sales price, currency in which costs of providing goods and services are incurred, currency of the country whose competitive forces and regulations mainly determine the sales prices of goods and services, and currency in which funds are raised and retained. In addition, factors such as, application of USD-based pricing in mining sector, international presence and significant costs in USD, may indicate USD to be the functional currency in many mining operations. An entity's functional currency may differ from its presentation currency, which is defined as the currency in which the financial statements are presented.

Functional currency determination can have a considerable effect on the results and financial position of a company because Ind AS requires all foreign currency amounts (e.g., foreign currency assets, liabilities, revenues and expenses) to be translated into the functional currency.

The net profit of one large mining and metals group decreased by 24% on account of foreign exchange fluctuation accounting under Ind AS.

## ■ Property, plant and equipment: Fair valuation deemed cost exemption

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind

AS, one of the choice that a company has is to measure PPE at fair value at the Ind AS transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. If this choice is availed, the subsequent P&L depreciation charge is based on the fair valued asset base. One large mining and metal company in our sample, opted for this deemed cost exemption.

- **Provision for long term mine restoration obligations**

Provision for long term mine restoration obligations are required to be initially measured at a discounted amount. Subsequently there is P&L charge on account of unwinding of the discount. Under Indian GAAP, such provisions were accrued at the gross values.

- **Business combinations – reversal of goodwill amortization charge**

Indian GAAP required amortization of goodwill in the case of amalgamations. Many companies also followed the practice of amortization of goodwill arising of consolidation. Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually.

This reversal of goodwill amortization charge increased the net profit of one large mining and metals group in our sample companies by 11%.

- **Employee benefits**

Under Indian GAAP, actuarial gains and losses on postemployment benefit plans and other long term employment plans are to be recognised immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans employment benefit plans are to be recognised in equity through other comprehensive income.

- **Other Ind AS adjustments**

In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- **Accounting for major overhaul:** Under Indian GAAP, generally, major overhaul expenses were charged off to P&L as incurred. Ind AS requires major repairs and overhaul expenditure to be capitalized as replacement costs, if they satisfy the recognition criteria.
- **Accounting for spares:** Major spares and stand-by equipment were treated as inventory by many power companies. Under Ind AS, all spare parts, stand-by and servicing equipment qualify as PPE if the company intends to use these during more than a period of 12 months.
- The repurchase or buy back of own shares by a company is subject to the requirements of the Companies Act. However, in practice, many companies hold their own shares through consolidated or unconsolidated trusts. Many companies followed this to administer their employee share stock options and other share-based payments. Accounting practice varied under Indian GAAP on treatment of 'gains' that arise on any subsequent 'sale' of such shares. Ind AS requires consideration paid for repurchased shares (referred to as 'treasury shares') to be recognised as a deduction from equity. Further, no gain or loss is recognized in P&L on purchase, sale, issuance, re-issuance or cancellation of a company's own equity instruments.

## 9.11 Oil and gas

Sample size- **5** covering oil and gas extraction companies, oil refining and marketing & retailing companies.

Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Indian GAAP</b>	<b>54,060</b>	<b>890,711</b>
<b>Ind AS Impact:</b>		
Proposed dividend		10,614
Property, plant and equipment	10,987	89,923
Oil and gas accounting	(136)	(79,140)
Financial instruments	271	41,060
Deferred taxes	(801)	(26,837)
Business combinations and consolidation		1,426
Foreign exchange	(946)	
Employee benefits	818	
Revenue	(77)	
Provision	89	(874)
Others	80	(1,029)
<b>Net Ind AS impact</b>	<b>10,285</b>	<b>35,143</b>
<b>FY 2015–16 Consolidated Profits/ 31 March 2016 Equity as per Ind AS</b>	<b>64,345</b>	<b>925,854</b>

### ■ Property, plant and equipment (PPE)

This sector is capital-intensive and, expectedly, the biggest impact area was around PPE.

#### – Fair valuation as deemed cost for property, plant and equipment

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. One such choice is to revalue some or all items of PPE to their fair value as at the transition date with a corresponding adjustment in the retained earnings/ reserves.

Use of this option for land by an oil and gas major resulted in increase of the 31 March 2016 Indian GAAP consolidated net worth by 21%. The consequential impact on P&L on account of depletion and reversal of impairment charged under Indian GAAP boosted net profits up by 14%.

- **Accounting for enabling assets**

Companies, particularly, public sector undertakings, setting up their factories/plant in remote places, incur significant expenditure on building roads (e.g. approach roads to factory) on land which is not owned by them. Under Indian GAAP, there was an EAC opinion issued a couple of years back which required such expenditure on construction of roads on land not owned by them to be expensed. Under Ind AS, if the expenditure is necessary for the item of PPE capable of operating in the manner intended by the management, it is capitalised. Having such approach roads are often necessary for the construction and running of the factory/plant. Therefore, Ind AS would require capitalisation of expenditure on enabling assets such as roads as a component of the factory/plant.

Three oil public sector undertakings in our sample had impacts on account of this change.

- **Major spare parts**

Cement plants regularly require wear parts, resistance parts, mechanical and electrical spares for their normal operations. Major spares and stand-by equipment have been accounted for using divergent practices under Indian GAAP. Many cement companies treated them as inventory. Under Ind AS, all spare parts, stand-by and servicing equipment qualify as PPE if the company intends to use these for a period of more than 12 months. This capitalization constituted 19% of the total net IndAS P&L impact in case of one large cement company in our sample.

- **Change in accounting for extractive assets**

One oil & gas major in our sample change its accounting policy from full cost method to successful efforts method with a consequential impact at the date of

transition in retained earnings/reserves. This resulted in decrease in its opening reserves by 16% of its 31 March 2016 Indian GAAP net worth.

### ■ **Foreign currency accounting**

Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. If the long term foreign currency monetary item relates to other than acquisition of a depreciable capital asset, exchange differences are accumulated in the 'Foreign Currency Monetary Item Translation Difference Account' which is subsequently amortised through the P&L over the life of such long term asset or liability. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary items.

An oil extraction company in our sample that had this adjustment was impacted by further increase in its net loss by 10%.

### ■ **Deferred tax**

Deferred tax is recognized for the Ind AS transition adjustments giving rise to temporary differences. This impacted all the companies in the sample.

### ■ **Financial instruments**

#### – **Fair valuation of investments**

Investments in equity shares of other companies (other than that in subsidiaries, joint venture and associates) and mutual fund units are required to be fair valued under Ind AS. Under Indian GAAP, they are



generally classified as long term or current. Long term investments are measured at cost less other than temporary diminution in the value of investment. Current investments are measured at lower of cost or market price.

This impacted one gas extraction company in our sample by increasing its 31 March 2016 Indian GAAP net worth by 7%.

- **Treasury shares**

Companies often hold their own shares through consolidated or unconsolidated trusts. Public sector companies oil companies followed this to administer their employee welfare schemes. Accounting practice varied under Indian GAAP on treatment of 'gains' that arise on any subsequent 'sale' of such shares. Ind AS requires consideration paid for repurchased shares (referred to as 'treasury shares') to be recognised as a deduction from equity. Further, no gain or loss is recognized in P&L on purchase, sale, issuance, re-issuance or cancellation of a company's own equity instruments.

- **Other Ind AS adjustments**

Due to the large sizes of the sample companies some of the Ind AS requirements which are complex did not result in significant P&L impact. Some of these changes were as follows:

- **Provisional pricing of sale and purchase agreements:** Often sale and purchase contracts in the sector are on provisional pricing basis and are finalized based on average index rates for a period of supply. Ind AS requires such provisional pricing features in arrangements to be treated as what is known as embedded derivatives, which are required to be separated at the date of recognizing the purchase/ sale and subsequently remeasured through P&L based on the index movement until settlement.
- Long term provisions arising on site restoration obligation are required to be initially measured at a discounted amount.

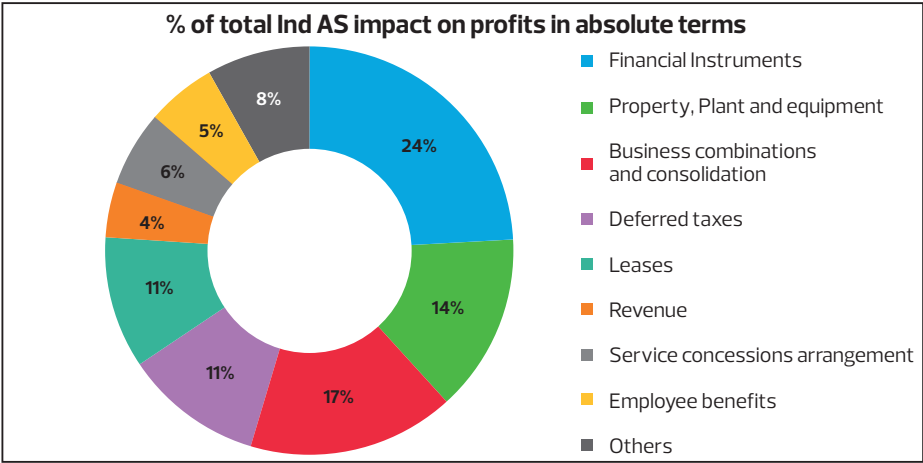
Subsequently there is P&L charge on account of unwinding of the discount.

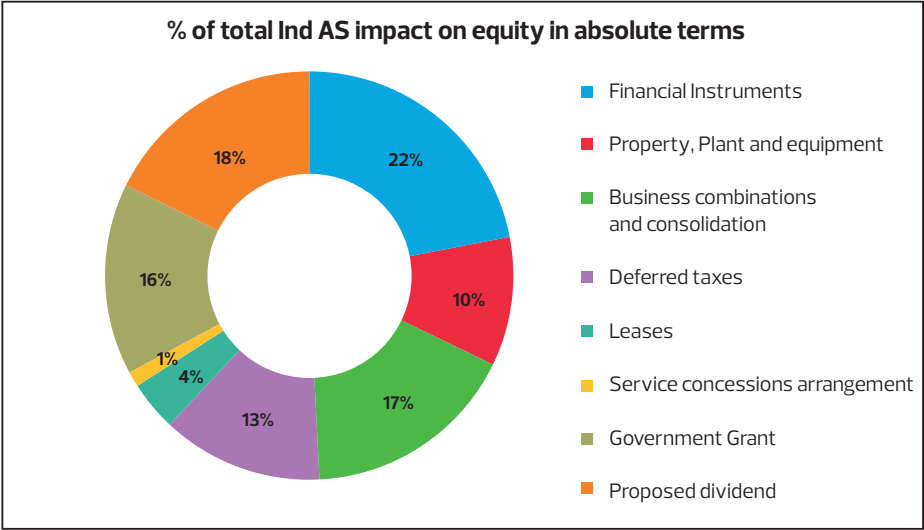
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI.
- Measurement of financial liabilities such as loans and borrowings at effective interest method.
- Derivatives are required to be fair valued through P&L under Ind AS.
- Financial guarantees issued in favor of bank on behalf of another company, for example, a subsidiary, are accounted for and are initially recognised and measured at fair value. Subsequently, the measurement is at the higher of: amount of loss allowance determined as per ion obligation are required to be initially measured at a impairment requirements of Ind AS 109, and amount initially recognized less, where appropriate, cumulative amortization.

9.12    Power and utilities

Sample size- **8** companies, including companies involved in generation, distribution and transmission of power or gas.

Following charts provides an area wise Ind AS adjustment to the profits and equity as a % of aggregated Ind AS impact (both in absolute terms).





■ **Financial instruments**

– **Fair valuation**

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI). If the FVOCI option is availed, fair value movement and gains/ losses on sale of the investments permanently escape P&L – all remeasurement changes other than dividend income are recognized in equity through OCI.

Fair valuation of derivatives resulted in 20% increase in the net profit of a gas utility company, while the loss of fair valuation of FVOCI equity investments for the period recognized in OCI constituted 221% of its net profits.

- **Measurement of effective interest rate**

Debt instruments are treated as financial assets and liabilities under Ind AS and are accounted for at amortised cost using effective interest method. Indian GAAP did not contain any such requirement and interest was generally accrued based on the stated interest rates.

Measurement based on effective interest rate resulted in 16% decline in the net profits on one power company in our sample.

- **Redemption premium**

The other Ind AS requirement that caused impacts on the sample companies was on account of redemption premium on debentures/ redeemable preference shares. Two companies in our sample were charging redemption premium to securities premium account under Indian GAAP. Under Ind AS, these instruments are required to be measured at effective interest rate through a charge in P&L. This change increased the finance cost of one of the sample companies by 50%.

- **Reclassification from equity to financial liability or vice-versa**

Under Ind AS, the liability and equity classifications of financial instruments may change substantially. Redeemable preference shares, classified as part of equity under Indian GAAP, are treated as, partly or entirely, as debt under Ind AS. This is due to the nature of the instrument giving rise to redemption obligation at a future date. Such debt instruments are initially measured at fair value and subsequently amortised through P&L by booking finance cost. Dividend distribution tax payable on such debt instruments are charged to P&L as finance cost.

Few companies issue perpetual non-redeemable callable bond with a fixed coupon rates. The bonds are normally redeemable only at the issuer's option. Coupon interest can be deferred in perpetuity at the issuer's option. Under Ind AS, if certain criteria are met, such instruments get classified as

equity.

One company in our sample reclassified its perpetual bonds as equity causing an increase in its equity.

## ■ **Business combinations and consolidation**

### – **Purchase price allocation**

Currently, Indian GAAP does not mandatorily require fair valuation of assets and liabilities acquired on amalgamation/acquisition. However, with the introduction of Ind AS, fair valuation of all assets and liabilities would be mandatory, except for common control transactions. Accounting for amalgamation/ acquisition transactions in pharmaceutical sector under Ind AS would lead to recognition of individual assets by the acquirer/transferee companies at fair values. There would be resultant impact of depreciation of fair valuation charges.

This resulted in 8% decline in the net profits of one of the sample companies.

### – **Consolidation of joint venture and associates**

Under Indian GAAP, all joint ventures are classified into three types, jointly controlled assets, jointly controlled operations and jointly controlled entities. An entity's investments in joint controlled entities are accounted for using proportionate consolidation method. Ind AS classifies joint arrangements into two types, joint ventures and joint operations. An entity's interest in joint venture is accounted for by using equity method. Investments in associates are also accounted for using equity method. Consolidation of all the joint ventures and associates is based on their Ind AS financial statements.

Ind AS adjustments on joint venture and associates' share of profits resulted in 32% decrease in the net profits of a large power company in our sample.

## ■ **Property plant and equipment**

PPE was one of the main impact areas and all the sample companies Ind AS adjustments on this account. All companies in our sample had Ind AS adjustment on account of PPE.

### – **Fair valuation as deemed cost for property, plant and equipment**

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. One such choice is to revalue some or all items of PPE to their fair value as at the transition date with a corresponding adjustment in the retained earnings/ reserves. If this choice is availed, the subsequent P&L depreciation charge is based on the fair valued asset base.

The additional depreciation charge arising on fair value deemed cost of PPE caused 35% decrease in the net profits on a major gas utility company in our sample.

### – **Accounting for major overhaul**

Mechanical and electrical equipment of power stations generally require regular overhauls, repair and refurbishment. Under Indian GAAP, generally, major overhaul expenses were charged off to P&L as incurred. Ind AS requires major repairs and overhaul expenditure to be capitalized as replacement costs, if they satisfy the recognition criteria.

### – **Accounting for spares**

Major spares and stand-by equipment were treated as inventory by many power companies. Under Ind AS, all spare parts, stand-by and servicing equipment qualify as PPE if the company intends to use these for a period of more than 12 months.

The changes in accounting for major overhaul and spare resulted in 7% increase in net profits of one of our sample company.

– **Decapitalisation of foreign exchange**

Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. Ind AS requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary items.

Decapitalisation of foreign currency losses under Ind AS resulted in a 34% decrease in net profit of a large power company.

– **Discontinuing operations**

Ind AS requires that non-current assets (or disposal groups) that meet criteria to be classified as held for sale to be carried at the lower of its carrying amount and fair value less cost to sell on the initial date of such identification. Ind AS also requires that a non-current asset classified as held for sale or forming part of disposal group should not be depreciated. These requirements are different from those under Indian GAAP which require that depreciation charge to continue.

This change caused 28% increase in the net profits of a large power company in our sample.

## ■ Embedded leases

Indian GAAP does not provide explicit guidance on accounting for lease transactions which are embedded in purchase/sale arrangements. Such arrangements are generally recognised based on their legal form. Ind AS provides specific guidance for the identification of embedded leases. Once identified as a lease, the principles for classification and accounting of the embedded lease would be the same as other leases. Under Ind AS, leasing would extend to many power purchase agreements which, in substance, meet the definition of a lease, even though not be structured as 'lease'. These arrangements convey a right to use an asset or assets for an agreed period of time in return for a payment or series of payments.

All the power companies in our sample had adjustments on account of embedded leases.

## ■ Government grant

Under Indian GAAP, government grants in the nature of promoter's contribution were to be credited directly to the shareholders' funds (reserves). Grants related to depreciable assets were either treated as deferred income and transferred to the P&L in proportion to the depreciation; or deducted from the cost of the asset. Ind AS does not permit recognition of grants directly in reserves. Therefore, government grants will be recognized as income, on a systematic basis, over the periods necessary to match them with the related cost, which they are intended to compensate. Further, asset-related government grants are presented in the balance sheet only by setting up the grant as deferred income and not as a reduction from PPE.

## ■ Other impact areas

Apart from the aforementioned adjustments following Ind AS differences were also evident, although quantitatively they did not have significant P&L impact.

- **Service concession arrangements:** There is no specific guidance under



Indian GAAP for accounting for service concession agreements and accordingly, practice in this area varies significantly. Ind AS provides specific guidance for public-to-private service concession arrangements in which: the public sector entity controls or regulates the services provided with the infrastructure and their prices; and controls any significant residual interest in the infrastructure. The operator does not recognise the PPE constructed as a part of the service concession arrangement. As per the service concession agreement, the operator is considered to have a right to access, rather than a right to use/right of ownership over the infrastructure asset. This right is recognised either as an intangible asset or a financial asset based on terms of the arrangement.

- Employee share based payment charge to be based on fair value method instead of intrinsic value method
- Redeemable preference share capital issued too to be classified as financial liability rather than equity
- Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance
- Fair value adjustments for assets and liabilities acquired in business combinations and acquisitions
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI
- Waiver of interest on loan given to subsidiary treated as deemed investment in equity under Ind AS
- Deferred tax resulting from all the Ind AS transition adjustment
- Acquisition cost incurred on business combinations considered as investment costs charged to P&L under Ind AS.

### 9.13 Pharmaceuticals and life sciences

Sample size – **9** companies. Our sample companies ranged from generic drug manufacturers to clinical research companies.

Aggregated profit and equity reconciliations of the companies covered in the sector are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/Equity as per Indian GAAP</b>	<b>15,542</b>	<b>84,933</b>
<b>Ind AS Impact:</b>		
Proposed dividend	–	1,927
Deferred taxes	203	1,762
Financial instruments	(332)	673
Business combinations and consolidation	(199)	(434)
Employee benefits	84	13
Revenue recognition	(24)	(355)
Provision	203	1,762
Government grant	(50)	89
Intangible assets	(80)	(13)
Others	(179)	(50)
<b>Net Ind AS impact</b>	<b>(575)</b>	<b>3,611</b>
<b>FY 2015–16 Consolidated Profits/Equity as per Ind AS</b>	<b>14,965</b>	<b>88,544</b>

#### ■ Deferred tax

As can be seen from the above, Ind AS adjustment on account of deferred tax significantly impacted the sector. In aggregate, deferred tax resulted in 2% increase in the aggregate equity of our sample companies. In case of one of the sample groups, the deferred tax adjustment constituted of 74% of net Ind AS impact.

Under Ind AS, deferred taxes computations are based on the temporary

differences rather than timing differences under Indian GAAP. This approach often results in more deferred tax to be considered for more items, which may be outside a company's P&L.

- **Deferred taxes on unrealized profits on intra-group transactions**

In pharmaceuticals sector, one of the main reason for Ind AS adjustment for deferred tax is primarily due to consolidation related adjustment arising on elimination of unrealized profit on subsidiary. Most Indian pharmaceutical companies who export their products overseas, first sell their products to their foreign subsidiaries, who, in turn, subsequently sell the products locally. In the consolidated financial statements of the group, the unrealized profits on the unsold inventory at the subsidiary's books have to be eliminated.

Under Indian GAAP, deferred tax in the consolidated financial statements is the sum of the tax expense of the parent and the subsidiaries. Under IndAS, deferred tax adjustments are made on account of this inter company elimination of unrealized profits. When unrealized profits are eliminated on unsold inventory purchased by a subsidiary from a parent, deferred taxes are recognized for the temporary difference arising between the tax base (normally the invoiced value) and the carrying amount in the consolidated financial statements (the group's cost after eliminating the unrealized profits).

- **Financial instruments**

- **Fair valuation**

Pharma companies were also affected by the Ind AS requirement to fair value financial instruments such as investments in equity shares (other than that of subsidiary, joint venture and associate companies). There is an irrevocable option to designate investments in equity shares, not held for trading, as fair value through other comprehensive income (FVOCI). At least two companies in the sample used this option.

- **Sales tax deferral scheme**

Under Ind AS, all financial instruments (including below market borrowings from the government) are initially recognised at fair value with reference to the market rate of interest for a borrowing with similar terms (currency, tenure, etc.) The difference between the initial carrying amount of the borrowing and the present value of future cash inflows and outflows discounted using the market rate of interest would be accounted for as a government grant. This government grant would be recognised as income over the period of the loan. Sales tax deferral schemes are treated as borrowings from government at below-market interest rates. This impacted at least 3 companies in our sample.

- **Impairment provision based on expected credit loss model**

Under Indian GAAP, there was no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments.

- **Business combinations**

- **Purchase price allocation**

Currently, Indian GAAP does not mandatorily require fair valuation of assets and liabilities acquired on amalgamation/acquisition. However, with the introduction of Ind AS, fair valuation of all assets and liabilities would be

mandatory, except for common control transactions. Accounting for amalgamation/ acquisition transactions in pharmaceutical sector under Ind AS would lead to recognition of several intangible assets by the acquirer/transferee companies. For example, knowhow and formulations, in-process research & development, distribution network of distributors, customer relationships and so on.

Retrospective application of Ind AS accounting for past acquisitions is voluntary – Ind AS 101 provides an exemption for business combinations arising prior to transition date. At least two companies in our sample opted to apply Ind AS business combinations accounting retrospectively. This resulted in 8% decline in the net profits of one of the companies.

- **Reversal of goodwill amortization charge**

Indian GAAP required amortization of goodwill in the case of amalgamations. Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually. This reversal of goodwill amortization charge increased the net profit of one of our sample companies by 8%.

- **Reversal of goodwill amortization charge**

Indian GAAP required amortization of goodwill in the case of amalgamations. Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually. This reversal of goodwill amortization charge increased the net profit of one of our sample companies by 8%.

- **Acquisition related costs**

Acquisition related costs (for example, fees paid to investment banks and costs of due diligence) are treated as capital costs under Indian GAAP and included in the cost of the investment. Ind AS generally requires all such acquisition related costs to be charged to the profit and loss account as

incurred. This adjustment constituted 40% of the net Ind AS impact on profits of one of our sample companies.

## ■ **Intangible assets**

Under Indian GAAP intangible assets are amortised over their useful lives. There is a rebuttable presumption that the useful life can not 10 years. Under Ind AS, an intangible can be assessed to have an indefinite useful life if there is no predictable time period over which it is expected to generate economic benefits for the company. Many pharmaceutical companies in our sample assessed their brands with certain attributes to be having indefinite useful lives. This caused reversal of Indian GAAP amortization charge, increasing earnings of 3 sample companies.

## ■ **Revenue**

Although revenue does not feature in the above table as a high impact Ind AS area of adjustments in quantitative terms, there have been several discussions and deliberations around revenue under Ind AS in the industry. Following are certain key issues.

### – **Estimated sales returns**

One of the prevalent trade practices in the Indian pharmaceutical industry is for the drug manufacturers to accept from the distributors and retailers the returns of products whose shelf lives have either expired or are nearing expiry. Under Indian GAAP, AS 9 provides that when goods are sold with an unlimited right of return to the buyer, it would be appropriate to recognise revenue, but a provision for the anticipated returns based on past experience is required. Consequently, under Indian GAAP, this provision can be presented as a separate expense item in the P&L without any adjustment to revenue.

Under Ind AS, when the buyer has a right of return the goods and there is uncertainty about the possibility of return, revenue is not recognised until the shipment has been accepted by the customer or the goods have been

delivered and the time period for rejection has elapsed. Under Ind AS 18, an adjustment would be made to revenue, cost of revenue, and inventories for estimated sales return based on past experience.

This impacted one pharmaceutical company in our sample, by reducing its FY March 2016 Indian GAAP revenue by 2%

- **Linked transaction/ multiple element transactions**

Many Indian pharmaceutical companies enter in to out licensing agreements for the purpose of selling their products overseas. Generally there are two deliverables – sale of product dossier based on which the customer gets 'market authorisation' and commitment to supply the products for sale in that specific country. Such arrangements take various structures and variations. Under Indian GAAP, revenue from sale of dossiers is generally recognized based on the contractual milestones while revenue from sale of goods is recognised separately on supply of goods when risks and rewards of ownership are transferred for those goods.

Under Ind AS, it is necessary to apply the revenue recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

This resulted in 2% decrease in one large pharmaceutical company in our sample.

- **Other Ind AS impact areas**

- Under Indian GAAP, companies could have used intrinsic value method or fair value method to measure their share based arrangement. Ind AS requires the use of fair value method to measure the employee costs over the vesting period. This change in the measurement of employee share

based payment caused a decrease in the net profits of the sample companies.

- Under Ind AS 101 there is a first-time adoption exemption to selectively fair value the items of property, plant and equipment as at the date of Ind AS transition. This is then treated as deemed cost of those items of PPE under Ind AS and forms the basis of subsequent depreciation charge. One company in our sample opted for this fair value deemed cost exemption, increasing FY March 2016 depreciation charge.
- Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance
- Cash discount provided to customers to be estimated and deducted from revenue
- Under Indian GAAP, actuarial gains and losses on postemployment benefit plans and other long term employment plans are to be recognised immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans employment benefit plans are to be recognised in equity through other comprehensive income and permanently escape P&L.
- Indian GAAP explicitly states that provisions should not be discounted to their present value. Ind AS requires provisions to be discounted to their present value where the effect of the time value of money is material.

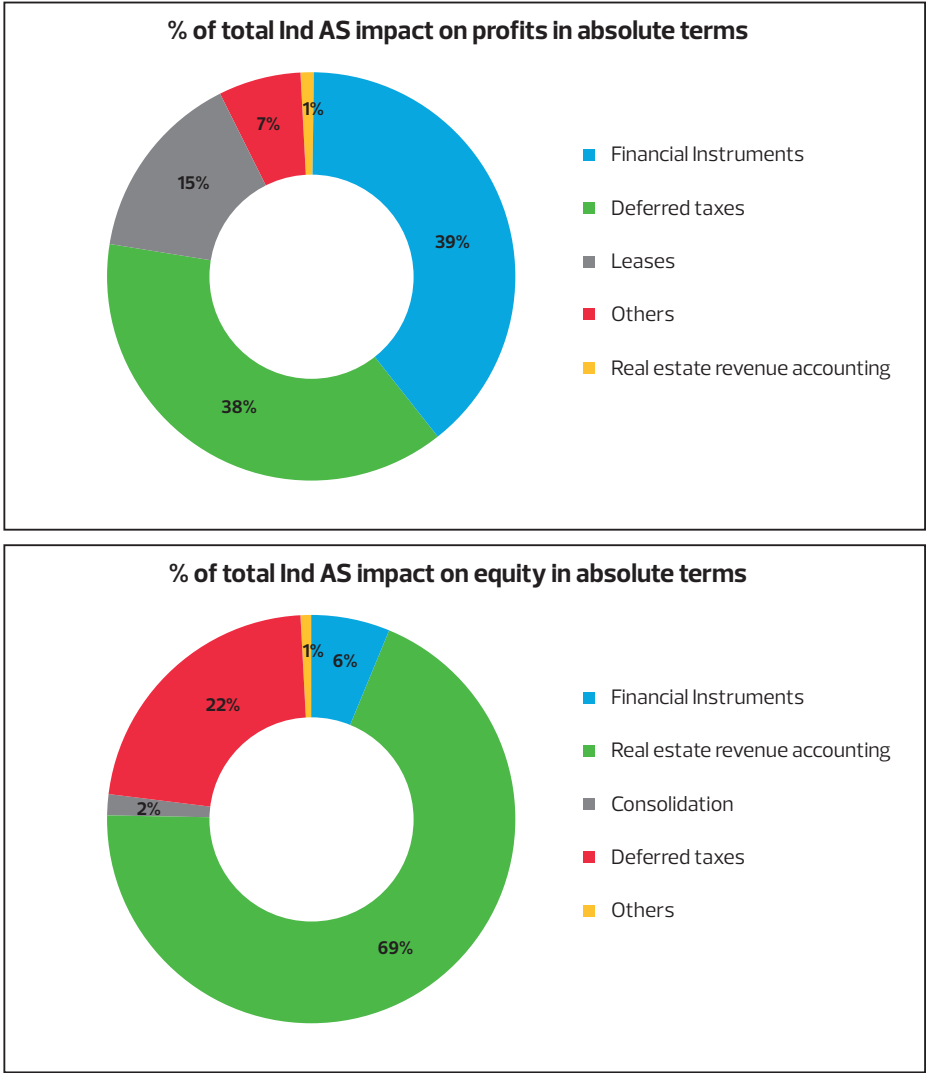
Discounting resulted in lower provision and therefore an upfront increase in the equity and higher interest charge over the provision period in the P&L under Ind AS.

## 9.14 Real estate and construction

Sample size- **3** companies, including companies involved in construction& development of real estate projects and/or renting out commercial properties.



Aggregated profit and equity reconciliations of the sample companies are as follows:



■ **Revenue**

One of the major Ind AS issues in the sector is around revenue recognition for real estate development. In fact, one of the carve outs from IFRS is on account of non-

inclusion of the equivalent of an IFRS interpretation, IFRIC 15 – *Agreements for the Construction of Real Estate*, under Ind AS. Instead, there is guidance note issued by the ICAI for real estate sales that is to be applied. As per the Ind AS GN, revenue is recognized generally by applying the percentage of completion method on the basis of the methodology explained in Ind AS 11 *Construction Contracts*. The treatment is similar to that given in the ICAI GN of real estate issued by the ICAI under Indian GAAP.

– **Barter and joint development agreement**

Real estate companies in India often enter into redevelopment agreements with residential flat owners/societies for the demolition and reconstruction of existing building. The developer gets the development rights acquired by way of construction of built-up area. Real estate companies also enter into various types of joint development agreements (JDAs) with land owners for permission to construct buildings in return for ownership of a part of the building. In practice such agreements are structured in different ways, often to optimize the tax impact or to facilitate fund-raising.

Under the Indian GAAP, most developers treated the construction cost as the acquisition cost of development rights. However, Ind AS requires intangible assets (development rights) acquired in an exchange transaction to be measured at the fair value of the asset given up. This resulted in fair value of the development right to be accounted for.

Real estate developers often provide add-on incentives to buyers in addition to the construction/ development of real estate – e.g, property management services, decorative fittings, etc. The practice under Indian GAAP was to club all the amenities along with revenue from flats, while applying the percentage of completion method. However, under Ind AS, some of such amenities will need to be evaluated for a multiple-element arrangement.

## ■ Financial instruments

### – Measurement at effective interest method

Real estate companies are debt heavy. Ind AS requires financial liabilities, such as loans and borrowing, to be initially fair valued, net of initial transaction costs, and subsequently to be measured at amortised cost using effective interest rates. This affected all the companies in our sample. This adjustment caused 31% decrease in the net profit of a company in our sample.

### – Fair valuation

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI).

### – Accounting financial guarantee obligations

Real estate entities often provide financial guarantees to related parties in respect of banks loans. Under Indian GAAP, such borrowings were disclosed as contingent liabilities in the financial statements of the issuer. Under Ind AS, financial guarantee contracts are initially measured at fair value.

## ■ Lease escalations

Indian GAAP requires lease rental escalations to be straight-lined over the lease term. In the Indian context, given the inflationary situation, Ind AS states that the straight-lining of lease rentals may not be required in cases where periodic rent escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining.

The net profit of a sample company with operations in real estate and letting out property increased by 14% on account of this difference.

## ■ Deferred tax

Deferred tax is recognized for the Ind AS transition adjustments giving rise to temporary differences. This impacted all the sample companies.

## ■ Other Ind AS adjustments

In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- **Consolidation of land owning companies:** There are legal caps on the area of land that a company estate companies in many parts of the country. To deal with such restrictions, real estate companies often float various special purpose entities (SPE) that purchase land from the market. The arrangements may take various structures, for example, the developer may holding exclusive rights to develop land and may invest large amount in the SPE, often, termed as advance for development rights. The concept of "control" under Ind AS is broader than that under Indian GAAP, and goes beyond the shareholding and board nomination rights. Under Ind AS, such SPEs may be required to be consolidated. At times, investments treated as subsidiaries under Indian GAAP may have to be reclassified as joint ventures due to the contractual terms and investor rights associated.
- Employee share based payment charge to be based on fair value method instead of intrinsic value method
- Redeemable preference share capital issued to be classified as financial liability rather than equity
- Certain foreign currency convertible bonds are split in equity element and debt portion, as against, being entirely treated as debt under Indian GAAP. The debt portion is subsequently measured using effective interest method, resulting in higher finance cost
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI

## 9.15 Retail

Sample size– 4 companies involved in retail of merchandise including through e-commerce platform.

Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/Equity as per Indian GAAP</b>	<b>(75)</b>	<b>3,561</b>
<b>Ind AS Impact:</b>		
Financial instruments	7	38
Revenue	(8)	(41)
Leases	1	(11)
Business combinations	–	6
Deferred taxes	(13)	(1)
Others	7	(6)
<b>Net Ind AS impact</b>	<b>(7)</b>	<b>(15)</b>
<b>FY 2015–16 Consolidated Profits/ Equity as per Ind AS</b>	<b>(83)</b>	<b>3,546</b>

### ■ Financial Instruments

#### – Discounting of interest-free lease deposits

Retail companies, particularly those who have physical stores, largely take stores on lease basis. In India, interest-free refundable lease deposits are integral to the leasing arrangements. All financial assets including, interest-free lease deposit, have to be fair valued at inception under Ind AS. Subsequently, the deposit is measured using effective interest method and there is an interest income that accrues in the P&L due to unwinding.

The initial difference that arises from the fair valuation of such financial assets and liabilities is accounted for to reflect the substance of the

underlying transaction. The initial difference on fair valuation of interest free lease deposits relating to an operating lease is considered as prepaid lease rent to be amortised as additional lease expense over the lease term. One large retail company had an Ind AS interest income on unwinding equivalent to 27% of its net loss. At the same time, an additional lease rental charge was to the extent of 30% of the net loss of the aforesaid company. So although, the net impact on the bottom-line impact of adjustment was not so staggering, the company's key performance indicators such as, EBITDA, were impacted on account of this adjustment.

- **Fair valuation of investments and derivative contracts**

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. For investments in equity shares, there is an irrevocable choice to measure at fair value either through P&L or through OCI (FVOCI).

Fair valuation of financial instruments caused 20% increase in the net profits of a large retail company in our sample.

- **Measurement at effective interest method**

Ind AS requires financial liabilities, such as loans and borrowing, to be initially fair valued, net of initial transaction costs, and subsequently to be measured at amortised cost using effective interest rates. This affected all the companies in our sample.

- **Revenue**

- **Deferral of revenue**

Under Ind AS 18, revenue from sale of goods is recognized when an entity transfers the significant risks and rewards of ownership and gives up managerial involvement, usually associated with ownership or control, if

economic benefits are likely to flow. This means that the accounting should reflect the economic substance of transactions and not merely their legal form, leading one retail company in our sample to defer its revenue recognition and related costs, in turn, causing increase in its net loss by 7%.

- **Customer loyalty award schemes**

All retail companies provide loyalty incentives to their end-customers. Under Indian GAAP, there was no specific accounting standard dealing with accounting for award credits and loyalty point schemes. As a result, divergent practices emerged. Many retail companies made provision towards redemption of the award credits based on the actual costs that will be incurred to honor the award credits. Under Ind AS, award credits and other loyalty schemes are considered as a separate component of the main service transaction. Under this approach, the fair value of the award credits/points is separated, based on a fair value allocation of the overall revenue, and deferred. Such deferred income is subsequently recognised when the award credits/points are utilized by the customer or when the same lapse unutilized.

- **Deferred tax**

All Ind AS transition adjustment that cause in temporary differences between book base and tax base of assets and liabilities result in recognition of deferred tax assets or liabilities.

- **Other Ind AS adjustments**

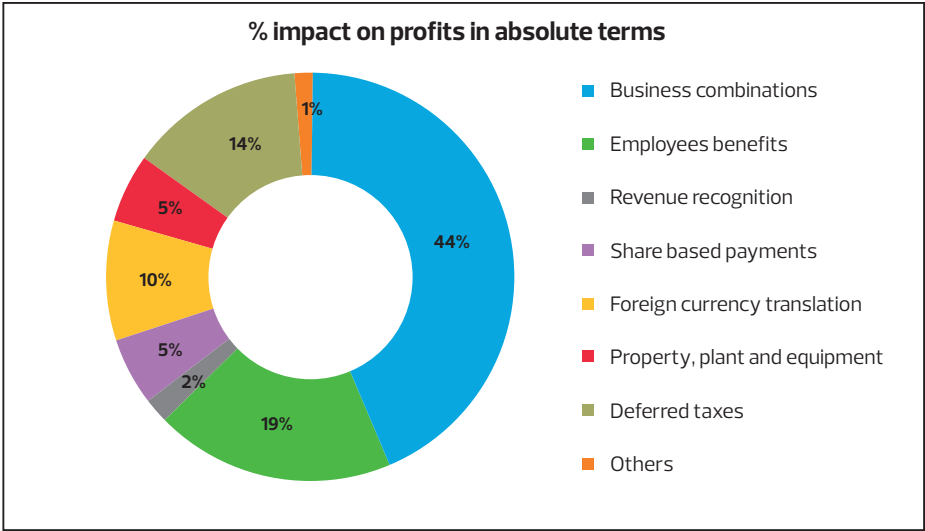
In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- Indian GAAP requires lease rental escalations to be straight-lined over the lease term. Ind AS states that the straight lining of lease rentals may not be required in cases where periodic rent escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining.

- Lease incentives, including initial rent-free period are straight-lined over the lease term under Ind AS.
- Under Indian GAAP, actuarial gains and losses on postemployment benefit plans and other long term employment plans are to be recognised immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans employment benefit plans are to be recognised in equity through other comprehensive income

9.16    Technology and Information Technology enabling services

Sample size – 8 companies. Our sample consisted of IT and business process outsourcing companies. We have analysed based on the consolidated financial results of the sample companies.



■    Deferred tax

Deferred tax consisted of more than half of the total net Ind AS impact on net profits of our sample companies. Technology companies generally have foreign subsidiaries, joint venture or associates in order to cater to clients overseas. Deferred tax on undistributed profits of such foreign operations was one of the most significant differences that impacted our sample companies.



- **Deferred tax on undistributed profits of subsidiaries, joint ventures and associates**

The differences in tax base and carrying amount of investments would arise due to the existence of undistributed profits of a subsidiary, joint venture or associate. Under Ind AS, deferred taxes are recognized on such temporary differences, unless the parent or investor is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future. This exemption is generally available for undistributed profits of a subsidiary or a joint venture where the parent or investor controls distribution of dividends, and there is no current management intention to declare dividend from such undistributed profits. Deferred taxes are recognised on the portion of undistributed profits of a subsidiary, which have already been proposed for or are intended for distribution as dividend. The exemption from recognition of deferred taxes would most likely not be met for investments in associates since an investor only has significant influence over an associate and not control.

- **Business combinations**

There has been fair deal of mergers and acquisitions in technology space in recent times. Intangibles such as customer contracts and relationships are one of the main value drivers in sector.

Under Indian GAAP, assets and liabilities acquired are recognised at carrying value in the books of the acquired entity. Under Ind AS, all assets including intangibles and contingent liabilities are recorded at fair value. Such intangibles are amortized over their useful life. This resulted in a decrease in the net profits in the sample companies.

- **Earn outs in an acquisition– contingent and deferred considerations**

Acquirers often have earnouts in their acquisition agreements wherein a variable consideration is agreed based on subsequent profits or revenues of the acquired companies is agreed upon in addition to the fixed consideration. The practice under Indian GAAP was that such contingent considerations were generally recorded as

additional goodwill, when the contingency is resolved. Ind AS requires the fair value of the contingent consideration to be recorded upfront as a component of the total consideration. Any subsequent changes to the value of cash-settled contingent consideration are recorded in P&L.

Under Indian GAAP, any deferred consideration was recorded at the amount contractually payable. Under Ind AS, deferred consideration is recorded at its present value. Subsequent accrual of imputed interest expense for such deferred payments is recorded in P&L.

These GAAP differences impacted at least 4 sample companies.

### ■ **Common control acquisitions**

A common control business combination transaction refers to a business combination involving companies or businesses in which all the combining companies or businesses are ultimately controlled by the same party or parties both before and after the business combination and such control is not transitory. For instance, an amalgamation of two companies controlled by the same parent would be considered as a common control transaction.

Indian GAAP does not differentiate between common control transactions and other acquisitions. In the case of common control business combinations Ind AS requires the assets, liabilities and reserves of the acquired company to be recognised at their carrying values (the only adjustment allowed is for harmonisation of policies). The difference between the consideration paid and share capital of the acquired company is recorded as capital reserve. Comparative information is restated. This treatment is similar to the pooling of interests method prescribed under Indian GAAP.

The net worth of one of our sample companies reduced by 8% on account of the impact arising on account of the above difference for common control acquisition.

### ■ **Foreign currency**

Technology companies significantly operate in foreign countries and are thereby

exposed to foreign currency exposures. Accounting for foreign currencies was another major impact area for the sample companies.

Under Indian GAAP, companies prepared their financial statements using Indian rupees. Under Ind AS, a company needs to determine its functional currency, which may not necessarily be the currency of the country in which it is domiciled. Thus, it is possible that the functional currency of an Indian company may be a foreign currency.

Determination of functional currency based on the primary economic environment in which the company operates. Factors used for determining the functional currency include the currency that determines the sales price, currency in which costs of providing goods and services are incurred, currency of the country whose competitive forces and regulations mainly determine the sales prices of goods and services, and currency in which funds are raised and retained. For foreign subsidiaries, one of additional factors include – whether the operations of the foreign company are an extension of the parent.

In practice, technology companies operate using a mixture of currencies, example costs are incurred in INR, while revenues are denominated in USD. The consideration of the above factors may not result in an obvious conclusion as to the company's functional currency. Further, in some cases, an analysis of the criteria may indicate mixed results and would involve management judgement.

Under Indian GAAP, translation of foreign currency financial statements to the reporting currency of the parent depends on the classification of the foreign operations as either integral or non-integral. Under Ind AS, the translation is driven by the determination of the functional currency of the foreign operation. The translation principles for a foreign operation whose functional currency is the same as the parent company is similar to the translation of an integral foreign operation under Indian GAAP. Similarly, translation of a foreign operation whose functional currency is the different from the parent company is similar to the translation of a non-integral operation under current principles.

## ■ Employee benefits

Technology sector is characteristically employee intensive. Therefore any GAAP difference around accounting for employee difference would affect the sector. Employee benefit accounting constituted about 36% of the net Ind AS impact (in absolute terms).

Under Indian GAAP, actuarial gains and losses on postemployment benefit plans and other long term employment plans are to be recognised immediately in P&L. Under Ind AS, all actuarial gains and losses with respect to defined benefit plans employment benefit plans are to be recognised in equity through other comprehensive income and permanently escape P&L.

## ■ Other impact areas

- Under Ind AS 101 there is a first-time adoption exemption to selectively fair value the items of property, plant and equipment as at the date of Ind AS transition. This is then treated as deemed cost of those items of PPE under Ind AS and forms the basis of subsequent depreciation charge. One company in our sample opted for this fair value deemed cost exemption, consequentially resulting in increase in depreciation charge under Ind AS.
- Software companies often provide post-contract technical support services (PCS) to its customers. Ind AS requires an entity to identify all such components or elements within a sale contract with the customer. Consequently, the revenue attributable towards the PCS would have to be deferred as it would generally constitute a separate element.
- Under Indian GAAP, any deferred consideration was recorded at the amount contractually payable. Under Ind AS, deferred consideration is recorded at its present value. Subsequent accrual of imputed interest expense for such deferred payments is recorded in P&L.
- Under Indian GAAP, there was no detailed guidance on methodology for determining the impairment of financial assets, such as loans and

receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and supportable forecasts that affect the expected collectability of the future cash flows of the financial instruments.

### 9.17 Telecom operations and infrastructure

Sample size- 5 covering telecom operators, infrastructure and transmission companies. Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015-16 Consolidated Profits/ 31 March 2016 Equity as per Indian GAAP</b>	<b>10,388</b>	<b>127,167</b>
<b>Ind AS Impact:</b>		
Financial instruments	(719)	(2,133)
Property, plant and equipment	(211)	3,697
Business combinations and consolidation	2,772	16,701
Deferred taxes	(898)	(1,736)
Employee Benefits	57	(108)
Provisions	18	109
Revenue	10	(1,636)
Leases	95	(1,467)
Proposed dividend		1,940
Others	(1,004)	(391)
<b>Net Ind AS impact</b>	<b>121</b>	<b>14,977</b>
<b>FY 2015-16 Consolidated Profits/ 31 March 2016 Equity as per Ind AS</b>	<b>10,509</b>	<b>142,143</b>

## ■ Business combinations

Indian telecom sector has witnessed several big-ticket mergers, acquisitions and cross-border deals in recent years. Aptly, the GAAP difference between Indian GAAP and Ind AS around accounting for business combinations caused the biggest P&L impact for our sample companies.

### – Reversal of amortisation of goodwill

Under Indian GAAP, there are separate standards that deal with amalgamation, consolidation and assets acquisition. Acquisitions through share acquisition are recorded at carrying values of assets and liabilities of the acquired company under AS 21. Under Ind AS 103, all assets and liabilities acquired are recognized at fair value. Additionally, contingent liabilities and intangible assets not recorded in the acquiree's balance sheet are likely to be recorded in the acquirer's balance sheet on acquisition date. Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually. Indian GAAP, on the other hand, required amortization of goodwill in the case of amalgamations. Upon first-time adoption of Ind AS, application of Ind AS 103 to past business combinations prior to the date of transition to Ind AS is optional under Ind AS 101.

The Indian GAAP FY 2015-16 net profit of one telecom operator increased by 61% on account of reinstatement of previously amortised goodwill and the effect of restatement of past business combinations in accordance with Ind AS.

## ■ Financial instruments

### – Fair valuation of investments

Financial instruments such as investments in equity shares of other companies (other than that in subsidiaries, joint venture and associates) and investments in mutual fund units are required to be fair valued under Ind

AS. Under Indian GAAP, they are generally classified as long term or current. Long term investments are measured at cost less other than temporary diminution in the value of investment. Current investments are measured at lower of cost or market price. The Indian GAAP FY 2015-16 net profit of one telecom operator decreased by 9% on account of fair valuation of financial instruments.

Fair valuation may also introduce P&L volatility, particularly on quarterly interim results, on account of market movements. Following table is based on the extracts of the financial results of one of the telecom operator, depicting the impact of the fair valuation adjustment in the quarterly results.

Particulars	Quarter ended (Rs. Crores)				Year ended (Rs. Crores)
	30 June 2015	30 September 2015	31 December 2015	31 March 2016	31 March 2016
Net profit as per Indian GAAP	2,588.3	581.5	895.2	391.6	4,456.6
Effect of measuring financial instruments at fair value	(422.4)	96.4	(79.6)	24.9	(380.7)

#### – Expected credit loss impairment provision

Under Indian GAAP, there is no detailed guidance on methodology for determining the impairment of financial assets, such as loans and receivables. Ind AS introduces a new 'expected credit loss' (ECL) model for impairment of financial assets. This model requires more forward looking information to recognize either a 12-month or a lifetime expected credit losses. Consequentially, provision for bad debts no longer depends on a company identifying a credit loss or a default event. Rather, a company always estimates an 'expected loss' considering a broader range of information including; past events such as, historical loss trend for similar assets; current economic and trade conditions; and, reasonable and supportable forecasts that affect the expected collectability of the future

cash flows of the financial instruments. One major telecom group booked ECL based impairment provision to the tune of 3% of its net worth as at 31 March 2016.

#### ■ **Revenue**

Telecommunication companies charge initial fees for right of use of their cable infrastructure. Under Indian GAAP, the fees were recognized upfront. Ind AS requires such revenue to be recognized over a period of underlying contract of services.

This revenue deferral adjustment resulted in 5% decline in the equity/ net worth of a sample company.

#### ■ **Deferred tax**

Under Indian GAAP, deferred taxes are recognised on timing differences based on what is known as the income statement approach. Under Ind AS, deferred taxes are recognised on temporary differences based on what is known as the balance sheet approach. Deferred tax is also recognized for the Ind AS transition adjustments giving rise to temporary differences. As can be seen from the above table, this impacted all the companies in the sample.

#### ■ **Lease escalations**

Lease accounting was one of the other impact areas in the sector. Long term arrangements, that are, in form, and/or, in substance, leasing arrangements is a typical feature of the sector. Indian GAAP requires lease rental escalations to be straight-lined over the lease term. In the Indian context, given the inflationary situation, Ind AS states that the straight lining of lease rentals may not be required in cases where periodic rent escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining.

The Indian GAAP net worth as at 31 March 2016 of one of the telecom infrastructure companies in our sample reduced by 13% on account this adjustment.



## ■ Asset retirement obligations

Telecom infrastructure companies often have asset retirement obligations (ARO) at network infrastructure sites. Under Ind AS, an ARO provision is created at the present value of the best estimate of future cost of dismantling/ removing the asset and is generally measured as the best estimate of the expenditure to settle the obligation as of the balance sheet date. Provisions for such constructive obligations are required even though they may not represent legal obligations.

## ■ Other Ind AS adjustments

- Employee share based payment charge to be based on fair value method instead of intrinsic value method
- Minority interest regarded as non-controlling interest (as a part of equity) and losses in subsidiaries to attributable to the non-controlling interests even if this results in the non-controlling interests having a deficit balance
- Fair valuation of property, plant and equipment on date of transition resulting in higher or lower subsequent depreciation
- Actuarial gains/ losses on defined benefit employee benefits to be accounted in OCI

## 9.18 Transportation and logistics

Sample size– 3 companies, including companies involved in civil air transportation, shipping and logistics. Aggregated profit and equity reconciliations of the sample companies are as follows:

Description	(Rs. Crores)	
	Profit	Equity
<b>FY 2015–16 Consolidated Profits/Equity as per Indian GAAP</b>	<b>3,810</b>	<b>18,092</b>
<b>Ind AS Impact:</b>		
Proposed dividend		783
Property, plant and equipment	226	(2,007)

Description	(Rs. Crores)	
	Profit	Equity
Financial instruments	(172)	389
Consolidation	21	91
Leases	(1)	(8)
Revenue recognition	2	26
Deferred taxes	3	99
Others	164	132
<b>Net Ind AS impact</b>	<b>242</b>	<b>(496)</b>
<b>FY 2015-16 Consolidated Profits/ Equity as per Ind AS</b>	<b>4,052</b>	<b>17,596</b>

### ■ Financial instruments

This sector is capital-intensive and most companies are debt-heavy. Therefore, one of the main Ind AS impact areas was financial instruments.

#### – Measurement at effective interest method

Ind AS requires financial liabilities, such as loans and borrowing, to be initially fair valued, net of initial transaction costs, and subsequently to be measured at amortised cost using effective interest rates. This affected all the companies in our sample.

#### – Fair valuation

Ind AS generally requires investments in equity shares (other than that of subsidiaries, joint ventures and associates), investment in mutual funds units and derivative instruments at fair value. Shipping companies generally contract in foreign currency derivatives to hedge their foreign currency exposure. This resulted in 18% decrease in the net profits of a shipping company in our sample.

### ■ Property, plant and equipment

#### – Accounting for dry dock/ major overhaul expense

Ships and aircrafts have to regularly undergo major dry dock/overhaul. Under Indian GAAP, there were mixed practice for accounting for such costs. Broadly, there were two methods of accounting for dry-docking costs; capitalised cost method, i.e., capitalization of all costs related to dry-docking and depreciation of the same over the period until the next expected dry-dock; and the accrual method, i.e., estimating the cost of the next dry-docking and accruing for the same on a systematic basis up to the next dry-docking. Ind AS requires major repairs and overhaul expenditure to be capitalized as replacement costs, if they satisfy the recognition criteria.

– **Fair valuation as deemed cost for property, plant and equipment**

On transition to Ind AS, instead of recalculating the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date. In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE. One such choice is to revalue some or all items of PPE to their fair value as at the transition date with a corresponding adjustment in the retained earnings/ reserves. Subsequent depreciation charge is based on the fair valued asset base.

The PPE adjustments under Ind AS caused 11% increase in net profits of a large shipping company in our sample.

■ **Leases**

Indian GAAP requires lease rental escalations to be straight-lined over the lease term. Ind AS states that the straight lining of lease rentals may not be required in cases where periodic rent escalation is due to inflation. Indian GAAP did not contain this relaxation for straight lining.

■ **Other Ind AS adjustments**

In addition to abovementioned impact areas, following Ind AS adjustments also impacted our sample companies:

- **Revenue:** Under Indian GAAP, revenue on account of shipping voyages was accounted for either based on percentage of completion or the completed voyage method. Ind AS does not allow the completed contracts method; the percentage of completion method should be followed to recognise revenue from services.
- **Decapitalisation of foreign exchange difference:** Under Indian GAAP, exchange differences arising on translation of monetary items are recognised as income or expense in the period in which they arise. Further, paragraph 46A of AS 11 allows companies to adjust exchange differences arising on long-term foreign currency monetary items to the carrying value of depreciable capital assets (to the extent they relate to the acquisition of such assets) and are depreciated through P&L over the useful lives of the assets. Ind AS 21 requires exchange differences arising on translation/settlement of all foreign monetary items, including long-term foreign currency monetary items, to be recognized in P&L for the period in which they arise. It does not give an option to defer or to capitalize exchange differences arising on long-term foreign currency monetary
- Redeemable preference share capital issued to be classified as financial liability rather than equity

## Appendix – Key Changes in Indian GAAP

---

### Property, plant and equipment (PPE)

- Spares part, service equipment and standby equipment that meet the definition of PPE i.e. which are intended to be used for a period of more than 12 months, should be treated as PPE and not inventory.
- The amended PPE standard is based on unit of measure approach. This would enable capitalization of construction cost of approach roads on government land to facilitate construction of plant, which are otherwise available for the use general public, as a part of the project cost.
- Cost of an item of PPE purchased on a deferred payment basis, is the cash price equivalent. The difference between the cash price equivalent and the total payment treated as an interest cost.
- Initial estimated cost of dismantling/ retiring an asset and restoring the site is included in the cost of an item of PPE. The provision is measured at discounted amount.
- If revaluation model option is used for PPE, the entire class of assets should be revalued; revaluation is to be carried out with sufficient regularity.
- Useful lives and residual values of the items of PPE are reviewed periodically; change in depreciation method is to be accounted for as change in accounting estimate rather than change in accounting policy

### Investment property

Investment properties (properties held to earn rental income and/or capital appreciation) are required to be depreciated, using component approach, and tested for impairment, when there are impairment indicators

### Provision for proposed dividend

Dividends declared after the balance sheet date but before the financial statements are approved for issue are not recognized as a liability at the balance sheet date, but disclosed in the notes to accounts

### Consolidation

Where a company does not have a subsidiary, but has associate or joint venture company, it should prepare consolidated financial statements.

### Mergers and amalgamations

The disclosure in scenarios when the accounting as per the court schemes is different from that required in the accounting standards, does not apply to a scheme of amalgamation approved under Companies Act, 2013. Sections 230 and 232<sup>8</sup> of the Companies Act, require accounting treatment proposed in a scheme to be in conformity with the accounting standards.

<sup>8</sup> These sections have been notified vide MCA circular dated 7th December 2016.

## Appendix – Key Changes in Indian GAAP

These changes are by and large in lines with the Ind AS requirements. Due to these changes in Indian GAAP taking effect in FY 2016–17, the impact for phase II companies may be different from that experienced by phase I companies.

### Glossary

Terms	Definition
NBFCs	Non-banking financial companies
Ind AS	Indian Accounting Standards
IFRS	International Financial Reporting Standards
Indian GAAP	Indian Generally Accepted Accounting Principles – accounting standards notified in Companies (Accounting Standards) Rules, 2006
IRDA	Insurance Regulatory and Development Authority of India
SEBI	Securities and Exchange Board of India
IT	Information Technology
MCA	Ministry of Corporate Affairs
MAT	Minimum Alternate Tax under section 115 JB of Income Tax Act, 1961
GST	Goods and Services Tax
ICDS	Income computation and disclosure standards under Income Tax Act, 1961
FVTPL	Fair value through profit and loss
FVOCI	Fair value through other comprehensive income
OCI	Other comprehensive income
P&L	Profit and loss account
PPE	Property, plant and equipment
Ind AS 101	Indian Accounting Standard (Ind AS) 101 – <i>First time Adoption of Indian Accounting Standards</i>
ECL	Expected credit loss model under Ind AS 109 <i>Financial Instruments</i>
FMCG	Fast moving consumer goods
SPE	Special purpose entities

[illegible]

[illegible]



[illegible]

[illegible]

**Mumbai**

13th Floor, Bakhtawar  
229, Nariman Point  
Mumbai – 400 021

3rd Floor, A Wing,  
Technopolis Knowledge Park  
Mahakali Caves Road, Andheri (E)  
Mumbai – 400 093

201, Shree Padmini  
Teli Galli Junction  
Andheri (E), Mumbai – 400 069

**New Delhi – NCR**

2nd Floor, Tower-B  
B-37, Sector-1  
Noida – 201 301

**Chennai**

Abhinav Centre  
No. 4, Co-operative Colony  
Alwarpet, Chennai – 600 018

1A, Chamiers Apartments  
62/121, Chamiers Road  
R. A. Puram, Chennai – 600 028

**Kolkata**

A-6, 12th Floor  
Chatterjee International Centre  
33A, Jawaharlal Nehru Road  
Kolkata – 700 071

**Bengaluru**

3rd Floor, B Wing  
Jubilee Building, 45, Museum  
Road, Bengaluru 560 025

**Surat**

DTA-2, G-02 to G-05 Plot  
Gujarat Hira Bourse  
Ichhapore-2  
Surat – 394 510

T-720, Belgium Tower  
Opp. Linear Bus Stop  
Ring Road, Surat – 395 002

B/604-605, Tirupati Plaza  
Athwa Gate, Nanpura  
Surat – 395 001

**Hyderabad**

217, Maruthi Corporate Point  
Swapnalok Complex  
92, Sarojini Devi Road  
Secunderabad – 500 003

**Ahmedabad**

B-504, Narnarayan Complex  
Navrangpura  
Ahmedabad – 380 009

**Pune**

102, 1st Floor  
Shree Residency  
Baner Balewadi Road  
Balewadi, Pune – 411 045

**Gandhidham**

Divyasatika, Plot No. 41  
Ward 10-A, Gurukul  
Gandhidham – 370 201

**Jaipur**

346, 3rd Floor  
Ganpati Plaza, M.I. Road  
Jaipur – 302 001

For further information please contact:

**RSM Astute Consulting Pvt. Ltd.**

13th Floor, Bakhtawar, 229, Nariman Point, Mumbai – 400 021.

**T:** (91–22) 6108 5555 / 6121 4444

**E:** [emails@rsmindia.in](mailto:emails@rsmindia.in)

**W:** [www.rsmindia.in](http://www.rsmindia.in)

**Offices:** Mumbai, New Delhi–NCR, Chennai, Kolkata, Bengaluru, Surat, Hyderabad, Ahmedabad, Pune, Gandhidham and Jaipur.



[facebook.com/RSMIndia](https://facebook.com/RSMIndia)



[twitter.com/RSM\\_India](https://twitter.com/RSM_India)



[linkedin.com/company/rsm-india](https://linkedin.com/company/rsm-india)

RSM Astute Consulting Pvt. Ltd. (including its affiliates) is a member of the RSM network and trades as RSM. RSM is the trading name used by the members of the RSM network.

Each member of the RSM network is an independent accounting and consulting firm, each of which practises in its own right. The RSM network is not itself a separate legal entity of any description in any jurisdiction.

The RSM network is administered by RSM International Limited, a company registered in England and Wales (company number 4040598) whose registered office is at 50 Cannon Street, London, EC4N6JJ.

The brand and trademark RSM and other intellectual property rights used by members of the network are owned by RSM International Association, an association governed by article 60 et seq of the Civil Code of Switzerland whose seat is in Zug.

In this publication, we endeavour to bring out significant transition and first-time adoption (of Ind AS) related issues that are emerging in practice. In that context, we discuss various accounting options available under Ind AS, both, upon transition on first-time adoption of Ind AS, as well as those available on an ongoing basis. Information in this publication is in no way intended to replace or supersede independent or other professional advice. This publication should not be relied upon for taking actions or decisions without appropriate professional advice and it may be noted that nothing contained in this publication should be regarded as our opinion and facts of each case will need to be analysed based on specific facts. While all reasonable care has been taken in preparation of this publication, we accept no responsibility for any liability arising from any statements or errors contained in this publication.