The Institute of Chartered Accountants of India
(Setup by an Act of Parliament)

ICAI

One Day Seminar on Investor Awareness

Bangalore

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Accounting under IFRS and Ind-AS

Investor Awareness Programme

Discussion points

- ***What and Why of IFRSs***
- ***Ind-AS : Brief Introduction and MCA Roadmap***
- ***Significant Impact Areas***
    - ***Revenue Recognition***
    - ***Financial Instruments***
    - ***Lease Accounting***
    - ***Consolidation***
    - ***Business Combination***
- ***Key takeaways***

What & Why of IFRS?

What is IFRS?

International Financial Reporting Standards	▪ Several global accounting standards ▪ Developed by the IASB ▪ For preparation of financial statements and other financial reporting

IFRS®
International Financial Reporting Standards

Why IFRS?

International Financial Reporting Standards	*Can help to increase ……* Quality Comparability Transparency

Financial Information

IFRS has effectively become a "global accounting language"

Ind-AS
Brief Introduction & MCA Roadmap

Indian Accounting Standards (Ind-ASs) – *Prelude*

Overview of Indian Accounting Standards (Ind-AS)

What it is?

- *Ind-AS comprises 39 accounting standards, that are largely converged with International Financial Reporting Standards (IFRS)*
- *Ind-ASs are issued by the MCA*
- *MCA also periodically issues amendments to Ind-AS*
  - *Objective: to maintain convergence with IFRSs, issued globally by the IASB*

Key Highlights

- *Not adoption, but convergence to IFRS*
- *India – 1st country to adopt some of the new IFRS standards (like IFRS 9)*
- *Ind-AS has certain carve-outs to accommodate Indian business nuances*
- *Transition to IFRS is not just an accounting exercise; it has all pervasive business impact*
- *Ind-AS is in a dynamic state – developments in IFRS are being captured (new Standards on Leases and Insurance Contracts likely soon)*

Why Ind-AS?

- *Listing on overseas stock exchanges could become easier*
- *Ease in implementing cross border transactions*
- *Improved investor confidence in Indian Companies*
- *Opportunity to make some strategic improvements to the finance systems and processes*

"Convergence to IFRS" ….. (rather than 'Adoption of IFRS')

Standards Notified *so far ….*

Mapping between IFRSs and Ind-AS Standards

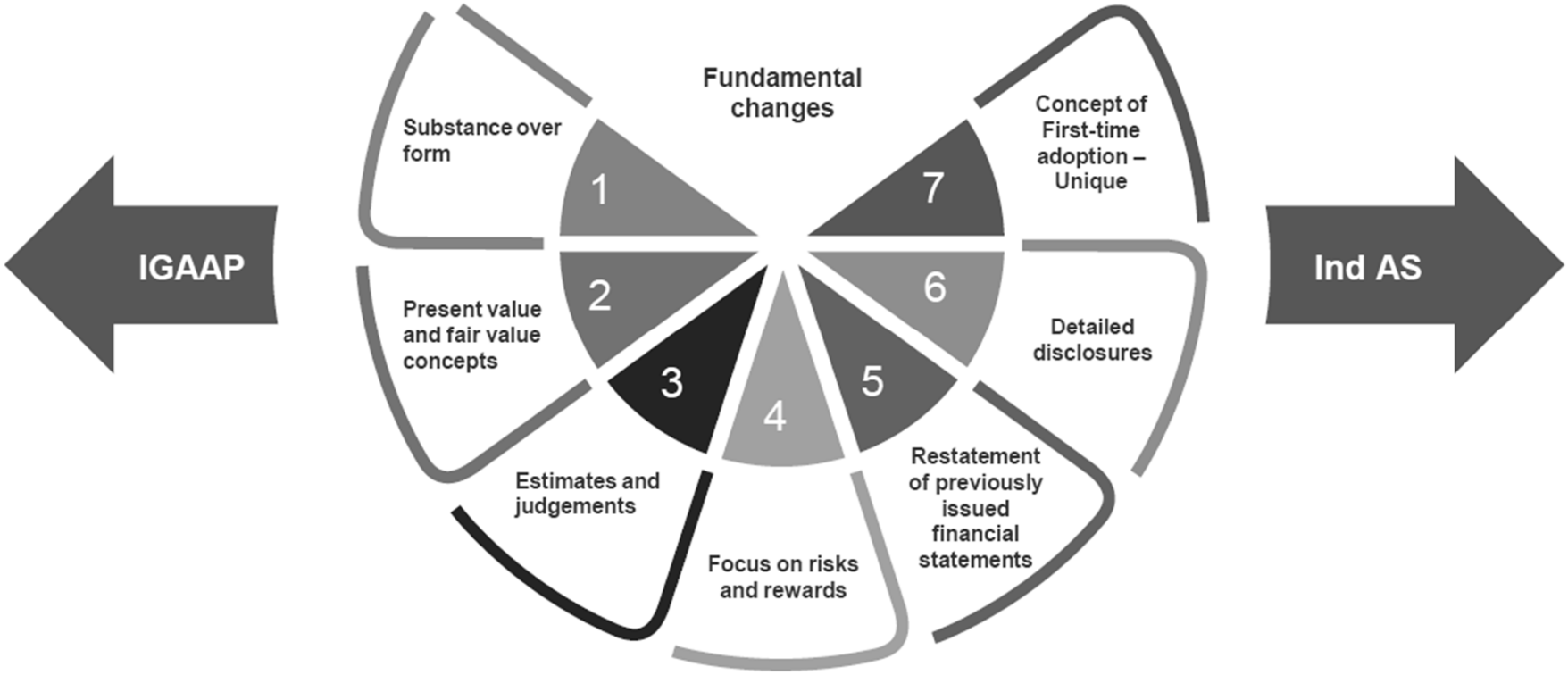
39 Standards Applicable

(w.e.f. FY 2018-19)

IFRS	Ind AS	IFRS	Ind AS	IFRS	Ind AS	IFRS	Ind AS
IFRS 1	Ind AS 101	IFRS 12	Ind AS 112	IAS 16	Ind AS 16	IAS 29	Ind AS 29
IFRS 2	Ind AS 102	IFRS 13	Ind AS 113	IAS 17	Ind AS 17	IAS 31	Not Issued
IFRS 3	Ind AS 103	IFRS 14	Ind AS 114	IAS 18 ✕	Withdrawn	IAS 32	Ind AS 32
IFRS 4	Ind AS 104	IFRS 15	Ind AS 115	IAS 19	Ind AS 19	IAS 33	Ind AS 33
IFRS 5	Ind AS 105	IAS 1	Ind AS 1	IAS 20	Ind AS 20	IAS 34	Ind AS 34
IFRS 6	Ind AS 106	IAS 2	Ind AS 2	IAS 21	Ind AS 21	IAS 36	Ind AS 36
IFRS 7	Ind AS 107	IAS 7	Ind AS 7	IAS 23	Ind AS 23	IAS 37	Ind AS 37
IFRS 8	Ind AS 108	IAS 8	Ind AS 8	IAS 24	Ind AS 24	IAS 38	Ind AS 38
IFRS 9	Ind AS 109	IAS 10	Ind AS 10	IAS 26	Not issued	IAS 39	Not issued
IFRS 10	Ind AS 110	IAS 11 ✕	Withdrawn	IAS 27	Ind AS 27	IAS 40	Ind AS 40
IFRS 11	Ind AS 111	IAS 12	Ind AS 12	IAS 28	Ind AS 28	IAS 41	Ind AS 41

- *MCA released two more Ind-AS Standards, viz. Ind-AS 11 (Construction Contracts) <u>and</u> Ind-AS 18 (Revenue) in March 2016*
- *This was in view of deferral of Ind-AS 115 deferred, in line with global developments and IASB's decision to defer IFRS 15*
- *Ind-AS 115 re-notified and is now applicable from FY 2018-19 (with Ind-AS 11 and Ind-AS 18 withdrawn)*

Fundamental Changes under IFRS and Ind-AS



Impact based on the type of transactions

MCA Roadmap for Ind-AS Implementation - *Corporates*

Implementation roadmap for Companies other than banking, insurance and NBFCs

	Phase I	Phase II	Voluntary Adoption
Year of Adoption	FY 2016 – 17	FY 2017 - 18	FY 2015 – 16 or thereafter
Comparative Year	FY 2015 – 16	FY 2016-17	FY 2014 – 15 or thereafter

Roll Back NOT Allowed

Companies Covered:

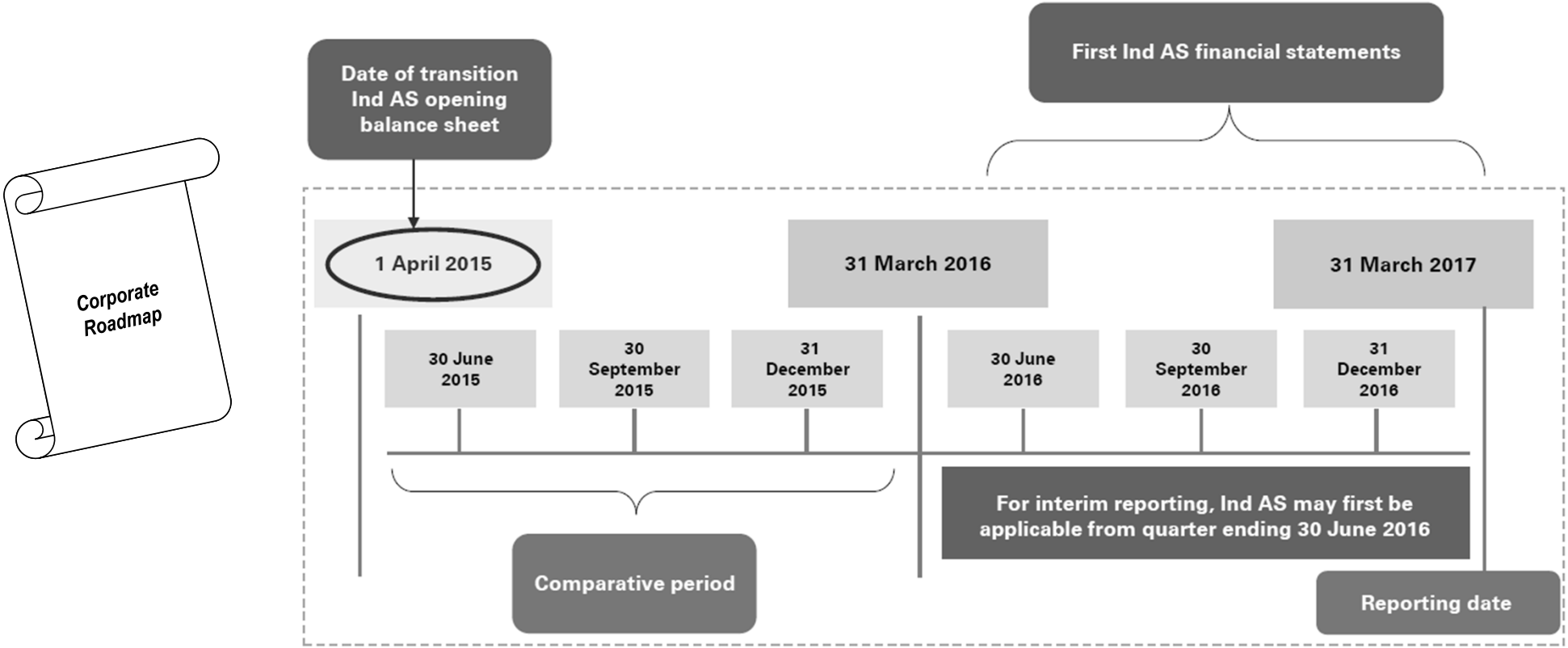
(1) Listed Companies	All listed companies with Net Worth of Rs 500 Crores or more	All companies listed (or, in the process of being listed)	Any company can voluntarily adopt IND AS
(2) Unlisted Companies	All unlisted companies with Net Worth of Rs 500 Crores or more	Unlisted companies with Net Worth of Rs 250 Crores or more	Any company can voluntarily adopt IND AS
(3) Group Companies	Also applies to holding, subsidiaries, JVs, or associate of companies covered in (1) and (2) above May also impact fellow subsidiary companies while preparing CFS		

- *Ind-AS to apply to both standalone and CFS*
- *No roll back is permitted*
- *Banks, NBFCs and insurance companies to follow their specific road maps*

- *Net Worth to be calculated on the basis of standalone financials as on 31st March 2014 or thereafter*
- *Net Worth definition as per Section 2(57) of Companies Act 2013 and accordingly does not include:*
  - *(a) revaluation reserve; and*
  - *(b) write back of depreciation reserve and amalgamation reserve*

MCA Roadmap for Ind-AS Implementation - *Corporates*

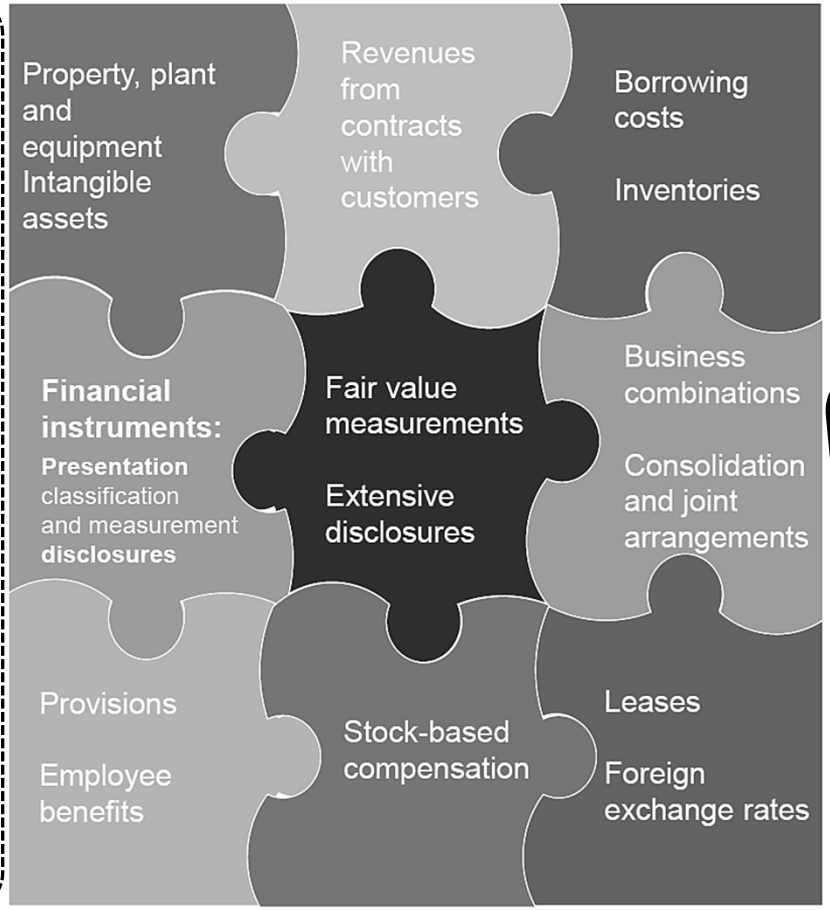
Mandatory implementation effective FY 2016-17



Significant Impact Areas

Significant Impact Areas

Some of the significant impact areas include….



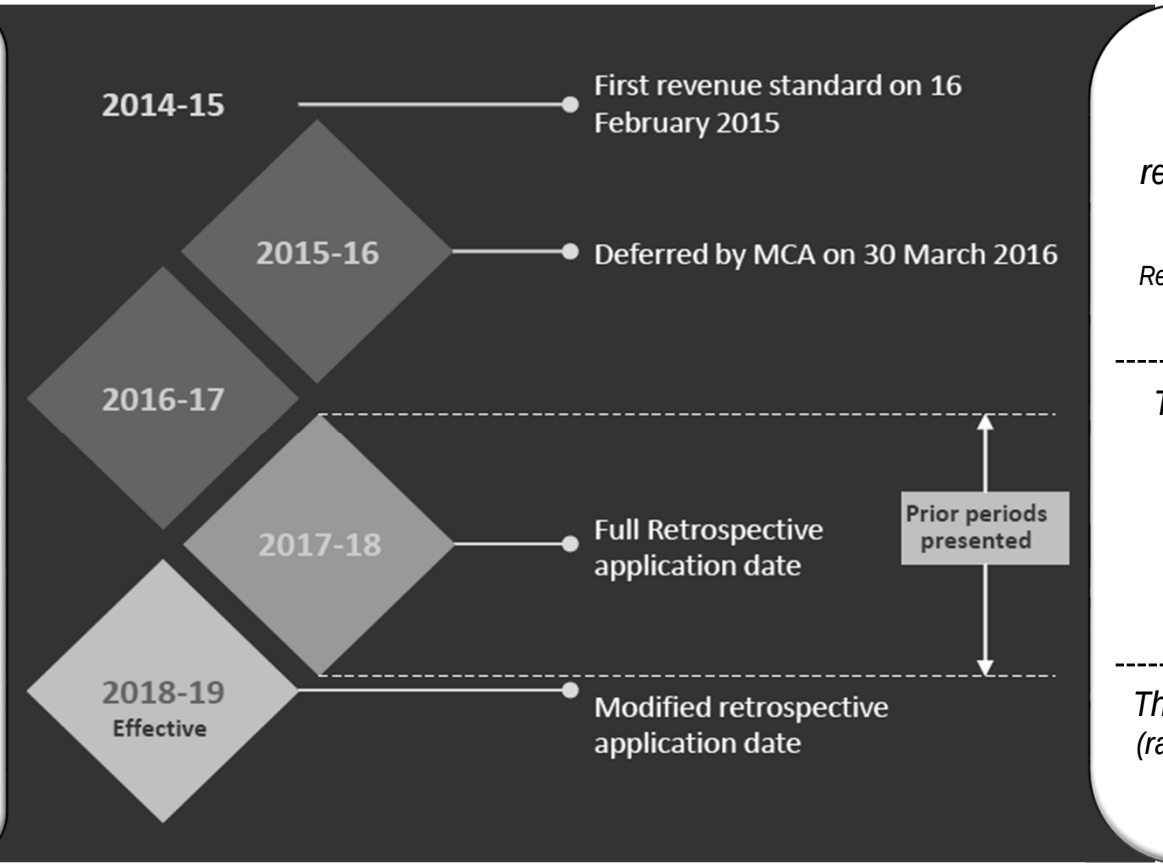
Let's see some of these ……

Revenue Recognition

Ind-AS 115* *(Revenue from Contracts with Customers) – Key Pointers*

New revenue recognition standard Ind-AS 115 kicks in, effective 1st April 2018 ……

Timelines



Ind-AS 115 replaces all Ind-AS revenue recognition requirements
viz. Ind-AS 11, Ind-AS 18 and Revised GN on Accounting for Real Estate Transactions for Ind-AS entities (2016 ver)

The new framework focuses on:
(a) performance obligation(s) in the contract
&
(b) allocating the transaction price to those obligations

The new model is a 'Control' Model
(rather than a 'risk and rewards' model)

* *IFRS 15 is the equivalent standard under IFRS*

Ind-AS 115 *(Revenue from Contracts with Customers) – Overview*

In March 2018, Ministry of Corporate Affairs (MCA) notified Ind-AS 115

Applicable for accounting periods beginning on or after 1st April 2018

Core principle

Recognise revenue to depict transfer of promised goods or services to customers in amount that reflects consideration to which entity expects to be entitled in exchange for those goods or service

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to performance obligations in the contract
5. Recognise revenue when (or as) the entity satisfies a performance obligation

Let's see some of these ……

Recognize revenue when (or, as) the entity transfers "control" of goods / services

Step 1 of Ind-AS 115 *Identify the Contract(s) with a Customer*

A contract with customer exists, when it meets all of the following criteria …

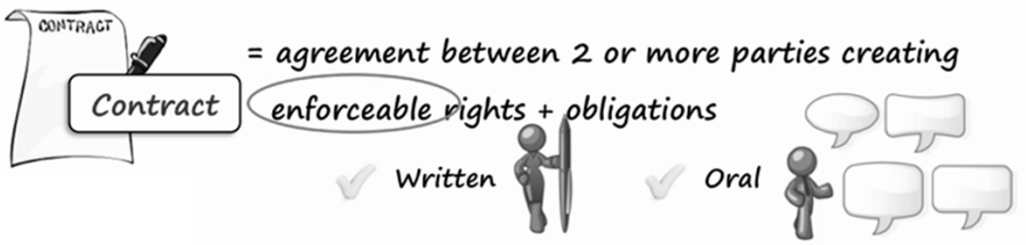
1 A contract exists if legally enforceable and …

2 … it is approved and the parties are committed to their obligations

3 … rights to goods or services and payment terms can be identified

4 … collection of consideration is considered probable

5 … it has commercial substance



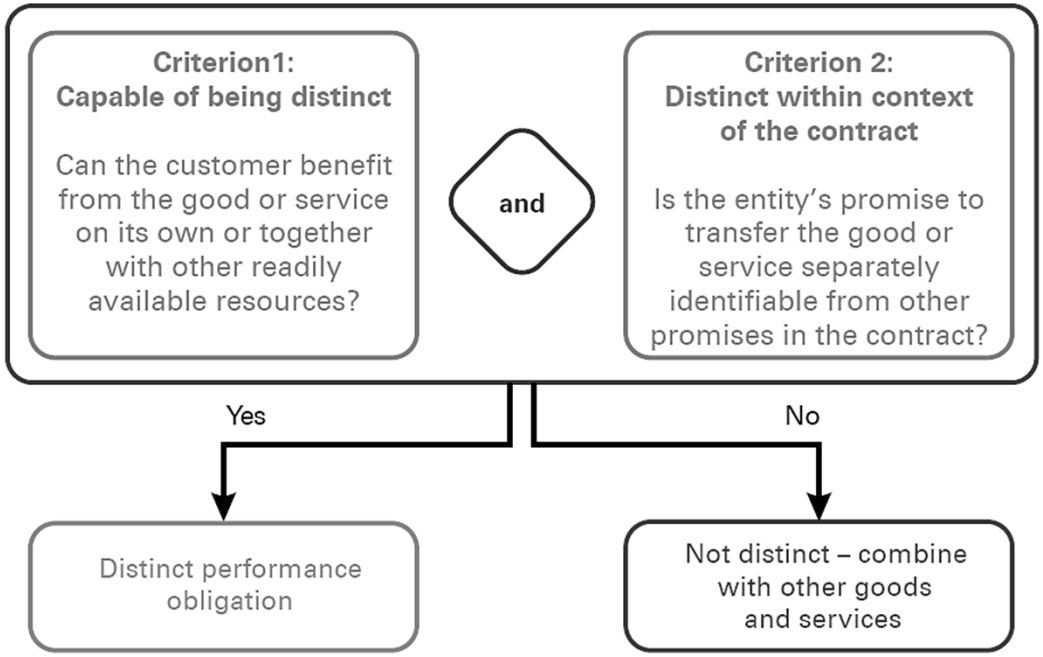
Step 2 of Ind-AS 115 *Identify the performance obligations*

Whether the agreement include elements that meet the 'distinct' test – to be accounted for separately?

At contract inception, an entity is required to identify the performance obligations under the contract ***and*** *these obligations are identified on the basis of:*

- *Contractual terms; and*
- *Customary business practice*

Performance Obligation = *an explicit or implicit promise (within a contract) to transfer distinct good or service to the customer*

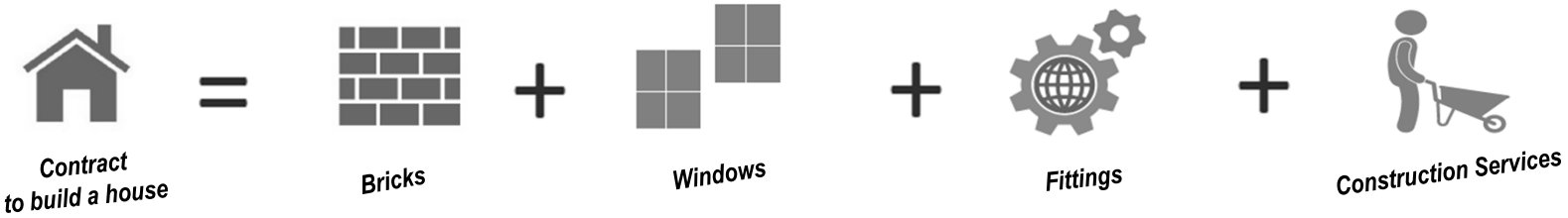


Exception: A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer may be a single performance obligation

Step 2 of Ind-AS 115 *Identify the performance obligations*

Whether the agreement include elements that meet the 'distinct' test – to be accounted for separately?

Single Performance Obligation



Q. Whether goods and services individually meet the "performance obligation" criteria?

Criteria 1

Benefit on its own OR with other resources ✓

Each material could be used with other readily available items

Criteria 2

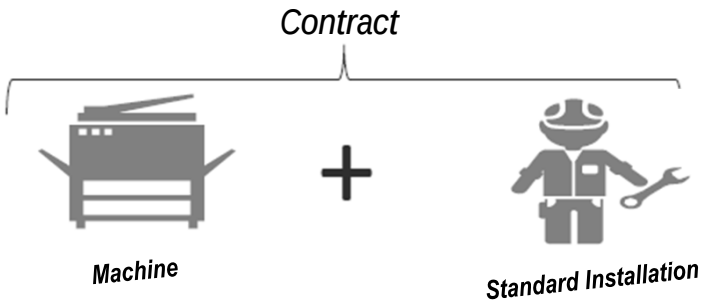
Goods or Services separately identifiable ✗

Entity is providing a significant integration service

Step 2 of Ind-AS 115 *Identify the performance obligations*

Whether the agreement include elements that meet the 'distinct' test – to be accounted for separately?

Multiple Performance Obligation



Installation services also offered by 3rd party service providers

Q. Whether the machine and the installation service meet the "performance obligation" criteria?

Criteria 1

Benefit on its own OR with other resources ✓

Machine and installation can be used with other available resources

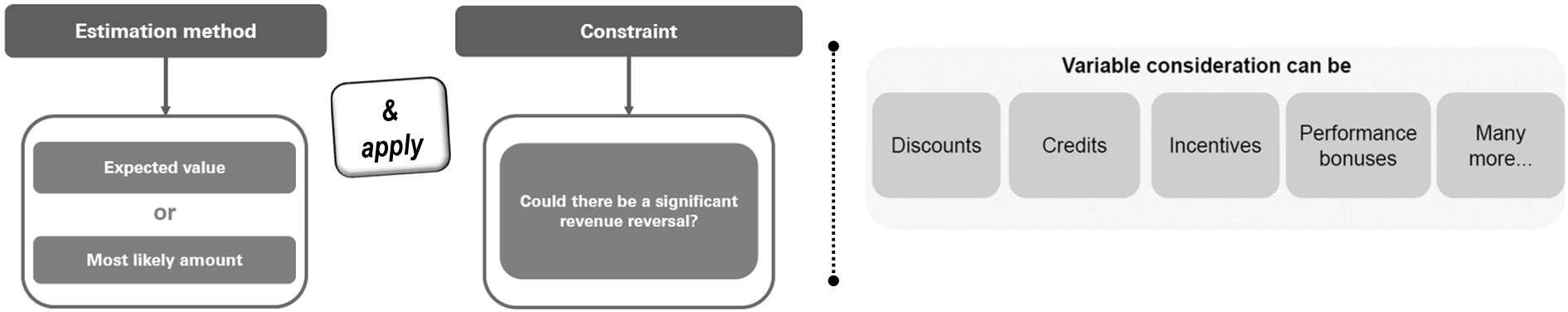
Criteria 2

Goods or Services separately identifiable ✓

No significant integration service
Installation is a standard service +
Machine & Installation are NOT highly inter-related

Step 3 of Ind-AS 115 *Determine Transaction Price*

If the contract price contains variable consideration, an entity need to decide on the ……



Variable consideration is estimated, using most appropriate method of either:

Expected Value
(Sum of probability-weighted amounts in a range of possible outcomes)

Most Likely Amount
(Single most likely outcome, when the transaction amount has a limited number of possible outcomes)

and… capped at an amount for which it is 'highly probable' that a significant revenue reversal will not occur

Step 3 of Ind-AS 115 *Determine Transaction Price*

An entity needs to assess if deferred or, advance payment terms in the contract, if any, gives rise to a Significant Financing Component ……

While determining 'transaction price' - an entity need to consider time value of money when:

- ***it is significant; and***
- ***the primary purpose of the payment terms is to provide financing to counterparty***

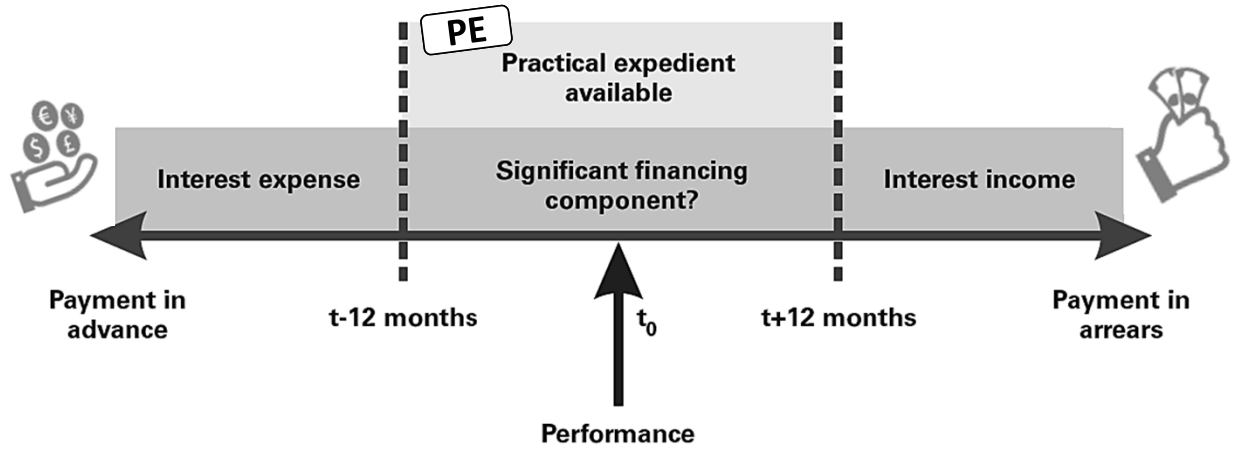
***Transaction price is adjusted** for the effect of time value of money **if** the contract provides either party with a significant financing benefit*

Significant Financing Component may be

explicit in the contract

OR

implied by payment terms in the contract

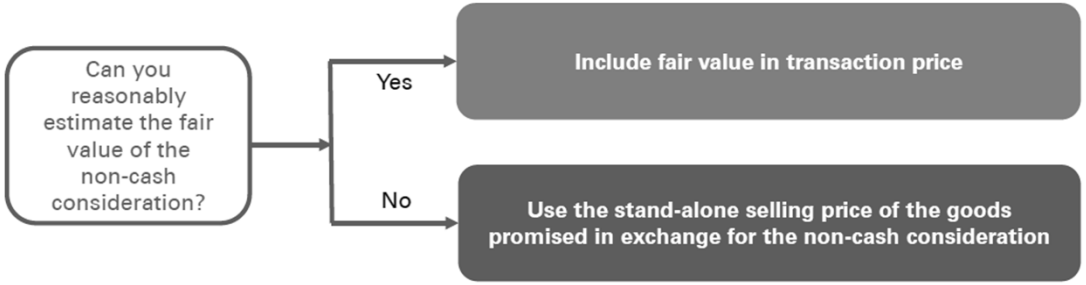


PE *At contract inception, if the period between (a) transfer of goods or services & (b) payment from the customer is one year or less, revenue is recognized at gross undiscounted amount (either over time or, at a point in time), by applying Step 5 of Ind-AS 115*

Step 3 of Ind-AS 115 *Determine Transaction Price*

*An entity also needs to identify if there is any non-cash consideration** in the contract ……*

** received by the entity…. from its customers …..



Non-cash Consideration

Non-cash consideration (like equity instrument) is measured at:
FV of consideration received or promised ***and*** *is included in the transaction price*

If FV of the non-cash consideration is not possible to be measured, then the entity is required to estimate this indirectly - by using Standalone Selling Prices of the goods or services provided by the entity

If fair value varies because of
Entity's performance
then, **apply *constraining requirements***

If fair value varies due to
Form of non-cash consideration *e.g. (shares)*
then, *NO constraining requirements*

Step 4 of Ind-AS 115 *Allocate Transaction Price to Performance Obligations*

An entity needs to decide .... (a) how to determine Standalone Selling Prices of the POs ***and*** *(b) then, to allocate the transaction price to POs .....*

Allocation objective

=to allocate the transaction price to each performance obligation in an amount that depicts the amount of consideration for transferring promised goods/services.

Overview

Determine Standalone Selling Prices

Standalone selling price is the price at which an entity would sell a promised good / service separately to a customer

Best evidence of Standalone Selling Price = Observable price of good / service sold separately ***by the entity*** *– in the similar circumstances, to the similar customers*

Price lists ***should not*** *be presumed to be* ***observable price***

Allocate the Transaction Price

On the basis of Relative Standalone Selling Prices of promised good / services

Step 4 of Ind-AS 115 *Allocate Transaction Price to Performance Obligations*

An entity needs to decide .... (a) how to determine Standalone Selling Prices of the POs ***and*** *(b) then, to allocate the transaction price to POs .....*

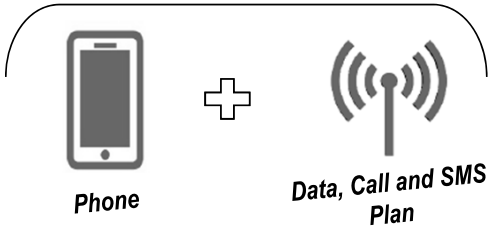
Various approaches ....

1 *Adjusted Market Assessment Approach*	2 *(Expected Cost + a Margin) Approach*	3 *Residual Approach (in limited circumstances)*
▪ *Evaluate the market, in which the goods and services are sold* & ▪ *Estimate the price that customers in the market will be willing to pay*	▪ *Forecast the expected costs of satisfying the performance obligation* & ▪ *Then, add an appropriate margin for that goods or, service*	▪ *Determine the total transaction price* & ▪ *Then, subtract the sum of observable selling prices of other goods and services promised in the contract*

Step 4 of Ind-AS 115 *Allocate Transaction Price to Performance Obligations*

Allocation methodology - Example

Two year contract for a consolidated price of INR 650



Assume that the entity also sells (a) Phone and (b) Data Plans separately

- *Phone is sold for INR 350; and*
- *24-month plan for Data costs INR 360 @ INR 15 p.m.*

Allocation of transaction price will be as follows ....

TP * = INR 320	TP * = INR 330
Being	*Being ....*
$\frac{650}{710} \times 350$	$\frac{650}{710} \times 360$

* *TP stands for "Transaction Price"*

Methods for estimating Standalone Selling Price

1. *Observable Price*
2. *Adjusted Market*
3. *Cost Plus*
4. *Residual*

Step 5 of Ind-AS 115 *Recognize Revenue when (or, as) the entity satisfies POs*

*At contract inception, an entity needs to evaluate whether it transfers "Control" of the goods / services** ....*
(a) over time <u>*or*</u> *(b) at a point-in-time .....*

** *Ind-AS 115 provides that a "control-based approach" – to be applied for recognizing revenue for all transactions*

Revenue is recognised…

At a point-in-time when the customer obtains control **or** **Over-time if specific criteria are met**

Indicators of whether 'Control' is transferred include ...

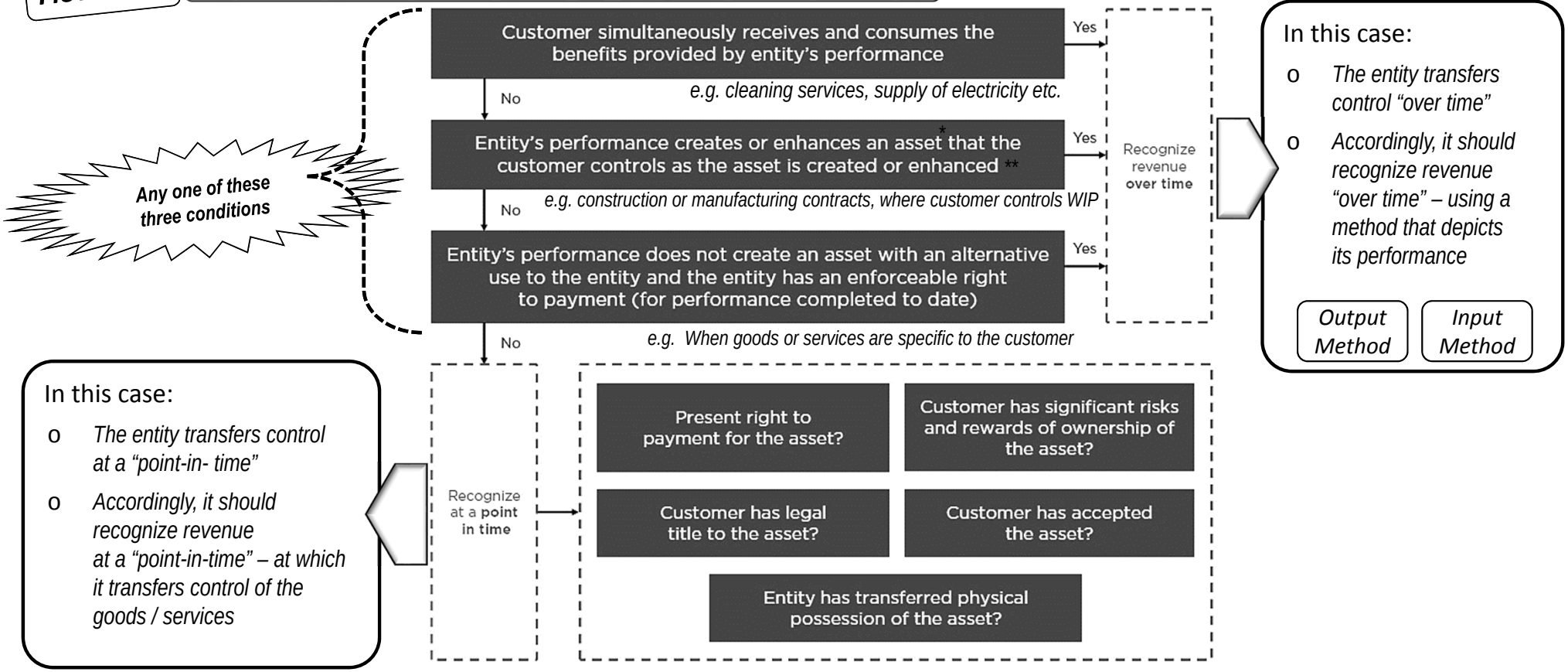
- *The customer has:*
  - *legal title to the asset*
  - *taken physical possession of the asset*
  - *accepted the asset*
- *The entity has:*
  - *present right to payment*
  - *transferred significant risks and rewards to the customer*

Indicators that control has passed include a customer having ...

... a present obligation to pay | ... physical possession | ... legal title | ... risks and rewards of ownership | ... accepted the asset

Step 5 of Ind-AS 115 *Recognize Revenue when (or, as) the entity satisfies POs*

Flowchart ***Revenue Recognition @ a Point in time vs. Over Time***



* *e.g. Work-in-progress (WIP)* ** *the asset can be tangible or, intangible*

Ind-AS 115 *(Revenue from Contracts with Customers) – Industry-specific Issue*

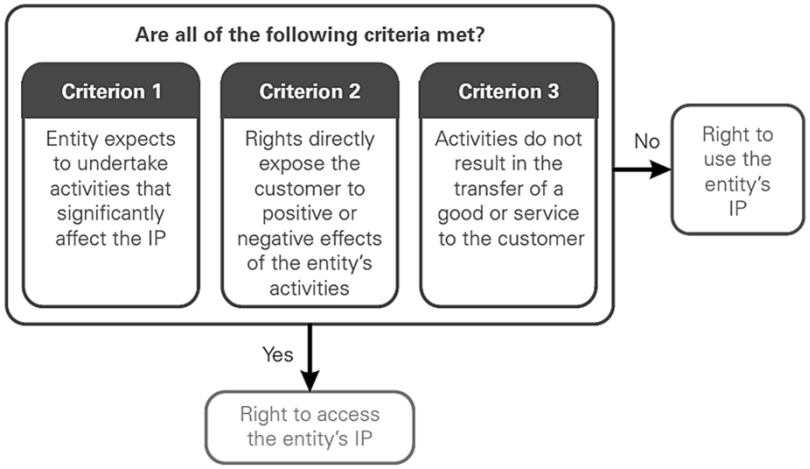
How to account for license of intellectual property or, licensing arrangements?

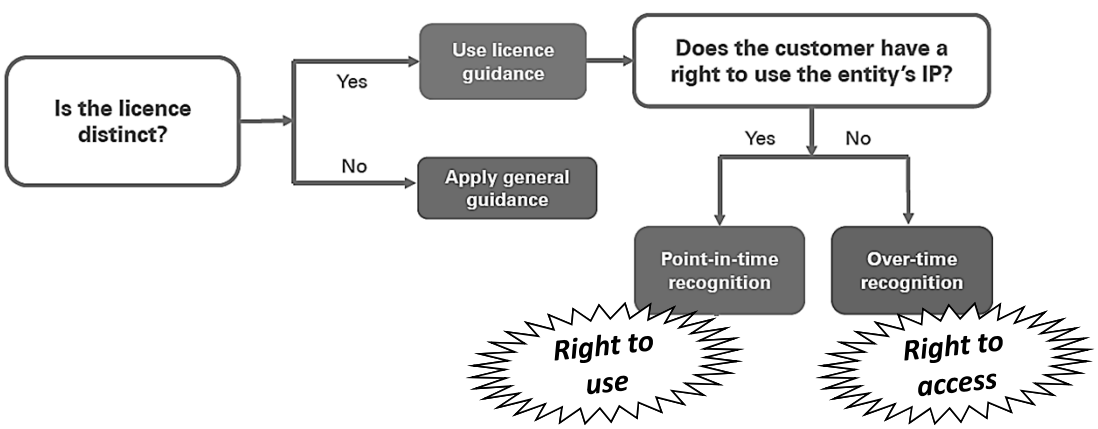
- *Ind-AS 115 provides specific guidance on licenses of IP*
- *A contract to transfer a license to a customer may include promise to deliver other goods or services in addition to the promised license*
- *These promises may be specified in the contract OR may be implied by the entity's customary business practices*
- *An entity need to apply Step 2 of Ind-AS 115 – to identify each of the POs in the contract (as explained earlier)*

- *A license of IP – that is distinct from other goods and services in the contract – is a separate performance obligation*

&

- *To determine - whether the PO is satisfied (a) at a point-in-time OR (b) over time – an entity needs to consider the nature of the promise and ascertain whether the promise provides the customer with the:*
  - *Right to use entity's IP (as it exists at a point-in-time, at which the license is granted) OR*
  - *Right to access the entity's IP throughout the license period*



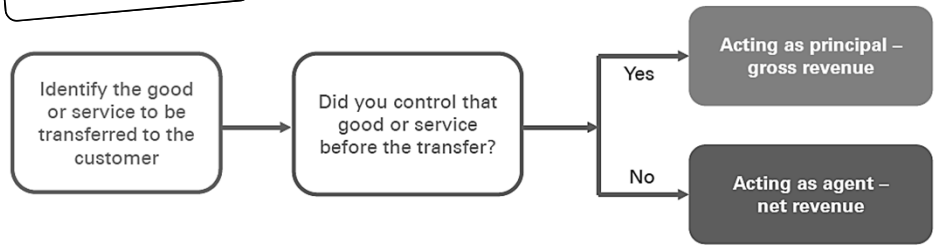


Ind-AS 115 *(Revenue from Contracts with Customers) – Industry-specific Issue*

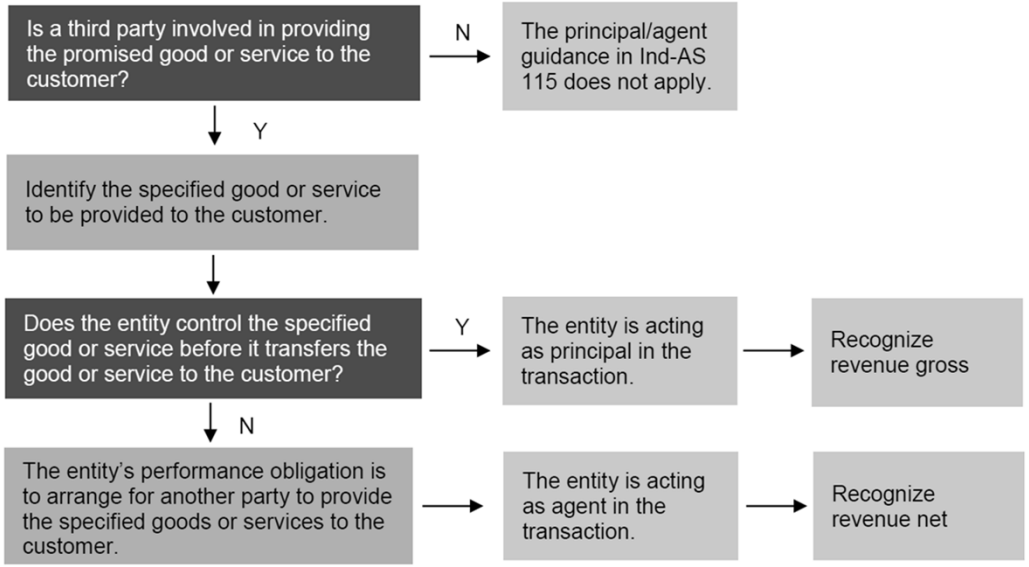
The entity needs to assess if it is acting as a Principal or, an Agent ……

- *When more than one party is involved in providing goods or services to a customer, Ind-AS 115 requires an entity to determine whether it is a principal or an agent*
- *An entity is a principal - if it controls a promised good or service.... before transferring that good or service to the customer*
- *However, it is an agent if its role is to arrange for another entity... to provide the goods or services*
- *Reasoning: In order for an entity to conclude that it is providing the good or service to the customer, it must first control that good or service*

Overview

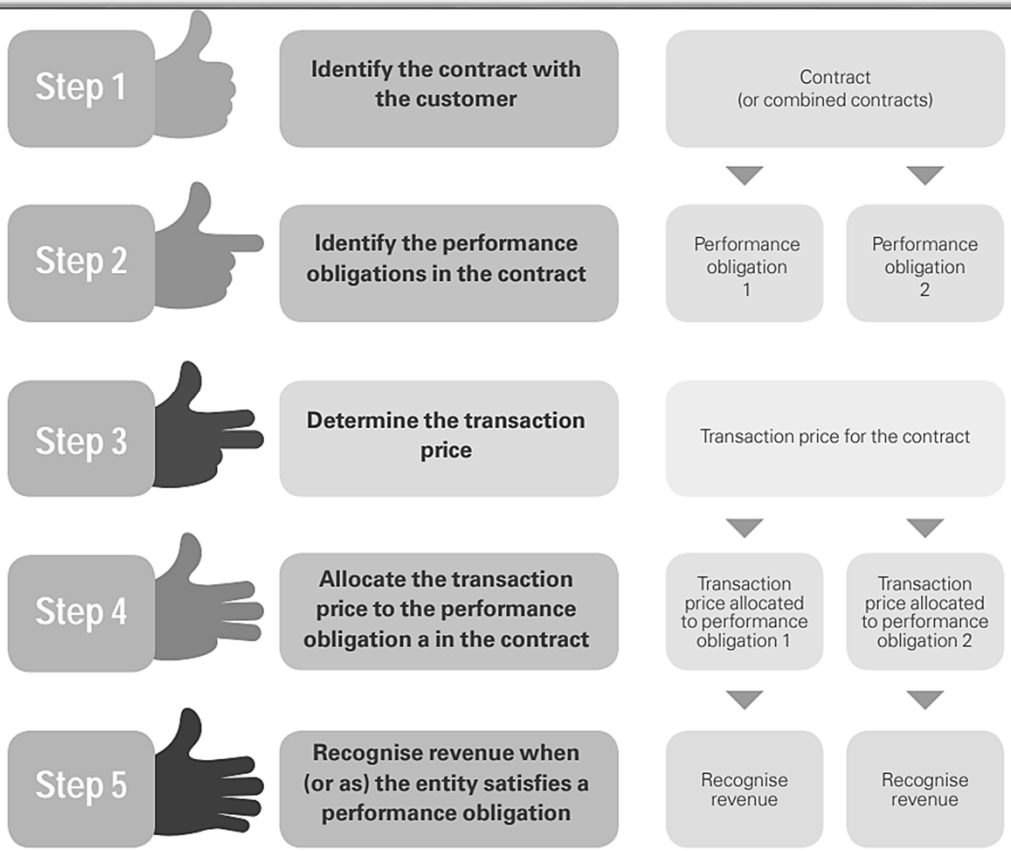


Flowchart



Ind-AS 115 *(Revenue from Contracts with Customers) – Key considerations*

Key considerations under Ind-AS 115 …. at a glance …….



Ind-AS 115 *(Revenue from Contracts with Customers) – Practical Issues*

Step-wise likely practical issues under Ind-AS 115

1 Identify Contract	2 Identify Performance Obligation	3 Determine Transaction Price	4 Allocate Transaction Price	5 Recognition of Revenue	Other areas
Identification of Contract	Multiple Element Arrangements (PO)	Significant Financing Component	Estimating Standalone Selling Price for allocating transaction price to identified Performance Obligations	Timing of Revenue Recognition, viz. Over time vs. Point-in-time	Contract Costs
Contract Modification	Installation & Warranty	Variable Consideration			Principal vs. Agent
Contract Combination	Right of Return	Non-cash Consideration		Measure of Progress, viz. Input vs. Output Method	Presentation & Disclosure
	Material Rights	Implied Price Concession			Transition Methods
	Free Vouchers (or, Loyalty Points)	Discount & Incentives			Licenses

Ind-AS 115 *(Revenue from Contracts with Customers) – Implementation Issues*

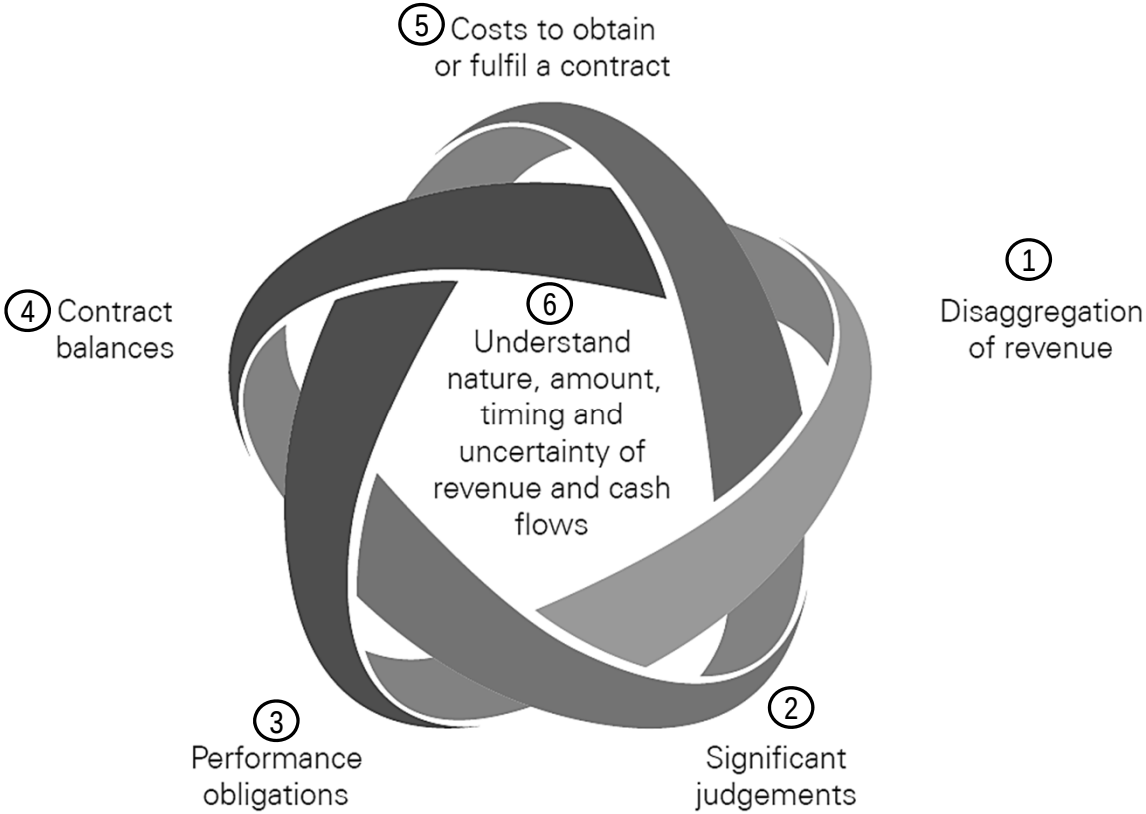
Step-wise key implementation issues under Ind-AS 115

1 Identify Contract	2 Identify Performance Obligation	3 Determine Transaction Price	4 Allocate Transaction Price	5 Recognition of Revenue	Other areas
Is this a contract with a customer?	Sale contract for products including services**	Variable consideration (rebates, performance bonus etc.)	Standalone Selling Price may not always be observable	When does control transfer?	Contract Costs, viz. costs to obtain contracts
Contracts with oral or, implied terms	Co-development and co-marketing contracts	Constraint on Variable Consideration		License agreements right to access vs. right to use	
Service agreement or, collaborative agreement	Transportation & Insurance – as separate PO	Financing Component	Need to apply appropriate estimation method, if applicable	Recognition of sales-based royalties	
	Principal vs. Agent analysis	Consideration paid to customers			
Contract Combinations		IT system enable identification of VC @ contract inception		Recognition of milestone payments	

** e.g. (a) medical device along with (b) product / sale support

Ind-AS 115 *(Revenue from Contracts with Customers) – Key Disclosure Requirements*

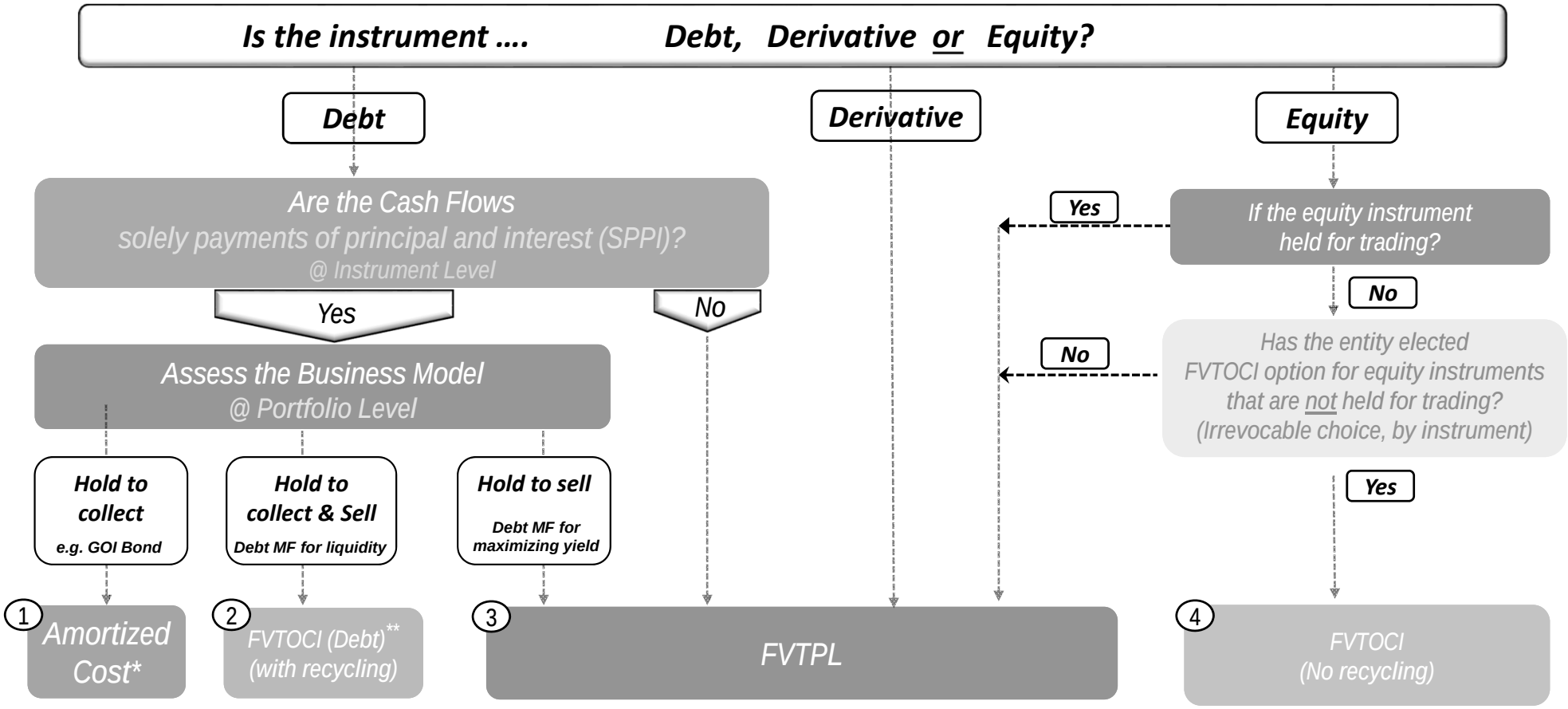
Ind-AS 115 has specific disclosure requirements in the following areas ……



Financial Instruments

Classification of Financial Instruments

Ind-AS 109 Financial Instruments - *Classification Overview*



* *impairment considerations apply*

** *FVTOCI designation for debt instruments is available only when it either (a) eliminates or, (b) significantly reduces accounting mismatch*

Measurement of Financial Instruments

Measurement of Financial Assets - *Summary*

Initial Recognition	*@ Fair Value, as per Ind-AS 113 (Fair Value Measurement)*			
	Plus transaction cost	*Plus transaction cost*	*-*	*Plus transaction cost*
Subsequent Measurement	*Amortized Cost*	*FVTOCI (Debt Instruments)*	*FVTPL*	*FVTOCI (Equity Instruments not held for trading)*
Balance Sheet	*Amortized Cost* **Explained later**	*Fair Value*	*Fair Value*	*Fair Value*
Profit & Loss	o *Interest revenue* o *Impairment losses (ECL)* o *Forex gain / loss*	o *Interest revenue* o *Impairment losses (ECL)* o *Forex gain / loss*	*All Fair Value Changes*	*Dividend* *(Not recovery of initial investment)*
OCI	-	*(Other) Fair Value Changes*	-	*(All) Fair Value Changes*
Recycling Permitted *(on de-recognition)*	-	*Yes* *Cumulative gain / loss – previously recognized is reclassified to P/L*	-	*No* *Transfer the realized profit / loss to Equity (never to PNL)*

Initial Measurement of Financial Instruments

Illustration - Initial Measurement of Financial Assets and Financial Liabilities

Assume a scenario wherein:

- *CT Corp lends Rs. 10 lacs to ABSPL*
- *The loan is repayable in full after a period of 5 years and carries interest @5% p.a. – payable annually, even though market interest rate for similar loan is 8% p.a.*
- *To compensate CT Corp for the below market interest rate, ABSPL pays an origination fees of Rs.120,000 to CT Corp*
- *There are no other directly related payments, by either party*

Advice CT Corp as to how to account for the loan

In this case:

- *CT Corp will recognize the loan @ its fair value of Rs 8.80 lacs*
  (being Rs. 10 lacs less origination fee of Rs. 1.20 lacs)
- *This fair value is also equal to:*
  PV of (contractual cash inflows by way of interest and principal repayment), as shown in the below tables
- *CT Corp will need to recognize interest income on loan, using EIR method, which works out to be 8.01% in this case (shown in the below tables)*

IRR Computation

Year	Cash Flows
0	(8,80,000)
1	50,000
2	50,000
3	50,000
4	50,000
5	10,50,000
IRR =	**8.01%**

EIR or, IRR = 8.01%

Table showing recognition of financial asset using Ind-AS 109 principles

Year	Opening Balance (In Rs.)	Interest @ EIR of 8.01% (In Rs.)	Cash Payment (In Rs.)	Closing Liability (In Rs.)
1	8,80,000	70,452	(50,000)	9,00,452
2	9,00,452	72,090	(50,000)	9,22,542
3	9,22,542	73,858	(50,000)	9,46,400
4	9,46,400	75,768	(50,000)	9,72,169
5	9,72,169	77,831	(10,50,000)	-

Concept of Amortized Cost – *for financial assets & financial liabilities*

Illustration

Amortized Cost ***(for Financial Assets)***

Refundable Security Deposit given to the lessor

Consider the following information in respect of a refundable security deposit ……

- *Date of security deposit* — *1st April 2012*
- *Date of repayment of security deposit* — *31st March 2017*
- *Total lease period* — *5 years*
- *Amount of security deposit* — *Rs. 10,00,000 (A)*
- *Discount rate* — *12%*
- *PV Factor @12% for 5 years =1/(1.12)^5* — *0.567427*
- *PV (Security Deposit) on 1st April 2012* — *Rs. 567,427 (B)*
- *Difference (being Prepaid lease payment)* — *Rs. 432,573 (A – B)*

Amortization Schedule

Year	YE	Opening Balance (In Rs.)	Interest Income @ 12% (In Rs.)	Cash Inflow (In Rs.)	Closing Liability (In Rs.)	Prepaid Amortization (in Rs.)
1	31-Mar-13	5,67,427	68,091	-	6,35,518	86,515
2	31-Mar-14	6,35,518	76,262	-	7,11,780	86,515
3	31-Mar-15	7,11,780	85,414	-	7,97,194	86,515
4	31-Mar-16	7,97,194	95,663	-	8,92,857	86,515
5	31-Mar-17	8,92,857	1,07,143	(10,00,000)	0	86,515
Total			**4,32,573**			**4,32,573**

In this case, the accounting for refundable security deposit will be as follows…

On initial recognition:

Debit	*Security Deposit*	*567,427*	
Debit	*Prepaid Rent*	*432,573*	
	Credit Bank		*10,00,000*

(Being the JE for providing refundable security deposit to the lessor)

On subsequent measurement:

Debit	*Security Deposit*	*68,091*	
	Credit Interest Income		*68,091*

(Being the JE for unwinding of interest)

Debit	*Lease Rent*	*86,815*	
	Credit Prepaid Rent		*86,815*

(Being the JE for amortization of prepaid rent)

Similar JEs for year 2 through 5

Compound Instruments

(or, Hybrid Instruments)

and

Split Accounting

Compound Financial Instruments

Compound Financial Instruments

Compound Financial Instrument is an instrument, whose terms indicate that it contains – both a liability and an equity component

e.g. a "Convertible Bond"

Split Accounting

At the issuance + not revised!

Liability Component
= Obligation to pay interest and principal

Equity Component
= Equity conversion option

- *Must meet the definition of Equity; and*
- *Is calculated as a 'residual'*

- *Issuer of a non derivative financial instrument (like convertible debentures) needs to evaluate the terms of the financial instrument – to determine whether it contains both a liability and an equity component*
- *If such components are identified, they must be accounted for separately as:*
  - *(a) financial liabilities; and*
  - *(b) financial asset or, equity*

Split accounting

- *Accordingly, the liability and the equity components – are shown separately in the balance sheet*

Compound Financial Instruments

(Illustrative Types of) **Compound Financial Instruments**

Instrument	Liability Component	Equity Component
Convertible Debentures *(with conversion option, available to the debenture holder)*	• *Principal Repayment; and* • *Periodic Interest Payment*	• *Conversion option to the holder*
Redeemable Preference Shares *(with discretionary dividend)*	• *Principal Repayment*	• *Discretionary Dividend*

Convertible Debt

Liability =	Fair Value *using applicable rate for non-convertible debt*
✚	
Equity =	Balance Figure

Transaction costs are allocated to the liability <u>and</u> equity components, in the same proportion as above split

Compound Financial Instruments

Compound Financial Instruments - *Illustration*

Assume that:

- *CT Corp has issued 2000 convertible debentures, with face value of Rs. 1000 each debenture, at par*
- *The debentures:*
  - *Carry an interest rate of 6% p.a. – payable in arrears*
  - *Has a 3 year term*
- *When the debentures are issued, the prevailing market interest rate for similar debentures, without conversion options is 9% p.a.*
- *Each debenture is convertible, at any time up to the date of maturity, into 250 equity shares*

How should CT Corp classify and account for the debenture?

Step 1	*Compute cash inflows and outflows, as per contractual terms of issue*
Step 2	*Discount cash inflows and cash outflows @ interest rate for similar instrument without conversion feature*
Step 3	*The discounted value, so arrived at in Step 2 above is = Fair Value of the liability component*
Step 4	*Subtract, "fair value of liability component" <u>from</u> "total sale proceeds"…. to arrive at FV of equity component (as a residual)*
Step 5	*Recognize interest obligation on the liability component by applying the EIR method under Ind-AS 109*
Step 6	*The equity component is not re-measured subsequently*

Detailed in subsequent slides ….

Compound Financial Instruments

Compound Financial Instruments - *Solution*

Table showing computation of Liability and Equity Components

Year	Particulars	Cash Outflow = Interest (in Rs)	Cash Outflow = Principal (in Rs)	Total Cash Outflow (in Rs)	PV Factor at discount rate = 9%	PV of Cash Outflows (in Rs.)
1	Interest @6% p.a.	1,20,000	-	1,20,000	0.9174	1,10,092
2	Interest @6% p.a.	1,20,000	-	1,20,000	0.8417	1,01,002
3	Interest @6% p.a. & Principal Repayment	1,20,000	20,00,000	21,20,000	0.7722	16,37,029
	A. Total					**18,48,122**
	B. Gross Proceeds from issue of debentures					**20,00,000**
	C. Hence, Equity component (B - A)					**1,51,878**

- *The equity component of Rs.151,878 is* ***not*** *subsequently re-measured*
- *It is assumed that the liability is* ***not classified as FVTPL*** *(rather, it is classified as 'measured at amortized cost')*
- *Upon initial recognition of the convertible debenture, the issuer will record the following JE:*

Debit	*Cash*	*20,00,000*
Credit	*Financial Liability*	*18,48,122*
Credit	*Equity*	*1,51,878*

- *Transaction costs, if any, for issuing the convertible debenture is* ***allocated*** *between (a) the debt component and (b) the equity component, in the* ***ratio of their relative fair values*** *(being 18,48,122 to 1,51,878 – in this Illustration)*

Compound Financial Instruments

Compound Financial Instruments - *Solution* *.... concluded*

The issuer recognizes interest expense under EIR method, using Ind-AS 109 principles as follows:

Table showing recognition of interest expense (under EIR method), using Ind-AS 109 principles

Year	Opening Liability (In Rs.)	Interest @ EIR of 9% (In Rs.)	Cash Payment (In Rs.)	Closing Liability (In Rs.)
1	18,48,122	1,66,331	(1,20,000)	18,94,453
2	18,94,453	1,70,501	(1,20,000)	19,44,954
3	19,44,954	1,75,046	(21,20,000)	-
Total		**5,11,878**		

In this case:

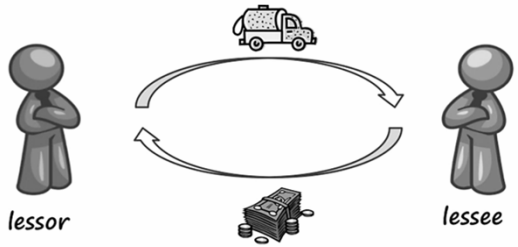
- *Total cash outflow = Rs. 23,60,000* *being (20 + 1.20 + 1.20 + 1.20) lacs*
- *Which is equal to ...* *FV of liability component + Interest expense (as per EIR method, calculated above)*
  i.e. (18,48,122 + 511,878)

Lease Accounting
Discussion on Ind-AS 116

Ind-AS 116* Leases – *Overview*

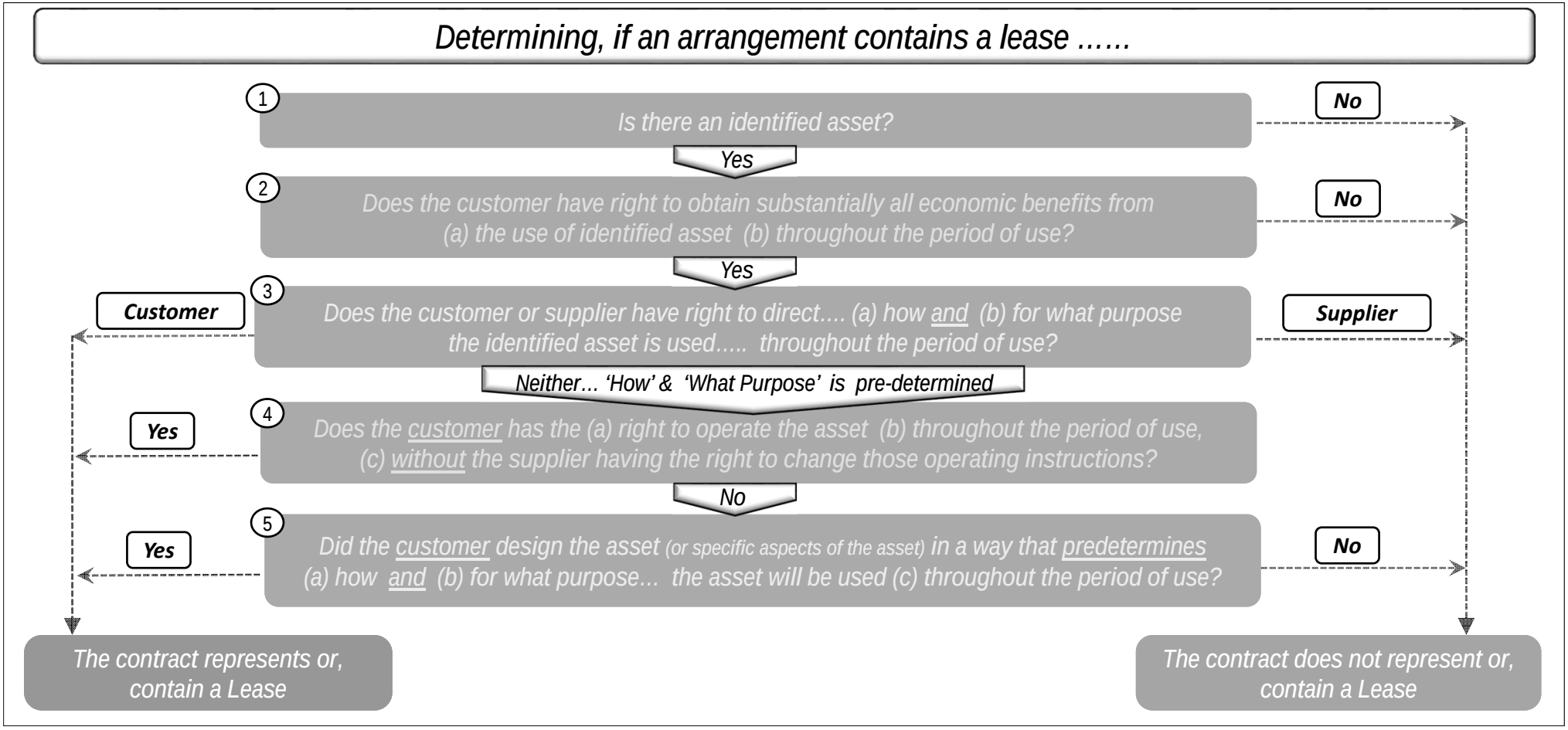
Background	Proposed Lease Accounting Standard Ind-AS 116		
	Headline Impact	Disclosure Requirement	Other Business Impacts
In Jan 2016, IASB issued IFRS 16 (Leases) *IFRS 16 replaces all existing lease accounting standard IAS 17 and related IFRIC* *In July 2017, ICAI issued ED on Ind-AS 116* *Ind-AS 116 is expected to be effective for annual reporting periods beginning on or after 1st April 2019* *Early application – not permitted*	o *Lessees will have a single on-balance sheet accounting model for all leases* o *Exemptions for short-term leases and leases of low-value assets available to lessees* o *Lessor accounting is substantially unchanged*	*Both lessees and lessors will have **additional disclosure requirements**, compared to current accounting*	o *The new standard may potentially have broad implications for entities'* ✓ *Finances* ✓ *Operations; and* ✓ *EBITDA* o *An entity will need to develop new processes and controls (or, adjust existing ones) - to identify and account for leases*

As per an IASB study on a sample of 14,000 listed companies – the new lease accounting standard can cause an impact on
~ $2.86 trillion off-balance sheet leases



* *IFRS 16 is the equivalent standard under IFRS*

Ind-AS 116 Leases – *Determining, if there is a lease*



Ind-AS 116 Leases – *Recognition and Measurement for Lessee*

Recognition and Measurement

Balance Sheet

Asset	=	"Right-of-use" of the underlying asset
Liability	=	Obligation to make lease payments

Profit and Loss

Lease Expense	=	Interest	+	Depreciation

Consider exemptions ....

(a) Short-term lease & (b) lease of low-value assets

Key Judgements and estimates

Is it a lease?

Are there non-lease components in the contract?

Should the practical expedient for short-term leases be considered?

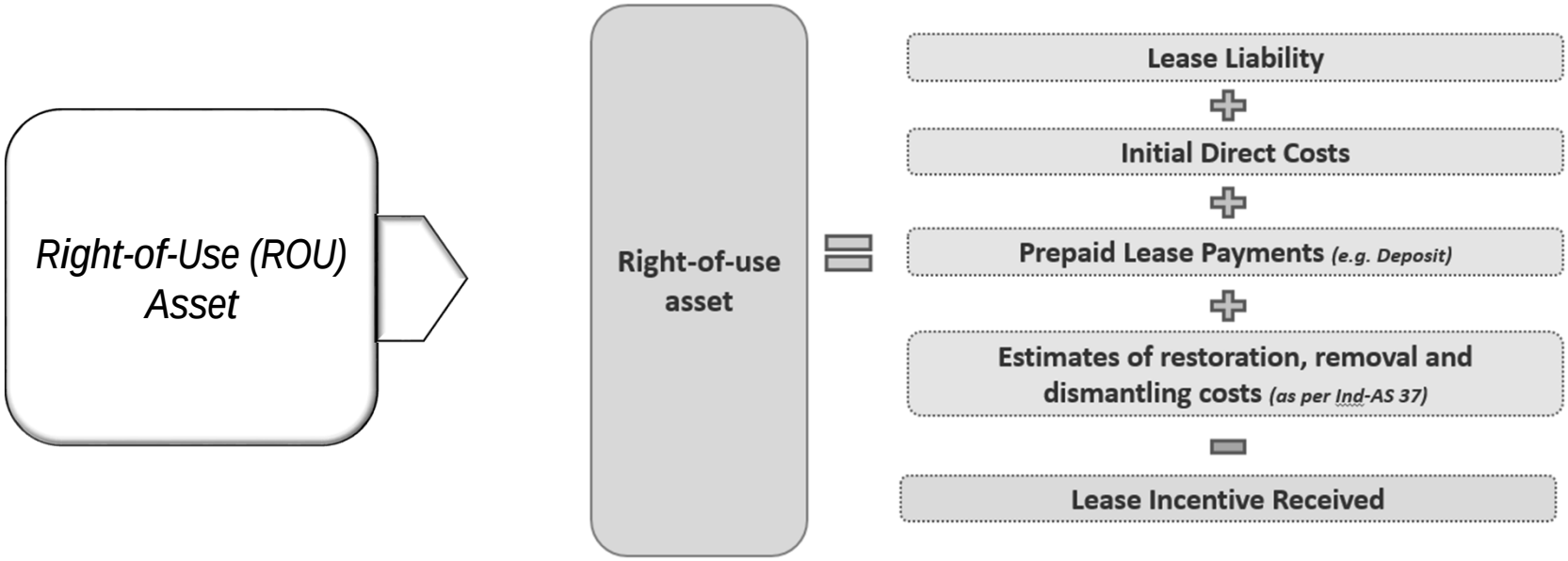
What is the lease term (considering renewal, termination and purchase options)?

Are there variable lease payments and residual value guarantees?

What is the discount rate?

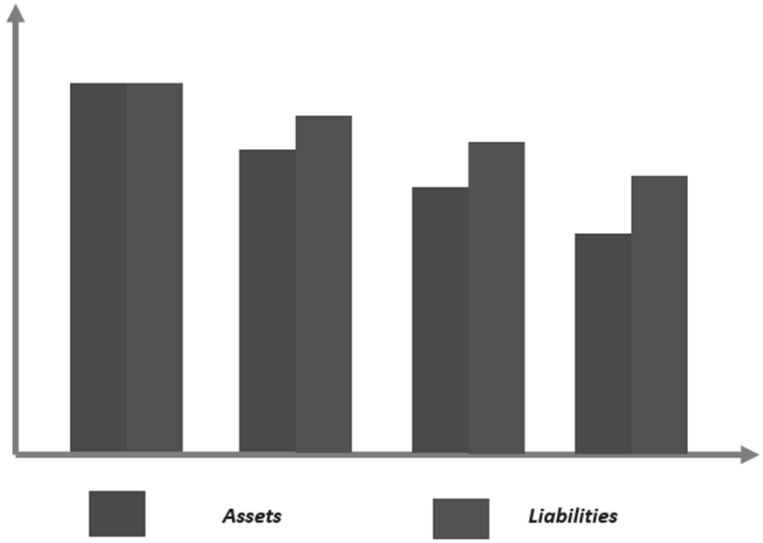
Which transition approach to be adopted?

Ind-AS 116 Leases – *Initial Measurement for lessee*



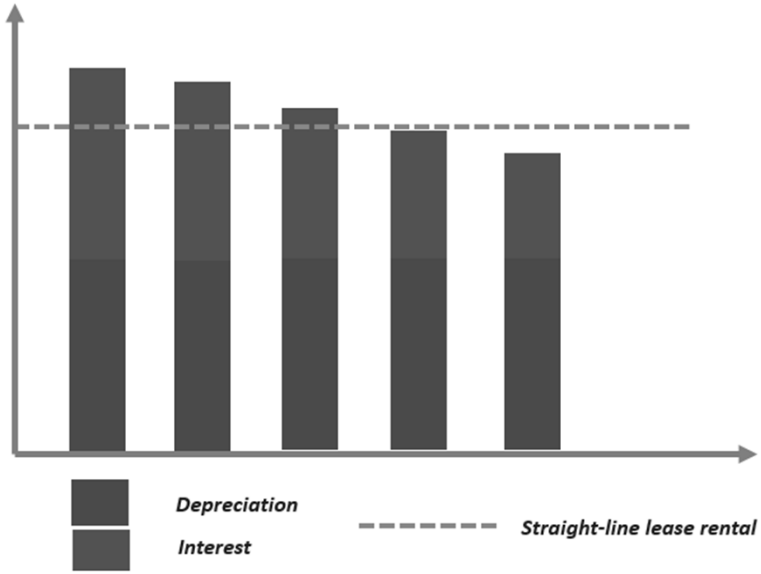
Ind-AS 116 Leases – *Illustrative Impact on Financials for lessee*

Balance Sheet



Companies with operating leases will appear to be ***more asset-rich,*** *but also* ***more heavily indebted***

Profit and Loss Account



Total lease expense will be front-loaded, even when ***cash rentals are constant***

Ind-AS 116 Leases – *Illustrative Impact on Financial Ratios for lessee*

Possible impact on financial ratios

	Profit and Loss	Balance Sheet	Ratios
↑	**EBITDA**	**Total Assets**	**Gearing**
↓	**Earnings Per Share** ***….. in initial years***	**Net Assets**	**Interest Coverage** **Asset Turnover**

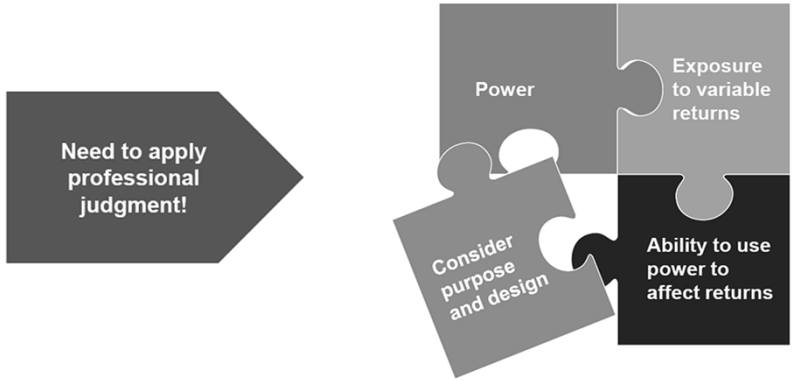
Other Significant Impact Areas

Consolidation

Control – as contemplated under Ind-AS 110 (and under Ind-AS 103**)*

Under Ind-AS 110, an investor controls an investee when:

- ***the investor is exposed to variable returns from its involvement with the investee; <u>and</u>***
- ***has the ability to affect those returns;***
- ***through its power over the investee's (relevant activities)***



Power = existing rights that give the current ability to affect the relevant activities of investee

To have power, it is necessary for investor to have existing rights that give it *current ability* to direct the activities that significantly affect the investee's returns, i.e., the *relevant activities*

* *IFRS 10 is the equivalent standard under IFRS*

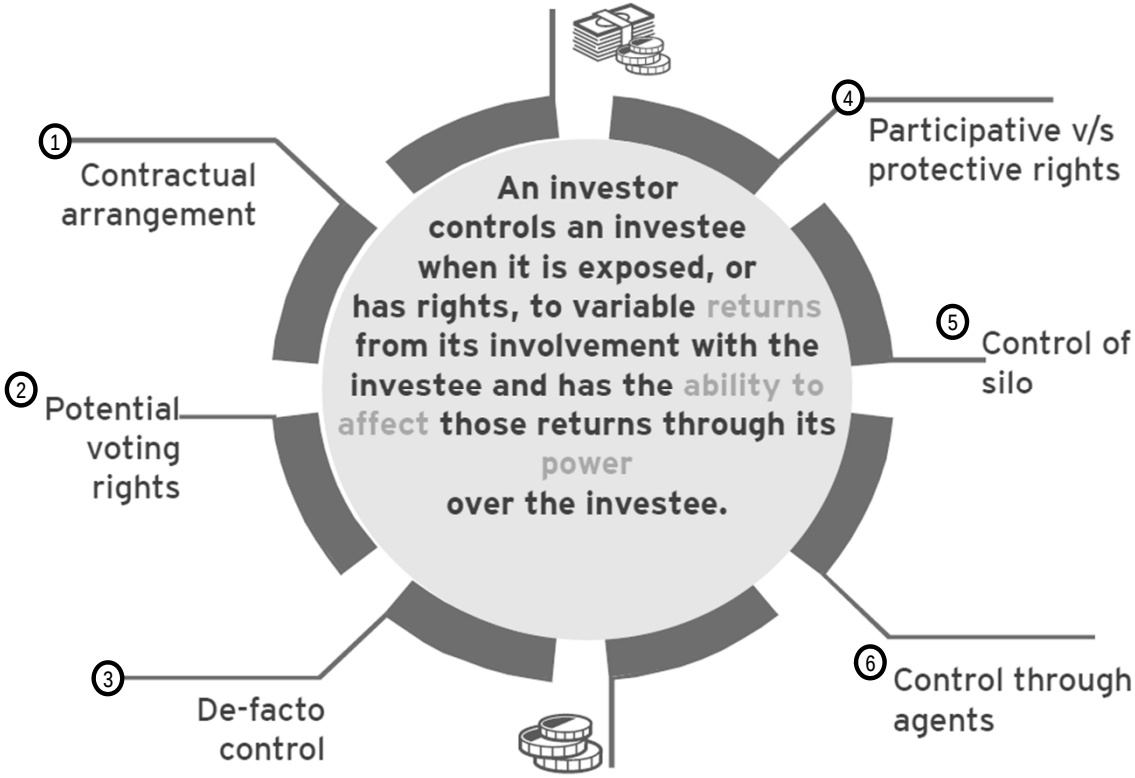
** *IFRS 3 is the equivalent standard under IFRS*

Factors to be considered for "Control" Analysis - Summary

Power	**Rights**	▪ Voting Rights (including potential voting rights) ▪ Contractual rights ▪ Depends on: (a) nature of activities, (b) legal structure *and* (c) manner in which decision are taken	▪ Majority rights at the board and shareholder level ▪ Consider all options to acquire shares ▪ De facto power and relative size of shareholding ▪ Contractual arrangements with other vote holders ▪ Special relationships with the investee
	Substantive	o Practical ability to exercise the rights o Current ability to direct relevant activities o Rights need not be exercised (a passive majority owner has "Power")	o Barriers to exercise voting rights o Potential rights are substantive, if ability to exercise exists, when decisions on relevant activities are made o Protective rights held by minority group of shareholders do not impede direction of relevant activities
	Relevant activities	▪ Activities that significantly affect the investee's returns ▪ How decisions over these activities are made ▪ Purchases / Sales, financing, investments, R&D etc.	▪ Activities that most significantly affect the returns ▪ Pre-determined activities (structured entities)
	Exposure to variable returns	▪ Vary in response to performance ▪ Can be positive, negative or both	▪ Broad definition ▪ Returns can be outside of the investee ▪ Can be a fixed return –variability introduced by default or credit risk
	Ability to affect return	▪ Affects returns through involvement (Power) ▪ Decision maker – Principal or, Agent?	▪ The greater the variability in the return for the decision maker, the more likely the decision maker is the principal

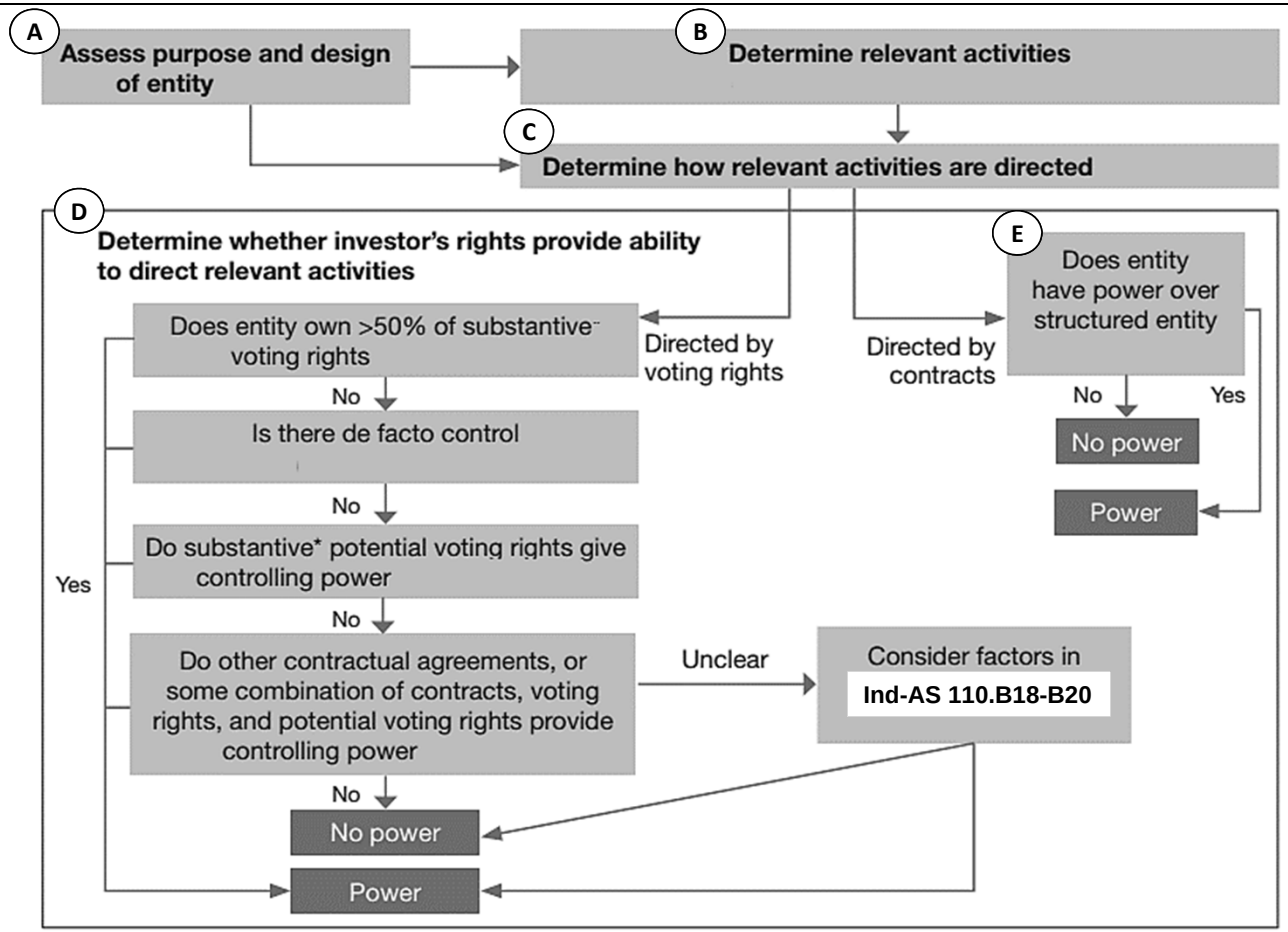
Crux of Ind-AS 110

Consolidation under Ind-AS 110 is substance driven and can be judgemental …….



Ind-AS 110

Evaluating "Power" - Flowchart

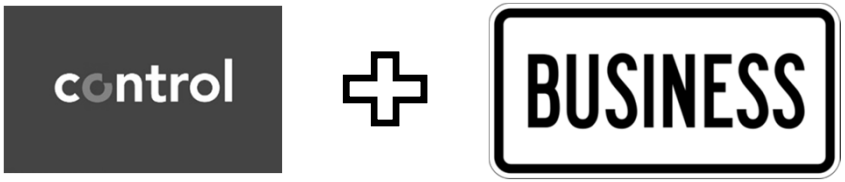


Business Combination

What is a Business Combination?

- ***A business combination is a transaction (or other event) in which:***
  - ***an entity ("acquirer")***
  - ***obtains "Control"*** *as defined under Ind-AS 110*
  - ***of one or more businesses ("acquiree")***

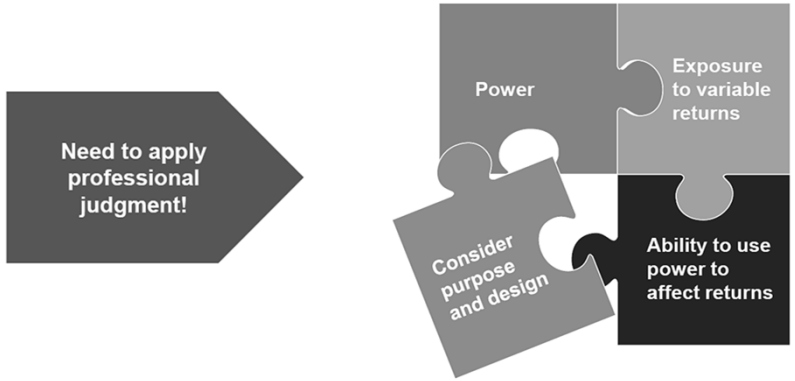
… so, how are control and business envisaged under Ind-AS 103?



Control – as contemplated under Ind-AS 110 (and under Ind-AS 103**)*

Under Ind-AS 110, an investor controls an investee when:

- ***the investor is exposed to variable returns from its involvement with the investee; <u>and</u>***
- ***has the ability to affect those returns;***
- ***through its power over the investee's (relevant activities)***



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* *IFRS 10 is the equivalent standard under IFRS*

** *IFRS 3 is the equivalent standard under IFRS*

Acquisition Method Accounting under Ind-AS 103 - *Overview*

Acquisition Method accounting views business combination from the perspective of an acquirer

Goodwill = ***Fair Value of Consideration transferred*** + ***NCI*** + ***Fair value of Previous Equity Interest ***** − ***Fair value of net identifiable assets***

***** For a business combination achieved in stages***

Steps involved in Acquisition Method Accounting

Acquisition Method accounting envisaged under Ind-AS 103 entails the following steps ....

Step 1	***Identify the acquirer***
Step 2	***Determine the acquisition date***
Step 3	***Identify and measure fair value of consideration transferred*** ***(including contingent consideration)***
Step 4	***Identify and measure identifiable net assets***
Step 5	***Measure Non-controlling Interest (NCI)***
Step 6	***Determine goodwill <u>or</u> gain on a bargain purchase***
Step 7	***Recognize any measurement period adjustments***

Key Takeaways
&
Recap

Revenue Recognition – *likely changes*

Key Impact Areas

- *Revenue recognition will witness certain high-impact changes*
- *Entities will move away from "transfer of risk and rewards" to "transfer of control"*
- *Timing of revenue recognition can significantly change for some industries*
- *Revenue contracts will need to be carefully drafted to avoid unintended negative impacts on the income statements*
- *Business development teams will have to work in tandem with the accounting and financial planning teams to ensure that there are no loose ends which could land their companies in judgmental territories*
- *Whether it is accounting for multiple element arrangements or identification of principal-agent relationships, both of which are likely to be a roller-coaster ride for companies*

Assess how your entity and industry is impacted by these changes

Financial Instruments – *likely changes*

Key Impact Areas

- *Accounting for financial instruments has undergone a comprehensive change*
- *Change in classification of the instruments as liability or, equity (e.g. Redeemable Preference Shares)*
- *Split accounting, required for compound (or, hybrid) financial instruments*
- *Fair valuation of financial instruments (including treatment of expenses on raising debt capital)*
- *Accounting for Fair Value changes in PNL (for instruments classified as FVTPL)*
- *Recording of interest and other transaction costs using Effective Interest Rate (EIR) method*
- *Impact:*
  - *May affect on Balance Sheet Ratios (like Debt/ Equity etc.)*
  - *May also affect operational performance measures like EPS*
  - *May trigger re-negotiation of debt covenants*
  - *May require companies to re-look at executive compensation plans*

Be cautious in drafting financing contracts – to avoid undesirable accounting implications

Consolidation – *likely changes*

Key Impact Areas

- *Definition of "Control" has undergone a paradigm shift*
- *Changes in "Control" definition makes evaluation of holding-subsidiary relationships more judgmental*
- *Substantive potential voting rights (currently exercisable), De Facto Control etc. play a significant role in determining who has control (and hence, who needs to consolidate)*
- *Companies will be required to assess (a) contractual rights, (b) de-facto control and (c) potential voting rights etc. before determining control*
- *Determining whether potential voting rights are substantive requires judgement*
- *Protective rights are not relevant for determining control*
- *Group structures are likely to include more entities (which were hitherto not consolidated)*
- *Companies will need to monitor:*
  - *Terms of loan availed (and, guarantees given) for financing of business*
  - *Existence of potential voting rights in the equity or, preference share instruments*

This monitoring will help determine whether or not such business needs to be consolidated

Business Combination – *likely changes*

Key Impact Areas

- *Accounting for business combination has become relatively more challenging*
- *Unlike present accounting practices (which involve use of "Book Values") – Ind-AS 103 mandates recognition of assets acquired and liabilities assumed @ "fair values on acquisition date"*
- *The Standard also requires to see through an acquisition transaction to identify hidden or unsaid elements therein which may further complicate accounting*
- *The acquirer can record assets – even if these were not recorded in the books of the target company*
- *Goodwill on acquisition is never amortized, but is only tested for impairment*

Fundamental changes to Business Combination Accounting

Q&A

Thank You