Grant Thornton

An instinct for growth™

COST ACCOUNTING & AUDITING IN IFRS & Ind-AS ARENA

Indian Accounting Standards

Discussion on transition

Gearing up to speak the new accounting language

Agenda

1. Introduction to Ind-AS
2. Employee benefits and share based payments
3. Property, Plant & Equipment (including Asset Retirement Obligations) & stripping costs
4. Inventory
5. Leases
6. Finance costs
7. Financial assets
8. Derivatives embedded in purchase contracts
9. Government grants
10. Business acquisitions
11. Foreign exchange transactions
12. Non-current assets held for sale

The bottom line…

Ind-AS is a framework of choices and management judgment…

an opportunity to tell your own story,

an obligation to disclose your narrative

Implementation roadmap

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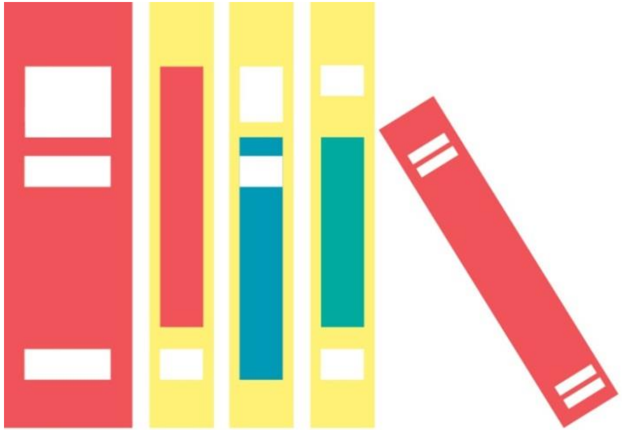
Net worth >= Rs. 500 crores (>= Rs. 5 bn.)	All listed companies + net worth > Rs. 250 cr (> Rs. 2.5 bn.) & < Rs. 500 cr (< Rs. 5 bn.)
• from March 31, 2017 • comparatives March 31, 2016 • opening balance sheet as of April 01, 2015	• from March 31, 2018 • comparatives March 31, 2017 • opening balance sheet as of April 01, 2016

Whenever any of the above criteria is met, Ind AS shall be applicable from immediately next year

Presentation of Ind AS financial statements



Financial statements – what's new?

- balance sheet
- statement of profit and loss – including other comprehensive income
- statement of changes in equity
- statement of cash flow
- notes
- comparative information

Complete set of financial statements

- balance sheet
- statement of profit and loss – including **other comprehensive income**
- statement of changes in equity
- statement of cash flow
- notes
- comparative information

Other comprehensive income (OCI)

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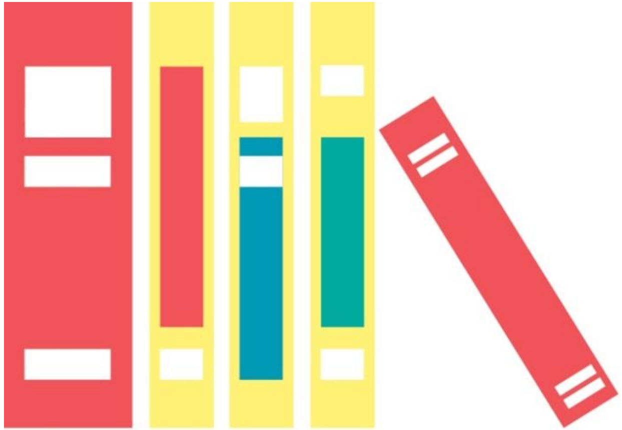
- Rule-based; no principles provided in Ind AS
- Specific list of 9 items given in Ind AS 1 which can/should be recognized in OCI
- To be segregated between:
  - Items that will not be reclassified to profit or loss:
    - ✓ Revaluation surplus
    - ✓ Re-measurements of defined benefit plans
  - Items that may be reclassified subsequently to profit or loss:
    - ✓ Exchange differences on translating foreign operations
    - ✓ Fair value changes in respect of financial assets classified as FVOCI

Employee benefits



Cost accounting standards: key concepts

- Employee cost includes payment made in cash or kind (CAS-7, para 4.7)
- Employee cost includes "benefits"; standard provides examples:
  - Free or subsidised food, housing, education, conveyance, any other facility
  - Employees' stock options
- Employee cost does not include imputed costs (CAS-7, para 5.5)

AS-15 (standard dealing with employee benefits under existing GAAP) and Ind AS 19 are largely similar – except with respect to gain or loss on re-measurement of defined benefit obligations

Imputed costs under Ind-AS

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- Interest free or concessional interest rate loans to employees
- Example:
  - A bank makes mortgage loans to its customers at market rate, which is currently 5%.
  - It also provides loans to its employees of up to Rs. 500,000 at a discounted rate of 2%.
  - The loans are for a 10 year period. The principal is repayable in equal annual instalments, along with interest due for the year.
  - The loans remain available if an employee leaves, but the interest rate reverts to the current market rate.
  - The entity estimates that employees on average remain in employment for 5 years from the date of advancing a loan.

Imputed costs under Ind-AS

Indian Accounting Standards
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- The terms of the arrangement provide a clear link between the interest benefit and future service
- The expected cash flows for a loan of CU500,000 are therefore:
  - 10 repayments of principal at CU50,000 per annum
  - 5 interest payments of the discounted rate of 2%
  - 5 interest payments at the market rate of 5%.
- These cash flows are discounted at 5% to estimate the loan's fair value. This is Rs. 447,413, which is Rs. 52,587 less than the loan amount.
- Interest benefit is amortised as employee cost over a period of 5 years

Example - Cash-settled SBP transactions

Employees & providers of similar services

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- Entity A grants 50 **cash share appreciation rights (SARs)** to each of its 100 employees, on condition to be in employment for the next 2 years
- during year 1, 10 employees leave. Entity A estimates that another 15 employees will leave during year 2
- during year 2, 5 employees leave. At the end of year 2:
  - all **SARs held by the remaining employees vest**
  - **50 employees exercise their SARs**
- **the remaining 35 employees exercise their SARs at the end of year 3.**
- set out below the year end fair value and the intrinsic value of the **SARs:**

Year	Fair value	Intrinsic value
1	INR 10	
2	INR 20	INR 18
3		INR 30

What is the employee cost for the years 1-3?

Example - Cash-settled SBP transactions

Employees & providers of similar services

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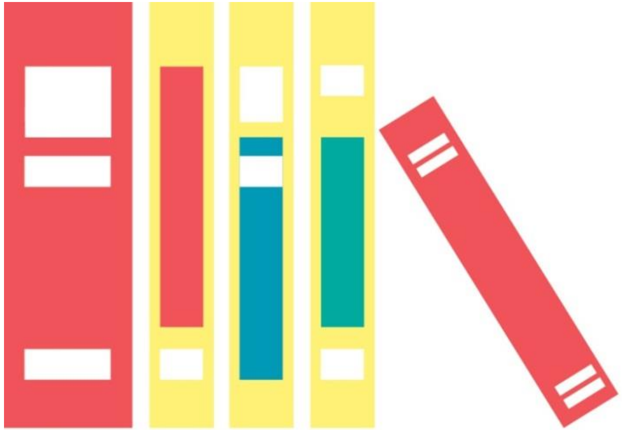
Year	Calculation of liability	Cumulative expense	Expense for period
1	75 employees*50 SARs*INR 10* 1/2years=	INR 18,750	INR 18,750
2	35 employees*50 SARs*INR 20=	INR 35,000	INR 16,250
3	0 employees	INR 0	(INR 35,000)

Year	Calculation of Cash	Cash	Expense for period
1	0 employees	INR 0	INR 0
2	50 employees*50SARs*INR 18=	INR 45,000	INR 45,000
3	35 employees*50SARs*INR 30=	INR 52,500	INR 52,500

Property, plant & equipment



Cost accounting standards: key concepts

Indian Accounting Standards
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- The impact of higher depreciation due to revaluation of assets shall not be assigned to cost object (CAS 16, para 5.8)
- The repair or overhaul of an asset which results in restoration of the asset to intended condition would also form part of repairs and maintenance activity (CAS 12, para 4.7)
- The cost of major overhaul shall be amortised on a rational basis (CAS 12, para 5.9)

Cost accounting standards: key concepts

- Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset (CAS 16, para 5.14)

- Cost of spares replaced which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost (CAS 12, para 5.7)

Key changes from existing Indian GAAP

Indian Accounting Standards
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Existing IGAAP	Ind-AS
• Cost of dismantlement, removal or restoration – no specific guidance	• Cost of dismantlement, removal or restoration – included in cost of PPE
• Cost of major inspections and overhauls are generally expensed when incurred, unless that increases the future benefits from the existing asset beyond its previously assessed standard of performance	• Cost of major inspections and overhauls are capitalised only when it is probable that it will give rise to future economic benefits
• Revaluation is permitted. No specific requirement on frequency of revaluation.	• Subsequent measurement of PPE may be based on the revaluation model, for a class of assets

Definition

Indian Accounting Standards
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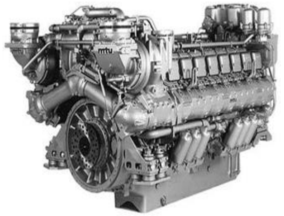
PP&E are:

- **tangible items** that held for:
  - **use in the production** or **supply** of **goods** or **services**
  - **rental to others**, or
  - **administrative purposes** and
- are **expected** to be used during more than **one period**

Items that could meet the definition of **PP&E:**

- spare parts
- standby and servicing equipment
- base stock (e.g. silverware and dishes in a restaurant)
- safety equipment.



Initial recognition – Elements of costs

Elements of **cost** Include:

- **purchase price less** trade discounts and rebates
- import duties
- **non refundable** purchase taxes
- initial estimates of **dismantle/ remove** item, including **site restoration**
- **borrowing costs**
- **directly attributable costs** to bring the asset to the location and condition necessary to operate.

Purchase price

(net of discounts)

Directly attributable costs

(operating in the manner intended by management)

Initial cost estimate of dismantling, removal, etc.

(legal and constructive obligation incurred as a result of acquisition/use)

Borrowing costs

(when borrowing funds to acquire or construct)

Initial recognition

Indian Accounting Standards
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Spare parts / servicing equipment

- usually carried as **inventory** and recognised in P&L as consumed
- **major spare parts** and **stand-by equipment** qualify as **PP&E** only when it is expected to be **used** during **more than one period**.
- can be used only in with an item of **PP&E**, they are accounted as **PP&E**

Major repair/overhaul

- expense is **capitalised**, if recognition criteria are met
- carrying amount of parts replaced is **derecognised** as per the derecognition provisions

Example:

- a furnace require relining after a specified number of hours of use
- aircraft interiors (seats and galleys) require replacement several times during the life of aircraft

Initial recognition: Deferred payment

The cost of an item of PP&E is the ***cash equivalent price.***

If payment is deferred **beyond** normal credit terms, the difference between:

- the cash price and
- the total payment

is recognised as **interest expense** over the **period of credit** unless **capitalised** under Ind AS 23 *Borrowing Costs*.

Subsequent costs

Indian Accounting Standards
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Subsequent costs are **capitalised** to **PP&E** if future economic benefits are **probable**.
Examples:

Type of cost	Expense	Capitalise
Day to day servicing, including small parts	✓	
Major inspection*		✓
Cost of relocating an asset already in use	✓	
Major modification that enhances the asset's output		✓
Expenditure on safety or environmental equipment		✓
Major replacement parts*		✓

**replaced part or cost of previous major inspection must be derecognised*

Subsequent measurement

Indian Accounting Standards
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After **initial recognition** entities may choose either:

COST MODEL
OR
REVALUATION MODEL

as their **accounting policy** and apply that **policy** to an entire **class of PP&E**.

A **class of PP&E** is a **grouping** of assets of **similar nature** and **use** in an entity's operations.

Subsequent measurement

Indian Accounting Standards
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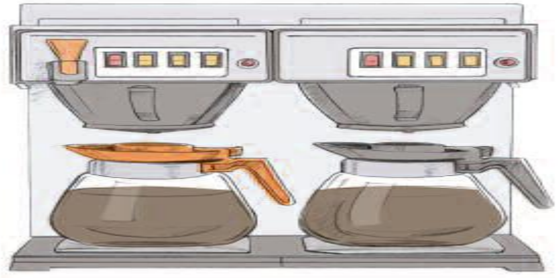
Cost model

Measure at:
- cost
- less depreciation
- less impairment

OR



Revaluation model **permitted** only **if** the **fair value** can be measured **reliably**

Revaluation model

Measure at:
- fair value at date of revaluation
- less depreciation
- less impairment

Initial recognition: Asset retirement obligation (ARO) / Dismantling cost

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In case of legal or constructive obligation for dismantling and removing the item and restoring the site

- **Initial estimate** of cost to be incurred in future in fulfilling the obligations is capitalised.
- **Present value** of future cash outflows of the cost is discounted at prevailing market rate of interest and **capitalised**.

Example:

On purchase of machine there is a legal obligation to restore the site for prevention of environmental damage

- Initial estimate of outflow at the end of 5th year is Rs. 500,000
- Discount rate - 10% p.a.

Answer:

- Amount to be capitalised – Rs. 310,461 (PV of Rs. 5,00,000 at 10% p.a.)
- Subsequently, provision needs to be compounded @10% as shown below:

Year	Provision	Compounded @ 10%	Annual interest charge	Closing Balance
1	310,461	310,461 * 10%	31,046	341,507
2	341,507	341,507 * 10%	34,151	375,657
3	375,657	375,657 * 10%	37,565	413,223
4	413,223	413,223 * 10%	41,322	454,545
5	454,545	454,545 * 10%	45,454	500,000

Optional exemptions upon transition to Ind AS

Indian Accounting Standards
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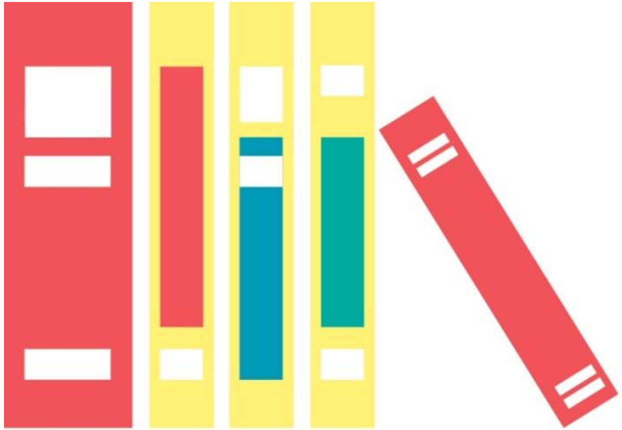
Exemption	Impact
Fair value as deemed cost for property, plant and equipment (PP&E), investment property and intangible assets	An entity can choose to measure PP&E at the transition date, as per: • **fair value** at the date of transition as deemed cost. • a **revaluation** carried out at a previous date (like a IPO) less accumulated depreciation till the date of transition as deemed cost, subject to certain conditions. • **carrying value** as on the date of transition The exemption can also be applied to intangible assets that meet the criteria for recognition and revaluation as per Ind AS 38 and to investment properties meeting the criteria for Ind AS 40
Changes in existing decommissioning, restoration (AROs), and similar liabilities included in the cost of property, plant and Equipment	For AROs, first-time adopter may elect to: • measure the liability at transition date in accordance with Ind AS 37. • estimate the amount of the liability that would have been included in the cost of the related asset when the liability first arose. • calculate the accumulated depreciation on that discounted amount, as of the date of transition to Ind AS.

Stripping costs



Cost accounting standards: key concepts

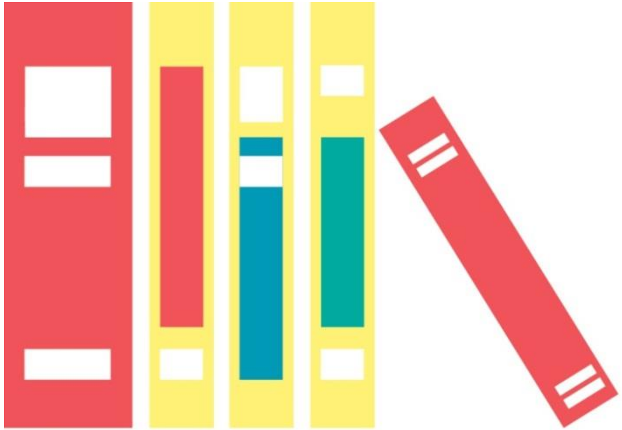
- The overburden removal cost attributable to a **development phase** of a mine area shall be **capitalised** as non-current asset when it is probable that future economic benefits to the area will flow to the entity and such cost can be identified and measured separately (CAS 23, para 5.4)
- The overburden removal cost attributable to **developed area** of mine shall be **charged to production of ore** at the Standard stripping ratio (CAS 23, para 5.5)
- The cost of advance stripping activity whose economic benefit is likely to flow to the entity during the subsequent period, shall be capitalised and amortised (CAS 23, para 5.5)
- If the removal of ore is more than the Standard stripping ratio, then the cost of short removal overburden shall be charged to the cost of production either by creating the reserve or by adjusting the earlier capitalized overburden removal cost (CAS 23, para 5.5)

Appendix B to Ind-AS 16

- **Development phase** of mine: stripping cost capitalized as PP&E or intangible asset; amortised using units of production method
- Benefit of stripping activity is in form of **inventory produced**: cost of stripping activity accounted for as inventory
- Benefit of stripping activity is in form of **improved access to ore**: cost of stripping activity accounted for as non-current asset (if certain criteria are met)
- Costs of stripping activity asset and the inventory produced are **not separately identifiable**: allocate production stripping costs between inventory and stripping activity asset by using a relevant production measure (example, volume of waste extracted compared with expected volume, for a given volume of ore production)

Concept is largely similar to CAS-23

Purchase of Inventory



Ind AS 1 - Measurement concepts

Indian Accounting Standards
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Cost

All costs of conversion and other costs incurred in bringing the inventories to their present location & condition

- Purchase price, import duties & other taxes
- Transport, handling etc
- Allocation of fixed & variable production overheads
- Less trade discounts, rebates etc

Net realisable value

Estimated selling price less estimated costs of completion & estimated selling costs

- Damaged goods
- Obsolete goods
- Declining selling prices

Measurement: Difference from IGAAP

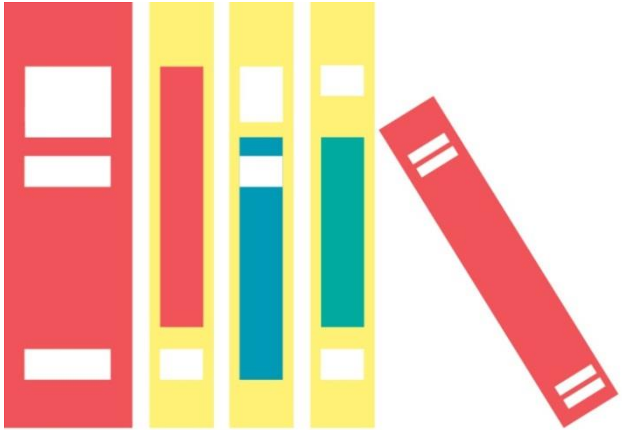
Extended Credit Period

Difference between the purchase price for normal credit terms and the amount paid for purchase in case of extended credit period, is recognised as interest expense over the period of the financing.

Examples:

- Payment of consideration as per terms of the contract after 12 months
- Early settlement discounts

Leases as lessee (including land leases)



Key changes from existing Indian GAAP

Indian Accounting Standards
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Existing IGAAP

- Leases of land are out of scope from the lease accounting standard
- Contracts which are not legally leases are not analysed as leases

Ind-AS

- Leases of land are within scope of the lease accounting and need to be classified as operating or finance

  Leases with both land and building components are split and component leases are evaluated separately
- Arrangements which are not legally structured as a lease may contain a lease, which needs to be accounted for separately

Definition and classification of lease (Ind AS 17)

Indian Accounting Standards
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A **lease** is an agreement whereby the lessor **conveys** to the lessee:

1. the **right to use** an asset for an **agreed period of time**
2. in return for a **payment** or **series of payments**.

Classification

Finance lease

A lease that transfers **substantially all** the **risks and rewards** incidental to ownership of an asset. Title may or may not eventually be transferred.

Operating lease

A lease **other** than a **finance lease.**

Lease classification is made at the **inception of the lease**.
The classification should only be re-considered if the provisions of the lease are changed.

Classification indicators (Ind AS 17)

• transfers ownership at the end of the lease term • bargain purchase option • lease term for major part of economic life of asset • at inception the present value of **minimum lease payments** amounts to **at least substantially all** the **fair value** of leased asset • specialised assets that only the lessee can use without major modification	Would normally lead to a lease being classified as a **finance lease**
• losses on cancellation borne by lessee • gains or losses upon fluctuation in residual value fall to lessee • secondary period at rent substantially less than market rent	Other factors to consider – may also lease to a lease classified as 'finance lease'

The standard takes a more principles-based **substance over form** approach. Classification of a lease depends on the substance of the transaction rather than the form of the contract.

Lease of land and building (Ind AS 17)

- when a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease **separately**

In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life

- split the minimum lease payments using relative fair values of **leasehold** interests at the inception of the lease (land element and building element)

if can't split **reliably**, assume the entire lease is a **finance lease** unless it is clear that both elements are **operating**, in which case the entire lease is classified as an **operating lease**.

Determining whether an Arrangement contains a Lease (Appendix C)

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Scope	An entity may enter into an arrangement, comprising a transaction or a series of related transactions, that: • does **not** take the **legal form of a lease** but • conveys **a right to use** an asset **in return for a payment or series of payments.**
Examples	• outsourcing arrangements • take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services
Core principle	Determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires assessment of whether: **(a)** **fulfilment of the arrangement** is dependent on the use of a specific asset or assets [Criteria I] **and** (b) the arrangement **conveys a right to use** the asset [Criteria II].

Determining whether an Arrangement contains a Lease (Appendix C)

Indian Accounting Standards
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Core principle	Criteria II: An arrangement does not convey the right to use an asset unless the purchaser has the **right to control** the use of the underlying item, which depends on **any one** of the **following conditions** being met: (i) Purchaser has the ability or right to – - **operate** or direct others to operate the asset in manner it determines;& - Obtains or controls more than an insignificant amount of the output. (ii) Purchaser has the ability or right to – - **Control physical access** to the underlying asset;& - Obtains or controls more than an insignificant amount of the output. (iii) Facts and circumstances indicate that – - Remote possibility of parties other than purchaser procuring more than an insignificant amount of the output; & - **Price** to be paid by purchaser for the output is neither contractually fixed nor equal to the current market price per unit of output as of the time of delivery.

Determining whether an Arrangement contains a Lease (Appendix C)

Indian Accounting Standards
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Core principle	Criteria I: Fulfillment of the arrangement depends on a specific asset or assets.

Factors	Assessment
• A specific asset explicitly identified by the arrangement, if arrangement is not dependent on the asset.	No lease
• If the seller is required under the arrangement to deliver a specified quantity of goods or services and has the right or ability to provide those goods using other assets not specified in the agreement	No lease
• if a specific asset is not explicitly identified but it would not be economically feasible or practical for the supplier to provide the use of alternative items. For example, the supplier may only own one suitable asset.	Indicator of lease

Determining whether an Arrangement contains a Lease (Appendix C)

Assessment	**Assessment** of whether an arrangement contains a lease shall be made at the **inception of the arrangement**, unless there is a change in the provisions of the arrangement.
Accounting under Appendix C	At inception of arrangement/reassessment of the arrangement - • **separate** payments and other consideration on basis of **relative fair values** into: - those for lease and - those for other elements • Whether lease is finance lease or operating lease shall be determined based on classification guidance in Ind AS 17. • account for **other** payments in accordance with other **relevant standards** • **If impracticable** to separate payments for all elements- - Finance lease – recognize asset & liability at fair value of underlying asset that was subject of lease - Operating lease – treat entire payment as lease payment

Examples of changes under Ind AS

Indian Accounting Standards
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Third party power plants accounted for a finance lease i.e. own assets

- Arrangement to buy power at a fixed + variable + margin based rate
- Contract to purchase entire power of the plant for a period for 35 years

Current accounting

- Entire amount paid for purchase of power is booked in profit and loss as power cost

Under Ind AS

- The power plant shall be capitalised as a finance lease asset and will be depreciated
- Since no money was paid upfront, the lease payable shall be booked and accrue an interest

P&L effect

- **IGAAP**: Power cost
- **Ind AS**: Depreciation + Interest cost

Examples of changes under Ind AS

Indian Accounting Standards
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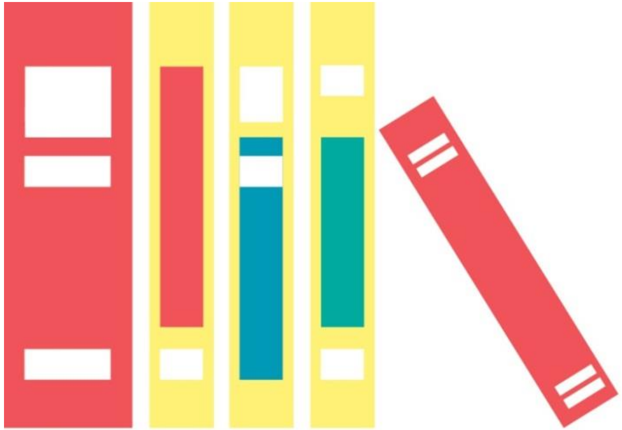
- Subcontractor's equipment and plants being accounted for as owned assets
- Recurring lease rentals of lease of land classified as a finance lease, accounted for as a liability which shall accrue interest cost

Financial Instruments



Cost accounting standards: key concepts

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- Interest and Financing Charges shall not include imputed costs i.e. Hypothetical or notional costs, not involving cash outlay, computed for any purpose (CAS 17, para 5.3 and 4.3)
- Interest and Financing Charges directly attributable to the acquisition /construction/production of a qualifying asset shall be included in the cost of the asset (CAS 17, para 5.2)

Though the presentation of borrowing costs as either a cost of asset or as an expense is consistent with Ind-AS, the scope thereof is much wider in Ind-AS.

Equity and liability classification

Financial instrument is an equity instrument only if both criteria are met:

- There is no obligation to deliver cash or another financial asset or to exchange financial assets or financial liability; and
- The issuer will exchange fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Does the entity have an unavoidable contractual obligation?

Yes → **Liability**

No → **Equity**

In case of financial liabilities, related finance costs are capitalized as specific or general borrowing costs along with the cost of underlying asset(s)

Example 1 – liability vs. equity

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- Target Ltd. issues redeemable preference shares that carry 9% cumulative dividend to Holding Ltd.
- Option with Holding Ltd. ('investor') to convert the instrument into fixed number of equity shares
- If conversion option is not exercised, entire instrument shall be redeemed at the end of 10 years.

Accounting under existing IGAAP

Depending on the type of instrument -

- Preference shares issued - classified as 'share capital' and part of Equity
- Dividend is an 'appropriation', not a 'charge' to the P&L
- Debentures or other loan instrument issued - classified as 'borrowings'

Example 1 – liability vs. equity

Indian Accounting Standards
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Accounting under Ind AS

- Instrument with features of both liability and equity -
  - (i) Liability - represented by cumulative dividend liability and mandatory redemption
  - (ii) Equity - represented by option to convert into fixed number of equity shares
- Dividend is a 'charge' to the P&L – affects profits
- Such instrument shall be accounted as 'compound instruments'; split - liability and equity.

Example 2 – liability vs. equity

- Target Ltd. issues compulsorily convertible preference shares ('CCPS') that carry non-cumulative 9% dividend and shall be convertible after a period of 9 years from date of issue
- Further, investor has an exit clause through a Put Option exercisable as follows –
    - When Company completes an IPO on or before 9 years – CCPS shall be converted into fixed equity
    - If IPO is not completed in such defined period – Holding Ltd. has an option to put CCPS back to the Target Ltd.'s parent entity at their fair value

Accounting under existing IGAAP

- CCPS issued shall be classified under 'share capital' and hence, part of Equity
- No impact in Target Ltd's financial statements of the put option given to the Investor

Example 2 – liability vs. equity

Indian Accounting Standards
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Accounting under Ind AS

- Accounting of the instrument shall factor in –
  - What obligations arise at the level the financial statements are prepared; and
  - Whether such instrument is akin to an equity instrument or an obligation to deliver cash
- In Target Ltd's financial statements – CCPS with mandatory conversion and no fixed dividend rights represents an equity instrument
- In consolidated financial statements – Such obligation shall be classified as financial liability measured at fair value at every reporting date.

The concept of amortised cost – financial liabilities

Indian Accounting Standards
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Amortised cost	=	Amount initially recognised	-	Principal repayments	+/-	cumulative amortisation using EIR

Effective interest rate is the rate that exactly discounts the expected stream of future cash payments through maturity to the net carrying amount at initial recognition.

No option to use straight line method

Applying effective interest rate (EIR) in practice – fixed interest rate

- On 1 January 2017, entity A took a loan of Rs. 1,000,0000 for 5 years at 10% coupon rate
- Entity A paid Rs 25,000 non-refundable loan fees to the lender

Microsoft Excel Worksheet

Applying effective interest rate (EIR) in practice – variable interest rate

- On 1 January 2017, entity A took a loan of Rs. 1,000,0000 for 5 years at MCLR + 1% which works out to 10% p.a.

- Entity A paid Rs 25,000 non-refundable loan fees to the lender

Microsoft Excel Worksheet

- No guidance in the standard as to how transaction costs incurred towards a floating rate loan should be amortised

- Appropriate to amortise such costs by reference to the interest rate at inception ignoring any subsequent changes in rates or to simply adopt a straight-line amortisation method

Categories of financial assets – based on subsequent measurement

Indian Accounting Standards
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Gearing up to speak the new accounting language

1
Amortised cost

2
Fair Value

2A
Fair value through OCI

2B
Fair value through P&L

Example – amortised cost

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Date of Security Deposit (Starting Date)	**1-Apr-12**
Date of Security Deposit (Finishing Date)	31-Mar-17
Description	Lease
Total Lease Period (Years)	5
Discount rate	12.00%
Present value annuity factor	0.56743
Security deposit (A)	1,000,000
Present value of deposit at beginning (B)	567,427
Prepaid lease payment at beginning (A-B)	432,573

Example – amortised cost

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- **Initial Recognition:**

Security Deposit (Dr)	**567,427**
Prepaid lease Payment (Dr)	432,573
To Bank (Cr)	(1,000,000)

- **Subsequent Recognition:**

Security Deposit (Dr)	**68,091**
To Interest Income (Cr)	(68,091)
(For recognition of interest on unwinding of present value	
Lease Expense (Dr)	86,515
To Prepaid Lease Payment (Cr)	(86,515)

Period	Opening	Interest Income	Cashflow	Closing Balance	Prepaid amortization
31-Mar-13	567,427	68,091	-	635,518	86,515
31-Mar-14	635,518	76,262	-	711,780	86,515
31-Mar-15	711,780	85,414	-	797,194	86,515
31-Mar-16	797,194	95,663	-	892,857	86,515
31-Mar-17	892,857	107,143	1,000,000	-	86,515

Circumstances in which FV measurement of financial assets/liabilities affects cost

1. Concessional rate loans (for example, to employees)

   Interest benefit (for example, to employee) is considered as cost (example, employee cost)

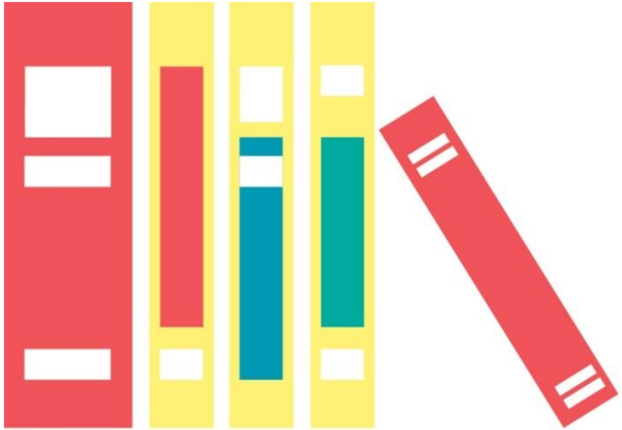
2. Interest free security deposits

   Interest benefit to lessor is considered as rental cost

3. Purchases made on deferred payment basis – inventory or capital assets

   Interest benefit of purchaser is netted off from cost of inventory or capital assets

Embedded derivatives in purchase contracts



Definition of a derivative

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'underlying'

- value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable
- exception for a non-financial variable that the variable is not specific to a party to the contract

initial net investment

- requires:
  - no initial net investment; or
  - initial net investment smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors

future Settlement

- settled at a future date

Underlying – examples

- An interest rate (e.g. LIBOR)
- A security price (e.g. the price of share of XYZ entity equity share listed on a regular market)
- A commodity price (e.g. price of a bushel of wheat)
- A foreign exchange rate (e.g. EURO/ USD spot rate)
- An index (e.g. a retail price index)
- Other variables (e.g. sales volume indices specifically created for settlement of derivatives)

Embedded derivatives – where can they arise?

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Host	+	Embedded derivative	=	Hybrid instrument

- Contracts may not meet the definition of a derivative on standalone basis, but may have features of both financial instruments as well as embedded derivatives.
- An embedded derivative is a component of a hybrid financial instrument that includes both
  - a derivative and
  - a host contract
- For example – Convertible bond
  - Host contract The bond
  - Embedded derivative Call option on shares
- Effect of embedded derivatives
  - Some of the cash flows of the combined instrument vary in a similar way to a stand-alone derivative.

Evaluation of embedded derivatives – scope

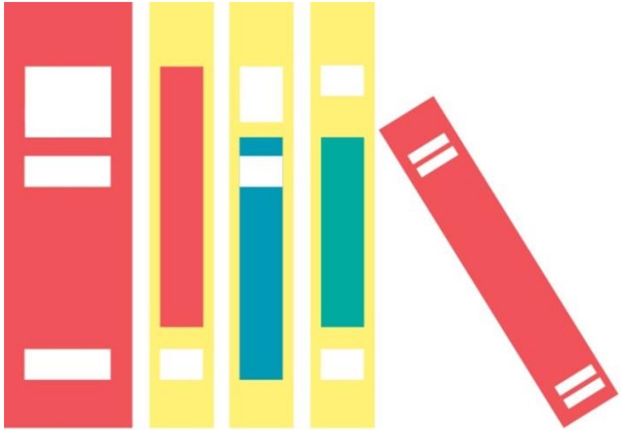
- Ind AS 109 eliminates requirement to separate embedded derivatives within hybrid contracts where **host contract is an asset** within the scope of Ind AS 109
  - such contracts will be likely to fail Ind AS 109's cash flow characteristics test and hence shall be subsequently measured at fair value through profit or loss
- entities must still consider the need to separate embedded derivatives where host contract is a financial liability or an asset outside the scope of Ind AS 109

Examples of changes under Ind AS

- **Eg. 1:** Entities dealing in currencies other than either party's functional currency
  - Company A is operational in Germany
  - Company B is operational in India
  - Company A enters into a contract with Company B, where the price is fixed in USD
  - The contract requires Company A to deliver 100 USD worth of goods to Company B, after 3 months
  - Date of contract, 1 USD = 50 INR, 3 month forward 1 USD = 55 INR
  - Date of receipt, 1 USD = 53 INR

- **Eg. 2:** Purchase of material hedged using an embedded derivative, e.g. delivery of goods taken though price to be determined in future

Government grants



Presentation of Grants

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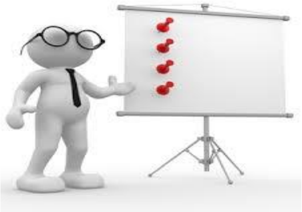
- **Grants relating to Assets**

  Government grants related to assets, including non-monetary grants at **fair value**, shall be presented in the **balance sheet** by setting up the grant **as deferred income** (recognised in profit and loss over the useful life of the asset)

- **Grants relating to Income**

  Grants related to income are presented as part of profit or loss, either separately or under a general heading such as **‘Other income’;** alternatively, can be deducted in **reporting the related expense**



Practical Problems

Q: **An entity received a government grant for the purchase of machinery to produce inventories for sale in ordinary course of business. Depreciation is reflected in the cost of inventories. How should an entity recognize the amortization of the deferred income related to the government grant received ?**

A: **The preferred treatment is to account for the amortization of deferred income in the same manner as the depreciation of the related machinery.** The amortization of deferred income should be included in the **production overheads & reflected in the cost of inventories.**

It may also be acceptable to recognize the amortization of the grant directly in P&L, provided the same is recognised in P&L in the same period as the cost of inventories that includes the depreciation of machinery.

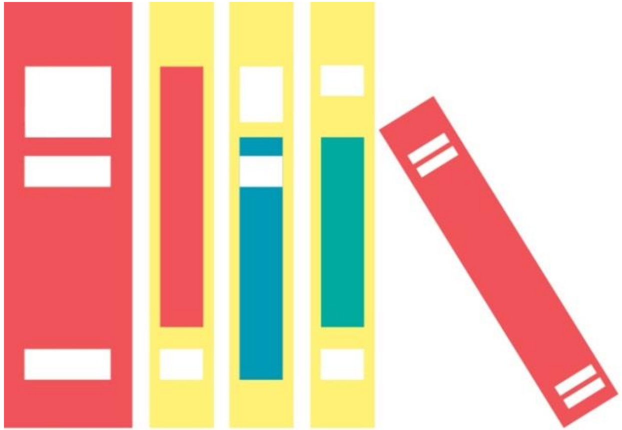
Other form of grants

The benefit of a government loan at **a below market rate** is treated as a government grant and recognized as per **Ind AS 109**, Financial Instruments

Grants related to **non-depreciable assets**, requiring fulfilment of certain obligations would be recognised in profit or loss **over the periods** that bear the cost of meeting the obligations.

A government grant as **compensation for expenses** or losses or for providing immediate financial support with no future related costs, would be recognised in the period in which it becomes **receivable.**

Business acquisitions



Definition - Business

Business
An integrated set of activities and assets capable of being conducted and managed for the purpose of providing a return in form of dividends, lower costs or other economic benefits directly to investors, other owners, members, or participants

- **outputs are not required** for an integrated set to qualify as a business
- it is **not relevant** whether the **seller previously operated the set as a**
- **business** or **whether the acquirer intends to operate as a business**
- a set **can be considered** a business when it does not contain all the assets and activities that the seller used in operating that business, **so long as market participants are capable of acquiring or otherwise providing the missing elements**.

Business combination v/s Asset purchase

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Topic	Business combination	Asset acquisition
Accounting	Accounted for using the acquisition method	Recognise assets and liabilities by allocating the cost on the basis of their relative fair values
Goodwill	Gives rise to goodwill or a gain on bargain purchase	Does not give rise to goodwill
Transaction costs	Expensed when incurred	Typically capitalised
Deferred tax on initial temporary differences	Recognised as assets and liabilities	Not recognised unless specific circumstances apply
Contingent consideration	Recognised and measured at FV on the acquisition date	No specific guidance in Ind AS

Recognition and measurement

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Measurement

Assets acquired and liabilities assumed are **recognised** at fair value if:

- **meet the definition** of an asset or liability at the acquisition date
- are **part of exchange** in the business combination

Classification

The **acquirer classifies and designates** assets and liabilities at **acquisition date** based on:

- acquirer's economic conditions
- contractual terms of the assets/liabilities
- acquirer's operating or accounting policies

Acquirer's classification/designations may differ from those of the acquiree

Exception to the classification

Leases are classified based on contractual terms and other factors as determined at the inception of lease contract and not on the acquisition date

Recognition : Exceptions

Contingent liabilities

Ind AS 37

- a **contingent liability** is…a **present obligation** that arises from past events but is **not recognised** because: (i) it is **not probable**…or (ii) the **amount** of the obligation **cannot be measured** with sufficient **reliability**

Ind AS 103

- recognised only if a **present obligation** exists **and fair value can be measured reliably**
- recognised **even if** an outflow of economic benefits is **not probable** (uncertainty is considered in the determination of fair value)

Recognition and measurement
Intangible assets

Is the asset identifiable?

does the asset meet the **contractual-legal criterion**

does the asset meet the **separability** criterion

Yes

Yes

is the entity **prohibited** from transferring/exchanging the information

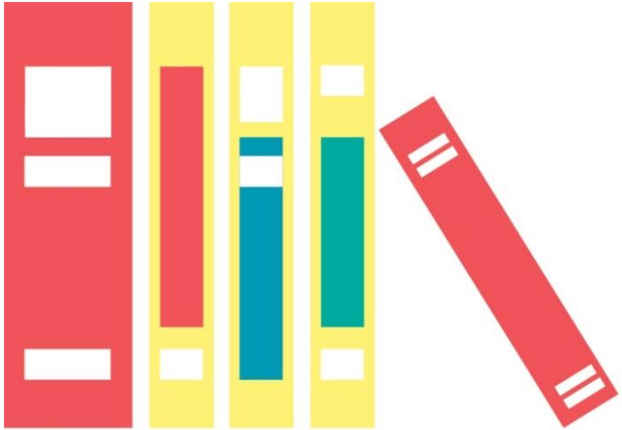
No

recognise, separately from goodwill, the **identifiable intangible assets** acquired

Examples of changes under Ind AS

- Revised cost basis due to fair valuation of all assets and liabilities
- Different cost basis in standalone and consolidated books

Foreign currency transactions



Effects of foreign currency

Determining the functional currency

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Functional currency is the currency of the **primary economic environment** in which the entity operates

The **primary economic environment** is normally the environment in which the entity primarily **generates and expends cash**

Primary indicators

The **currency** that mainly **influences**:
- sales prices
- labour, material and other costs of providing goods or services

Secondary indicators

The **currency** in which:
- funds from financing activities are generated (debt and equity)
- receipts from operating activities are usually retained

Effects of foreign currency

Foreign currency transactions: Initial recognition

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spot exchange rate
- the exchange rate for immediate delivery

all foreign currency transactions

- the amount is measured in the foreign currency in accordance with the relevant Standard
- the foreign currency transaction is translated into the functional currency
- apply the **spot exchange** rate between the functional currency and foreign currency **at the date of the transaction**

An average exchange rate for a specific period may be a suitable approximate rate for transactions during that period, particularly if exchange rates do not fluctuate significantly.

Effects of foreign currency

Foreign currency transactions: subsequent measurement

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Monetary items are:

1. **units** of **currency** held
2. **assets** to be received in a **fixed or determinable number of units of currency** and
3. **liabilities** to be paid in a **fixed or determinable number of units of currency.**

Item	Monetary	Non-monetary
Employee benefits to be paid in cash	✓	
Prepaid expenses		✓
Provisions to be settled in cash	✓	
Inventory		✓
Intangible assets		✓

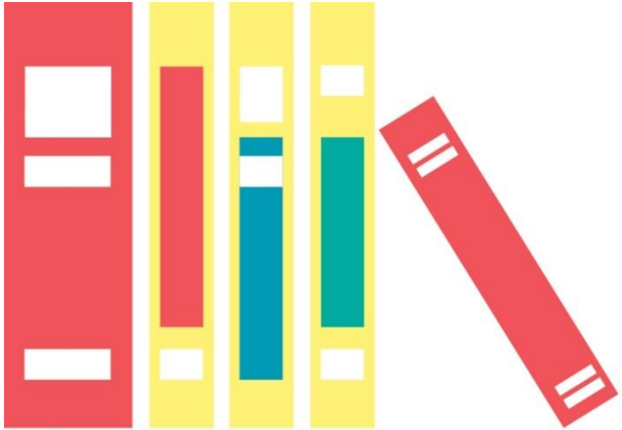
Effects of foreign currency

Long Term Foreign Currency Monetary Items

A company may continue the policy adopted for accounting for exchange differences

- arising from translation of long-term foreign currency monetary items
- recognised for the period ending immediately before the beginning of the first Ind AS period

Asset retired from active use



Navigating the standard

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Core principle	
	• asset/disposal group **held for sale** to be measured at the **lower** of **carrying amount** and **fair value less costs to sell** • **assets** that meet the criteria of **held for sale** to be presented **separately** in the statement of financial position • the results of **discontinued operations** to be **presented separately** in the statement of comprehensive income

Non-current asset & disposal group

Classification as held for sale / held for distribution

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An entity should classify a **non-current asset** or a **disposal group** as **held for sale** if its **carrying amount** will be **recovered principally** through a **sale transaction** rather than through **continuing use.**

A non-current asset or disposal group is classified as **held for distribution to owners** when the entity is **committed to distribute the asset/disposal group** to the **owners**.

Non-current assets or disposal groups held for sale

Classification criteria:

1. available for **immediate sale**
2. in its present condition
3. subject only to terms that are **usual** and **customary** for sales of such assets and
4. its sale must be **highly probable.**

Non-current assets or disposal groups held for distribution to owners

Classification criteria:

1. available for **immediate distribution**
2. in their **present condition**
3. the distribution must be **highly probable.**

Non-current asset & disposal group

Classification as held for sale / held for distribution

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what is highly probable?

Non-current assets or disposal groups held for sale	Non-current assets or disposal groups held for distribution to owners
• the appropriate **level of management committed** to a plan to sell • **active programme** to locate a buyer and complete the plan • **actively marketed** at **a reasonable price** compared to its **fair value** • the sale is expected within **one year** from the date of classification **(some exceptions)** • it is **unlikely** that the **plan** will be **withdrawn** or **significantly changed**	• actions to complete the distribution must have been **initiated** • the distribution is expected within **one year** from the date of classification • it is **unlikely** that the distribution will be **withdrawn** or **significantly changed**

Examples of changes under Ind AS

- Depreciation of assets retired from active use, though not qualifying for held for sale

About the presenters

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- Siddharth has about 15 years of experience in providing audit and advisory services to clients. He trained and has previously worked with one of the international accounting firms in their Assurance practice in India including a short stint at their London office.
- During the course of his career, Siddharth has worked with a number of Indian and multinational companies on various engagements involving assurance and accounting advisory services in IFRS and Indian GAAP.
- Siddharth has been a member of GT India's Professional Practices Group and has played an active role in internal consultations on accounting principles.
- He has also been a part of the quality control team of GT India and played a lead role in technical trainings at regional level within GT India.
- His experience includes Ind-AS advisory services to corporates in private and public sector, including, DLF, SAIL, MTNL, Rural Electrification Corporation, Indiabulls, Dish TV, PC Jeweller, Max Healthcare and Escorts. International GAAP advisory services to clients such as Air Works, Amtek International, Cinepolis, GMR, HPCL-Mittal, Samvardhana Motherson and Mubadala.
- Siddharth has led audits of several Indian and multinational companies in various sectors including, inter alia, Media & Entertainment, Real Estate and Financial Services. His clients have included, inter alia, Network 18 Group, DLF Group, GE Capital, GE Money, Citi Financial, ABN AMRO Bank, Standard Bank London and Northern Trust Bank London.

About the presenters

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- Samir is a Member of the Institute of Chartered Accountants of India (ICAI)
- Samir has over 11 years of experience in servicing large national and multinational clients in the areas of Assurance, Indian GAAP, US GAAP and IFRS technical accounting advisory, specifically in the areas of financial instruments, leases, consolidation and business combinations.
- Before becoming a part of the FRAS team Samir worked with another large global accounting firm's US based Accounting Advisory team on multiple IFRS and USGAAP advisory engagements.
- Samir has worked with many industries including, manufacturing, financial services, pharmaceutical, IT/ ITES and energy.
- Samir has lead and assisted with multiple GAAP conversion engagements, including Indian GAAP to Ind AS, Indian GAAP to IFRS, Indian GAAP to USGAAP, German GAAP and Japanese GAAP to IFRS and Indian GAAP.
- Samir also has significant experience with streamlining the financial reporting processes, spanning multiple units/ entities/ GAAPs.

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