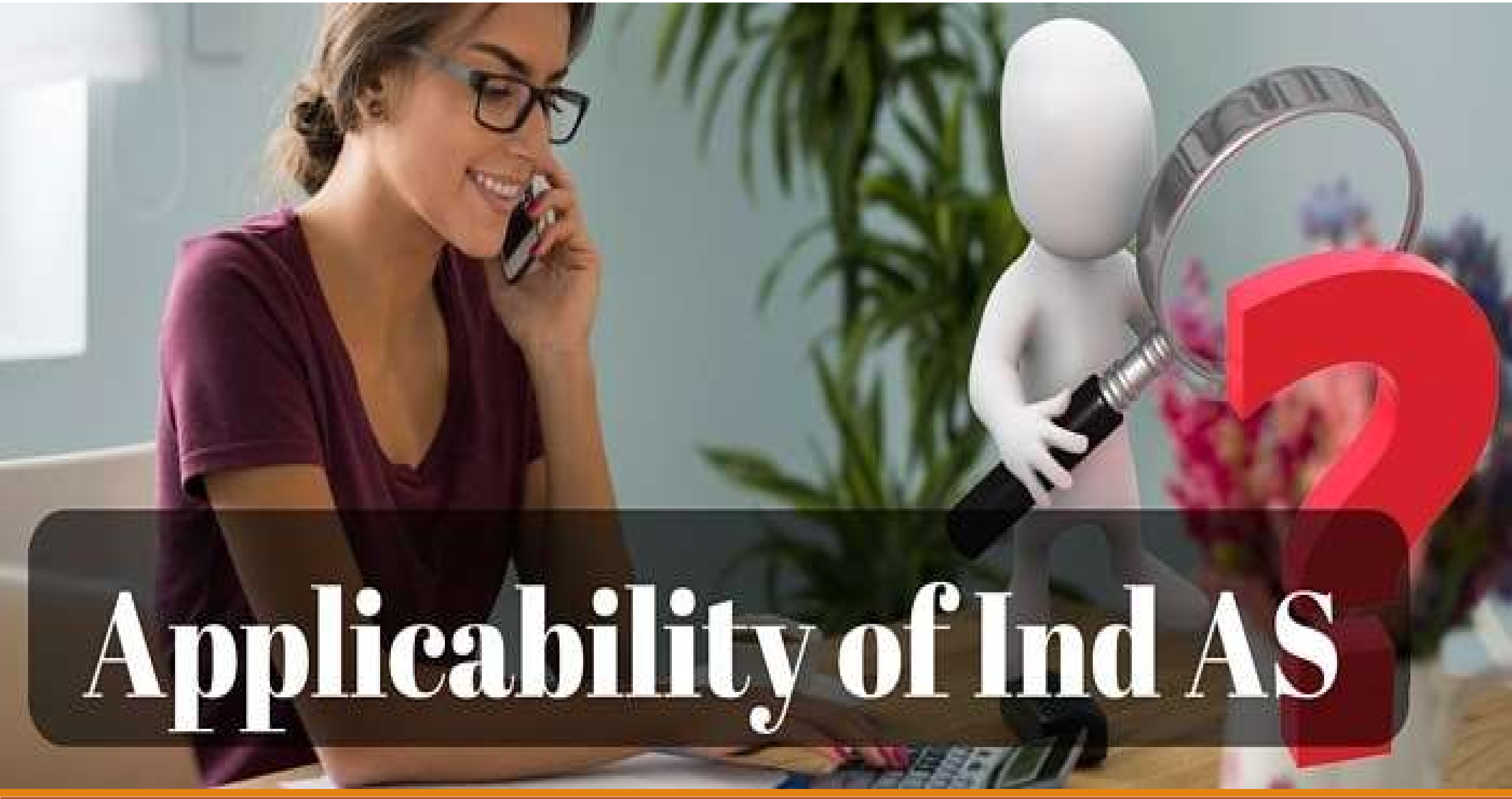
Introduction to Ind AS,

First time adoption – Transition Accounting & Key GAAP differences


Applicability of Ind AS

Applicability criteria for Companies

As per Indian Accounting Standards ("Ind AS") implementation roadmap issued by Ministry of Corporate Affairs (MCA) on dated 16 February 2015, currently the following companies shall comply with Ind AS:

- companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;
- unlisted companies having net worth of Rs.250 crore or more but less than Rs. 500 crore. - **net worth criteria shall be applicable as on 31 March 2014 or thereafter.**
- holding, subsidiary, joint venture or associate companies of companies covered above.

Note: (Rs. 500 crore and above companies were already covered in phase I and hence adopted Ind AS w.e.f. 1 April 2016).

First time adoption: key dates

Last financial statements under 'previous GAAP'

First Ind AS financial statements

Comparative period

Reporting period

31/03/2017
Date of determining net worth for assessing mandatory applicability

01/04/2017
Date of transition to **Ind AS - opening Ind AS Balance sheet**

1/04/2018
Beginning of the **first Ind AS reporting period**

31/03/2019
Reporting period i.e. **preparation of first Ind AS FS**

Comparative Information

First Ind-AS financial statements shall include at least **3 Balance Sheets**, **2 statements of profit and loss**, **2 statements of cash flows** and **2 statements of changes in equity and related notes.**

Agenda

1. Objective and Scope of the standard
2. First time adoption
3. Reconciliation aspects
4. Mandatory exceptions and optional exemptions: Key items
5. Challenges in First time adoption
6. A practical approach to Ind AS implementation

Objective

- First Ind AS Financial statements (FS) should contain a high quality information that:
  - Is transparent for users
  - Provides a suitable starting point for accounting in accordance with Ind-ASs
  - Generated at a cost that does not exceed the benefits

Scope

- Application of Ind AS in:
  - The first Ind-AS financial statements
  - Interim financial report for part of the period covered by its first Ind-AS financial statements (Ind AS 34)
  - An entity's first Ind AS financial statements are the first annual financial statements in which it makes an **explicit and unreserved statement in those financial statements of compliance with Ind ASs.**

First time adoption: Central theme

Assessment of change in Accounting policies for complying with Ind AS

Accounting Policies to Apply Retrospectively

Mandatory Exemptions where prospective approach to be followed

Optional exceptions from retrospective approach

Retained Earnings

First time adoption: A Road map

- Identify the first **Ind-AS financial statements.**
- Prepare an **opening balance sheet** at the date of transition to Ind-AS.
- Select **accounting policies** that comply with Ind-AS, (latest version of Ind-AS applicable on the reporting date) and apply those policies retrospectively.
- Apply the **mandatory exemptions** to avoid retrospective application.
- Consider whether to apply any of the **optional exemptions** to avoid retrospective application.
- Make **extensive disclosures** to explain the transition to Ind-AS.

First time adoption: Opening Balance sheet

Step I
- Recognize all assets and liabilities required to be recognized by Ind-AS

Step II
- De-recognize all assets and liabilities not permitted by Ind-AS

Step III
- reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs;

Step IV
- Measure all assets and liabilities in accordance with Ind-AS

Non Ind-AS comparative information and historical summaries

- Historical summaries need not comply with the recognition and measurement criteria
- If an entity presents any historical summary or comparative information in accordance with previous GAAP, an entity shall disclose that:
  - A specific mention that the summary is prepared in accordance with previous GAAP
  - Nature of main adjustments that would make it comply with Ind-AS (No Quantification is required)

Reconciliation

- An entity shall explain the transition from previous GAAP to Ind-AS by reporting reconciliations.
  - Reconciliation of equity under previous GAAP and Ind AS to be prepared for
    - Opening balance sheet (April 1, 2017)
    - At the end of latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP (2017-18)
  - Total comprehensive income under previous GAAP and Ind-AS for latest financial year as per previous GAAP (2017-18)
- Such reconciliation should give understanding of material adjustments to Balance sheet, statement of profit and loss and cash flow
- Subsequent modification of accounting policy, reconciliation of change in position between interim financial statements and financials at the end of 31 March 2018 to be explained
- Impact of correction of errors shall be distinguish from change in accounting policies

Ind AS 101 – Mandatory exceptions

Prohibition on retrospective application (para 14-17 and Appendix B

- **Estimates**
- **De-recognition of financial Instruments (B2-B3)**
- **Hedge Accounting (B4-B6)**
- **Non-controlling interest (B7)**
- **Classification and measurement of financial assets (B8-B8C)**
- **Impairment of financial assets (B8D-B8G)**
- **Embedded derivatives (B9)**
- **Government loans (B10-B12)**

Key Mandatory Exception - Estimates

Estimates

- An entity's estimate under Ind-AS at the date of transition of Ind-AS must be consistent with the estimate made for the same date under Indian GAAP unless:
  - Estimates were in error
- An entity may need to make estimates in accordance with Ind ASs at the date of transition to Ind ASs that were not required at that date under previous GAAP. Those estimates in accordance with Ind ASs shall reflect conditions that existed at the date of transition to Ind ASs.

Example:

- Warranty provision based on historic trend @ 5% till Mar 31, 2017
- In 2017-18, the products manufactured in 2016-17 - design defect, higher cost is expected
- Whether the company can revise its estimates of warranty cost for opening balance sheet?

Ans:

- A hindsight cannot be used to incorporate effect for financials prepared:
  - at the date of transition (i.e. April 1, 2017) or for the comparative period (i.e. 2017-18)
- Accordingly, the company cannot revise its estimate of warranty cost in its first Ind-AS financials (i.e. transition date and comparative period).

Key Mandatory Exceptions – De recognition of FA and FL

Derecognition

- Unless information needed to comply Ind AS 109 pertaining to financial assets and financial liabilities was obtained at the time of initial recording, de-recognition criteria should be applied prospectively

- For example, if a first time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to Ind ASs, it shall not recognise those assets and liabilities in accordance with Ind AS. (unless they qualify for recognition as a result of a later transaction or event)

Key Mandatory Exceptions - Others

Hedge Accounting

- As required by Ind AS 109, at the date of transition to Ind ASs, an entity shall:
  - a) measure all derivatives at fair value
  - b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP
- Transactions entered into before the date of transition :
  - If not designated as hedges earlier then - those can not be retrospectively designated as hedges
  - Recognised as a hedge but not meeting the certain conditions of Ind AS 109, the recognition should be discontinued prospectively

Government Loans

- Government loans can be continued to be shown as financial liability/loan
- The measurement of such loan at a below-market rate of interest and accounting for any corresponding benefit as required per Ind AS 20 requirements should be done prospectively

Key Mandatory Exceptions - Others

Non-Controlling interest

A first-time adopter shall apply the following requirements of Ind AS 110 prospectively from the date of transition to Ind ASs:

- Deficit balance in non-controlling interests
- Accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control
- Accounting for loss of control over a subsidiary and related requirements

However if the company elects to apply Ind AS 103 retrospectively then it shall also adopt Ind AS 110.

Embedded Derivatives

- An embedded derivative (variable element in a hybrid security) is required to be separated from the host contract as required under Ind AS 109
- To be recognised prospectively on date of reassessment which could be after the transition date

Key Mandatory Exceptions - Others

Classification and measurement of financial instruments

- Financial assets should be measured at amortized cost or fair value through comprehensive income based on facts and circumstances that exists as on the date of transition to Ind AS (Ind AS 109)

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

Optional Exceptions

- **Deemed Cost – Property Plant and Equipment, Investment Property & Intangible Assets**
- **Cumulative Translation differences**
- **Business Combination**
- **Investment in subsidiaries, associates and Joint Ventures**
- **Long term foreign currency monetary items**
- Share based payments
- Insurance contracts
- Leases
- Long term foreign currency monetary items
- Compound financial instruments
- Decommissioning restoration
- Service commission adjustment

Key Optional Exceptions

Deemed Cost – Property Plant and Equipment, Investment property and Intangible Assets

In case of Property, Plant and Equipment and Intangible Assets, a company can choose to measure at a deemed cost (assumed cost) using:

- Fair value at the date of transition as deemed cost; or
- A revaluation carried out under a previous GAAP, at the date of revaluation, broadly comparable to:
  - Fair value;
  - Cost in accordance with Ind-AS adjusted to specific price index or
- **Book Value (Carrying Value) of assets recorded in Indian GAAP as on the date of transition measured as per the previous GAAP.**

In simple words, companies have option to use existing book values (carrying value) of fixed assets in their first Ind-AS financial statement without requiring it to reopen past adjustments such as capitalization of borrowing costs, treatment of foreign exchange gains / losses, capitalization of indirect expenses, etc.

Key Optional Exceptions

Cumulative Translation differences

As per Ind AS 21:

- All translation differences should be form part of other comprehensive income and as a separate equity component
- Differences to be transferred to profit or loss on disposal of foreign operations

If a first time adopter uses this exemption:

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

Therefore the cumulative translation gains and losses arising from foreign operations as of the date of transition to Ind-AS are reset to zero.

Key Optional Exceptions

Business Combinations

For all transactions qualifying as business combinations under Ind-AS 103, a company can choose to:

- Not restate business combinations before the date of transitions;
- Restate all business combinations before the date of transitions;
- Restate a particular business combination in which all subsequent business combinations must also be restated and Ind-AS 36 impairment guidance must be applied.

1. Foreign currency Goodwill on past business combination – carrying amount should be considered as either goodwill to denominated in own functional currency or Non-monetary foreign currency item which are reported using the exchange rate applied in accordance with previous GAAP

Key Optional Exceptions

Investments in subsidiaries, joint ventures and associates

When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:

- at cost; or
- in accordance with Ind AS 109 Financial Instruments

If investments are measured **at cost** in accordance with Ind AS 27, it shall measure that investment at one of the following amounts in its separate opening Ind AS Balance Sheet:

- cost determined in accordance with Ind AS 27; or
- deemed cost. The deemed cost of such an investment shall be its:

  (i) fair value at the entity's date of transition to Ind ASs in its separate financial statements; or

  (ii) previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investments in each subsidiary, joint venture or associate that it elects to measure using a deemed cost.

Key Optional Exceptions

Long term foreign currency monetary items

Ind AS 101 includes an optional exemption to continue the existing policy as per the previous GAAP, i.e., existing AS 11 in respect of the long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period.

Other Optional Exceptions

- Requirement of Ind AS 102 in respect of **share based payments** are not applicable to options vested prior to date of transition of Ind AS.

- An entity shall apply Ind AS 104 **Insurance Contracts** for annual periods beginning on or after date of transition to Ind ASs

- An entity shall identify whether an arrangement contains a **Lease** on the basis of facts and circumstances existing at the date of transition to Ind AS, except where the effect is expected to be not material

- Requirement of Ind AS 21 for classifying **translation reserve** to equity until disposal of a foreign operations should not be followed by first time adopter of Ind ASs.

Other Optional Exceptions

- In case of **compound financial instruments**, bifurcation into debt and equity is not mandatory if the debt component has been already paid as on the date of transition
- **Changes Decommissioning restoration** and similar liabilities that occurred before the date of transition to Ind AS, need not be adjusted in cost of assets.
- Policy adopted for amortization of intangible assets on account of **service concession adjustments** should be recorded prospectively.
- When a lease includes both land and building elements, a first time adopter may assess the classification of each element as finance or an operating lease at the date of transition to Ind ASs on the basis of the facts and circumstances existing as at that date. If there is any land lease newly classified as finance lease then the first time adopter may recognise assets and liability at fair value on that date; and any difference between those fair values is recognised in retained earnings.

Joint arrangements

➢ **Joint ventures - transition from proportionate consolidation to the equity method**

When changing from proportionate consolidation to the equity method, that initial investment should be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition.

MAT impact on Ind AS first time adoption entries

MAT impacts on first time adoption

Transition amount	MAT impacts
Items included in Other Comprehensive Income (OCI), which will be reclassified to P&L subsequently. (like cash flow hedge reserve and debt instrument measured FVTOCI)	Should be included in book profits as and when recycled to P&L
Use of fair value as deemed cost exemption for PPE, Intangible asset and investment in subsidiary, JV and associates as on transition date. Changes in revaluation surplus of property, plant and equipment (PPE) and Intangible assets.	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred. Depreciation shall be computed ignoring fair valuation or revaluation as the case may be.
Gains or losses on FVTOCI equity instruments	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred.
Re measurements of defined benefit plans	To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS
Other items (e.g. equity component of compound financial instruments, etc.)	To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS

Transition Amount: "Transition amount" means the amount or the aggregate of the amounts adjusted in the other equity (excluding capital reserve, and securities premium reserve) on the convergence date.

MAT impacts – going forward

- No further adjustments to the net profits before other comprehensive income of Ind-AS compliant companies, other than those already specified under section 115JB of the Act shall be made.
- Items included in OCI, which will be reclassified to P&L subsequently. (like cash flow hedge reserve and debt instrument measured through OCI) - Should be included in book profits as and when recycled to P&L
- Items included in OCI, which shall not be reclassified to P&L subsequently. These items shall be included in book profits for MAT purposes at the point of time as specified below —

Items	**MAT impacts**
Changes in revaluation surplus of property, plant and equipment (PPE) and Intangible assets.	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred. Depreciation shall be computed ignoring revaluation.
Gains or losses on FVTOCI equity instruments	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred.
Re measurements of defined benefit plans	To be included in book profits every year as the re-measurements gains and losses arise
Any other items	To be included in book profits every year as the gains and losses arise

Thank you