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Ind-AS

India integrating

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India integrating

Adopting IFRS-converged financials – implications and challenges

India Inc. will adopt IFRS-converged financials (Ind-AS) in a phased manner over FY17-20, with over 350 companies from the BSE500 migrating from FY17. Ind-AS, based on 'substance over form' and 'fair valuation', will bring material changes to the operating metrics and return ratios of companies besides providing more disclosures. While some of the changes on revenue recognition, fixed assets and business combination will have sector-wide impact, the impact of changes in financial instruments, employee benefits and consolidation will be more company-specific. Migration to Ind-AS will have material implications for Banking, Telecom, Automobiles, Power, Media, IT and Consumer sectors. Our analysis of BSE200 companies suggests material implications for many companies.

Principle-led differences to adversely impact near-term operating metrics

Ind-AS, based on the principles of "substance over form" and "fair valuation", differs materially from IGAAP, which is focused on "legal form" and "conservatism". There will be significant differences in the presentation of financials with respect to revenue recognition, employee benefits, financial instruments, consolidation, business combination, fixed assets and foreign currency fluctuation among others. While Ind-AS will bring a more contemporary presentation of financials, it will adversely impact the operating metrics of India Inc. in the near term.

Impact to be felt across sectors

Our analysis of the differences between the two GAAPs suggest material impact on the operating metrics of (a) BFSI – earlier recognition of NPAs, fair valuation of ESOPs, deferment in recognition of fee income, and routing actuarial losses/gains through reserves, (b) Telecom – expensing forex gains/losses on loans and consolidation of joint ventures, (c) FMCG and IT – fair-valuing ESOPs, increased amortization post business combinations, and accrual-based recognition of income on MF, (d) Autos – consolidation of JVs / treasury shares, classification of take-or-pay contracts as deemed lease, (e) Power – arrangements with government classified as service concession arrangements, (f) Media – fair-valuing ESOPs, classifying redeemable preference shares as debt, and (g) All sectors – timing and quality of revenue recognition.

India Inc. might circumvent few provisions, but earnings to be impacted

Our discussions with various accounting experts suggest that companies might change arrangements to circumvent the applicability of certain provisions like deemed lease. Similarly, high dividend paying companies might prefer to declare high interim dividend, as final dividend declared but pending shareholder approval will continue to form part of reserves, impacting RoEs. However, we believe these changes are likely to have an adverse impact on earnings.

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Please click here for Video Link

Note: BSE-200 includes only companies covered in MOSL universe

Key implication on sectors

Sector	Overall
Banking	●●●
Telecom	●●●
Media	●●
Automobile	●●
Consumer	●●
Technology	●●
Power	●●
Healthcare	●●
Metals	●●
Oil & Gas	●●
Real Estate	●●
Agriculture	●●
Cement	●
Capital Goods	●

Impact: Low ● | Medium ●● | High ●●●

First-time adoption could trigger clean-up and tax planning

Migrating to Ind-AS will require corporates to prepare an opening balance sheet on the transition day, recognizing assets and liabilities in accordance with Ind-AS and adjusting the difference on migration through reserves. This will imply material change in the net worth of companies. We believe that investors need to be watchful for the adjustments made – the migration might provide companies a window to clean up their books. Further, the option to fair-value assets on first-time adoption might offer MAT-paying companies an opportunity to increase their future depreciation cost and lower book profits, which forms the basis for MAT payments.

Several challenges remain as we migrate

While India Inc. is set to migrate to the new regime, our discussions with various experts suggest that challenges remain on (a) varying levels of corporate preparedness, (b) high dependence on management estimates, which may vary and lead to incomparable financials within peers, (c) impact of financial covenants on loans availed, (d) lack of expertise on fair valuation, and (e) continuing anomalies of including gains/losses on exchange fluctuations relating to intra-group transactions in consolidated financials.

Exhibit 1: Major changes and their impact on key metrics

Key difference areas		IGAAP	Ind-AS	Impact due to transition
Revenue recognition	Multiple element contracts	No specific requirement for unbundling of services. Entire revenue recognized upfront.	Components of sale to be unbundled and recognized separately at the time of performance	Deferral of revenue and earnings
	Recognition Criteria	On transfer of risk and rewards	On transfer of risk and rewards and control	Deferral of revenue and earnings
	Fee income on (a) loans extended , and (b) guarantee services rendered	No specific guidelines. Generally recognized on receipt	Fee income is recognized over the life of the loan/period of service.	Deferral of revenue recognition leading to impact on margin and earnings
	Service concession arrangements (SCA)	No specific guidelines available under IGAAP for accounting of these arrangements.	Arrangements that satisfy certain criteria will be accounted using SCA.	Revenue and profitability of companies on construction activities will be advanced. This will be compensated by lower profits during the operation phase.
Employee benefits	ESOPs	Optional to account for ESOP cost on intrinsic basis or fair valuation	Mandatory to account for ESOP cost on fair valuation.	Increase in employee costs.
	Long term employee benefit plans	Gains losses on change in actuarial assumptions charged to the income statement	Gains/losses on change in actuarial assumptions charged to the reserves.	Reduction in volatility of income statement.
Consolidation	Consolidation of entity as subsidiary	Based on legal ownership	Based on control	Certain entities may be consolidated/ unconsolidated
	Joint venture	Accounted on proportionate basis	Decline in revenues and EBITDA. However, earnings will be unaffected.	Decline in revenues and EBITDA. However, earnings remain unaffected
	Treasury shares	Not mandatory to consolidate	Adjusted from equity on consolidation	Increase in EPS, Decline in net worth and increase in the ROCE/ROE
Business Combination	Mergers and Acquisitions	Separate guidance for acquisition of business unit (under As14) and acquisition of	Mandatory (a) fair valuation of assets and liabilities acquired on acquisition, (b) recognition of	Appropriate representation of assets/ liabilities. Goodwill will be carried at much lower value. Depreciation &

Key difference areas		IGAAP	Ind-AS	Impact due to transition
		shares (under AS14). Assets/Liabilities acquired can be recognized at book value or fair market value depending on methodology used. Goodwill recognized under AS14 is amortized while under AS21 is only tested for impairment	intangibles even when not recorded in the books of seller. Excess of consideration paid over net asset acquired is treated as goodwill and tested for annual impairment, while the deficit is adjusted in reserves	amortization cost will vary from current levels.
Financial Instruments	**Classification of financial instruments**	As per legal form :Perpetual Bonds as Debt ; Redeemable preference shares as equity	As per substance of the instrument - Perpetual Debenture as Equity; and Redeemable preference shares as debt	Preference dividend on redeemable preference shares - Finance cost ; Interest on perpetual debenture - adjusted in the equity
	FCCB	Treated as debt. Premium on redemption is either charged to reserves or forms part of contingent liability	Split accounting followed. Interest cost on liability portion to be provided through income statement	Increase in finance cost
	Deep discount bond/ZCB	Discount on issue / premium on redemption charged through reserves	Discount on issue / premium on redemption charged through P&L using effective interest rate method	Increase in finance cost
	Investments	Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less any permanent diminution in value of asset	Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI, or (c) FVTPL.	Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in return ratios.
	Derivatives	Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	Reduce volatility in income statements of companies currently not following hedge accounting
	Bill discounting	Debtors derecognized and shown as part of contingent liability even if risk is retained	Debtors are derecognized only if significant control and risk are transferred	Increase in debt and debtors. Decline in ROCE.
	Loan Provisioning - BFSI	NPA recognition as per RBI guidelines which is more on lines with the incurred loss model	NPA recognition as per expected credit loss method	NPA recognition will get proponed
Property Plant and Equipment	**Take or pay contracts with suppliers**	Recognized as a purchase transaction.	Considered as a deemed lease.	**Balance sheet**: higher asset base and debt. **P&L:** Higher depreciation and interest payment. EBITDA will improve. **RoCE:** will deteriorate.
	Asset retirement obligation	Companies recognize absolute contractual obligation for ARO as part of asset cost	Companies recognize present value of both contractual and constructive obligation as part of asset cost.	Profitability in initial years will decline, as base for amortization increases on recognition of constructive obligation.
	Intangibles - amortization	Life of intangibles is definite.	Intangibles like trademarks/brands can have indefinite useful life	Amortization expenses will reduce
	Revaluation of assets	Selective revaluation of assets is permitted. Depreciation on revalued asset is charged through the reserves	Does not permit selective revaluation of assets. While revaluation gains are adjusted in reserves, depreciation on revalued assets needs to be factored through the income statement	Decline in earnings
Others	**Forex fluctuations on long-term loans**	Optional either to expenses the exchange fluctuation on long term monetary assets/liabilities or to capitalize it in the B/S and amortize it over the life of the asset or a specified period.	Exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement	Reduces asset value and earnings

Key difference areas	IGAAP	Ind-AS	Impact due to transition
Deferred taxes	Computed using the 'income statement approach'	Computed using the 'balance sheet approach'	Deferred tax recognition may vary
Proposed dividend	Shown as an appropriation of profits for the year in which it is declared	To be shown as an appropriation of profits post getting declared and approved	Proposed dividend unless approved continues to remain as part of reserves
Government grants - Deferral loans	Amount collected from customer is recognized as a loan on absolute value.	Amount collected from the customer is recognized as a loan, which is carried at the present value (PV). The difference between the PV and absolute value is (a)treated as the finance cost on one side, and (b) deferred revenue income on the other	Increase in EBITDA and finance cost, while earnings may remain unimpacted

Source: MOSL

Exhibit 2: Key implications on operating metrics

	Key implications	Revenue	EBITDA	PAT	Net Worth	Debt	ROCE	ROE
Consolidation	Consolidation of entities	✓	✓			✓	✓	
	Consolidation of JVs	✓	✓			✓	✓	
	Treasury shares elimination				✓		✓	✓
Revenue Recognition	Multiple element contracts	✓	✓	✓	✓		✓	✓
	Service concession agreements	✓	✓	✓	✓		✓	✓
	Transfer of control	✓	✓	✓	✓		✓	✓
	Goss v/s net revenue presentation	✓						
Employee Benefits	Actuarial gain / loss		✓	✓			✓	✓
	Fair valuation of ESOPs		✓	✓	✓		✓	✓
Financial Instruments	Redeemable preference shares / Perpetual debentures			✓	✓	✓		✓
	FCCBs			✓	✓	✓		✓
	Deep discount bonds / ZCBs			✓				✓
	Investments – FMPs			✓	✓		✓	✓
	Investments - Equity / Debt – fair valuation			✓	✓		✓	✓
	Derivatives - hedges			✓	✓			✓
	Bill discounting					✓	✓	
	Loan provisioning		✓	✓	✓		✓	✓
Business Combination	Business combination - FV			✓	✓		✓	✓
PPE	Asset retirement obligation			✓	✓		✓	✓
	Revaluation of assets			✓				✓
	Intangibles - depreciation			✓	✓		✓	✓
	Deemed lease - lessor	✓	✓	✓	✓		✓	✓
	Deemed lease – lessee		✓	✓	✓	✓	✓	✓
Others	Exchange fluctuation - on loans			✓				✓
	Companies having high dividend payouts				✓		✓	✓
	Government grants - deferred loans	✓	✓				✓	

Source: MOSL

Exhibit 3: Key implications on major sectors

	Key implications	Automobile	IT	Power	Media	Telecom	FMCG	BFSI
Consolidation	Consolidation of entities	✓						
	Consolidation of JVs	✓	✓		✓	✓	✓	
	Treasury share elimination	✓	✓				✓	
Revenue Recognition	Multiple element contracts	✓			✓	✓		
	Service concession agreements			✓				
	Fee income on (a) loans extended, and (b) guarantee services							✓
	Goss v/s net revenue presentation	✓				✓	✓	
Employee Benefit	Actuarial gain / loss	✓		✓	✓	✓	✓	✓
	Fair valuation of ESOPs	✓	✓		✓	✓	✓	✓
Financial Instruments	Redeemable preference shares / perpetual debentures				✓			
	Investments - FMPs	✓	✓	✓			✓	
	Investments - Equity / Debt - fair valuation	✓	✓	✓			✓	
	Derivatives - hedges		✓	✓				
	Deep discount bonds / ZCBs							✓
	Bill discounting						✓	
	Loan provisioning (NPA recognition)						✓	✓
Business Combination	Business combination - FV	✓	✓				✓	
PPE	Asset retirement obligation			✓		✓		
	Intangibles - depreciation						✓	
	Deemed lease - lessor			✓				
	Deemed lease - lessee			✓				
Others	Exchange fluctuation - on loans	✓		✓	✓	✓		
	Companies having high dividend payouts		✓				✓	

Source: MOSL

Exhibit 4: Material implications for many companies

Company	Remarks
IndusInd Bank	(a) **Fee recognition**: Will get deferred over period of loan / rendering service. IIB's FY15 fee income stood at 2.3% of average assets. (b) **NPA recognition**: Likely to be advanced. IIB's 3QFY16 PCR stood at 34%. (c) **Fair valuation of ESOPs**: To adversely impact earnings (FY15: 2.2% of PAT).
Yes Bank	(a) **Fee recognition**: Will get deferred over period of loan / rendering service. YES' FY15 fee income stood at 1.6% of average assets. (b) **NPA recognition:** Likely to be advanced. YES' 3QFY16 PCR stood at ~33%. (c) **Fair valuation of ESOPs:** To adversely impact earnings (FY15: 1.8% of PAT).
SBI	(a) **Fee recognition**: Will get deferred over period of loan / rendering service. SBI's FY15 fee income stood at 0.8% of average assets. (b) **NPA recognition**: Likely to be advanced. SBI's 3QFY16 PCR stood at ~27%. (c) **Actuarial gains/losses:** Will be routed through reserves and not impact earnings (FY15: Loss of 11.9% of PBT).
Bank of Baroda	(a) **Actuarial gains/losses:** Will be routed through reserves and not impact earnings (FY15: Gain of 16.5% of PBT). (b) **NPA recognition**: Likely to be advanced. BoB's 3QFY16 PCR stood at ~31%. (c) **Fee recognition**: Will get deferred over period of loan / rendering service. BoB's FY15 fee income stood at 0.3% of average assets.
Punjab National Bank	(a) **Fee recognition**: Will get deferred over period of loan / rendering service. PNB's FY15 fee income stood at 0.6% of average assets. (b) **NPA recognition**: Likely to be advanced. PNB's 3QFY16 PCR stood at ~16%. (c) **Actuarial gains/losses:** Will be routed through reserves and not impact earnings (FY15: Loss of 55.6% of PBT).
IndiaBulls Housing Finance*	(a) **Fee recognition**: Will get deferred over period of loan / rendering service. FY15 fee income stood at 0.7% of average assets. (b) **Redemption premium on ZCB**: Will impact earnings (7.8% of FY15 PAT). ZCBs outstanding as at FY15 stood at INR2.1b. (c) **Fair valuation of ESOPs**: To adversely impact earnings (FY15: 2% of PAT).
Shriram Transport	(a) **NPA recognition**: Likely to be advanced. SHTF has NNPA of 4.1% of N/W as at 3QFY16. (b) **Securitization**: De-recognition of asset to become more stringent, leading to adverse impact on CAR.
Mahindra Finance	(a) **NPA recognition**: Likely to be advanced. MMFS has NNPA of 14.4% of N/W as at 3QFY16.
Bharti Infratel	(a) **Consolidation of JVs:** Will impact revenue and EBITDA. JVs accounted for 54% of FY15 revenue. (b) **Asset retirement obligation**: Amortization cost may increase in the initial period on recognition of additional constructive obligations for decommissioning assets.
Zee Entertainment	(a) **Redeemable preference shares:** Classification as debt will raise FY15 D/E to 0.6x (v/s 0x) and adversely impact FY15 PAT by 5.7%.
Dish TV	(a) **Exchange fluctuation on long-term monetary items:** To be recognized in income statement against the current practice of capitalizing to balance sheet. However, the current practice may continue for existing loans. (b) **Fair valuation of ESOPs**: To adversely impact earnings (FY15: ~19% of PAT). (c) **Barter transactions:** Recognition will increase revenue and operating expenditure.
TV18	(a) **Consolidation of JVs:** Will impact revenue and EBITDA. JVs accounted for ~44% of FY15 revenue. (b) **Fair valuation of ESOPs**: To adversely impact earnings (FY15: 6% of PAT).

Company	Remarks
Ashok Leyland	(a) **Consolidation of JVs**: Will impact revenue and EBITDA, since AL has significant operations though JVs. (b) **Revenue recognition:** Likely to be deferred. Revenue from sales, service and warranty to be separately recognized on performing activities. (c) (c) **PPE:** Deemed lease applicability may impact RoCE. Agreements with ancillaries can be altered to circumvent applicability, but this might have cost implications.
Mahindra & Mahindra	(a) **Elimination of treasury shares**: Will increase EPS and return ratios. 8.3% of MM's capital is held as treasury shares. (b) **Consolidation of entities:** Might vary based on the new definition of control. Could impact critical operating metrics. (c) **Revenue recognition:** Likely to be deferred. Revenue from sales, service and warranty to be separately recognized on performing activities. (d) **Business combination:** Depreciation costs may rise on recognizing assets at fair value. (e) **PPE:** Deemed lease applicability may impact RoCE. Agreements with ancillaries can be altered to circumvent applicability, but this might have cost implications.
Motherson Sumi	(a) **Business combination**: Depreciation costs may rise on recognizing assets at fair value. (b) **Consolidation of JVs**: Will impact revenue and EBITDA. MSS has significant operations through JVs.
Tata Motors	(a) **Consolidation of JVs**: Will impact revenue and EBITDA. TTMT has significant JVs and step JVs (Chery generating substantial revenues). (b) **Revenue recognition:** Unbundling of multiple element arrangements will lead to deferral of service revenue. (c) **PPE:** Recognition of assets based on substance (ultimate risk) may lead to assets being transferred to TTMT's books. Can be circumvented by altering contracts, but this might increase operating costs.
United Spirits	(a) **Actuarial gains/losses:** Volatility in employee cost to reduce on actuarial gains/losses being charged through reserves. Actuarial loss was INR1.1b in FY15. (b) **Elimination of treasury shares**: Will increase EPS and return ratios. 2.4% of capital is held as treasury shares. (c) **PPE**: Applicability of deemed lease might impact RoCE. Agreements with contract manufacturers can be altered to circumvent applicability, but this might have cost implications.
ITC	(a) **Fair valuation of ESOPs**: To adversely impact earnings (FY15: 5.5% of PAT). (b) **PPE**: Deemed lease applicability may impact RoCE. Agreements with contract manufacturers can be altered to circumvent applicability, but this might have cost implications. (c) **Financial instruments**: Fair valuation of investments to smoothen earnings and increase net worth on transition, impacting return ratios. ITC's mutual fund investments stood at ~13% of net worth at the end of FY15.
Jubilant Foodworks	(a) **Fair valuation of ESOPs**: To adversely impact earnings (FY15: 6.6% of PAT).
Tech Mahindra	(a) **Elimination of treasury shares**: Will increase EPS and return ratios. 9.9% of capital is held as treasury shares. (b) **Business combination**: Depreciation costs may rise on recognizing assets at fair value. (c) **Fair valuation of ESOPs**: Will adversely impact earnings (FY15: 1.5% of PAT).
Reliance Industries	(a) **Perpetual debentures**: To be classified as shareholders' funds. Will reduce finance cost; debt-equity to improve from 0.8x to 0.7x. (b) **Exchange fluctuation:** To be recognized in income statement against the current practice of capitalizing to balance sheet. However, the current practice may continue for existing loans (FY15 capitalization ~INR69b; ~22% of PBT). (c) **Fair valuation of investments:** To smoothen earnings; RIL has ~20% of its N/W investments in mutual funds.

Company	Remarks
JSW Steel	(a) **Exchange fluctuation:** To be recognized in income statement against the current practice of capitalizing to balance sheet. However, the current practice may continue for existing loans. (b) **Redeemable preference shares**: Classification as debt will raise FY15 D/E to 1.7x (v/s 1.6x) and adversely impact FY15 earnings by ~1%.
SAIL	(a) **Actuarial gains/losses:** Volatility in employee cost to reduce on actuarial gains/losses being charged through reserves. SAIL's FY15 actuarial loss: 36% of PBT. (b) **Asset retirement obligation**: Amortization cost may increase in the initial period on recognition of additional constructive obligations for decommissioning assets.
Jindal Steel	(a) **Exchange fluctuation:** To be recognized in income statement against the current practice of capitalizing to balance sheet. However, the current practice may continue for existing loans. (FY15 capitalization: INR1b; ~27% of PBT).

*Notification for applicability of Ind-AS to HFC's is yet to be announced Source: MOSL

India Inc migrates to global accounting regime

IFRS the global accounting language

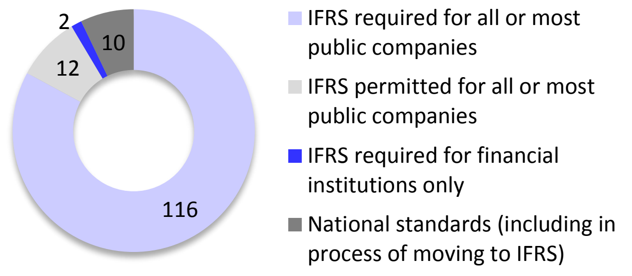
- Globally, more than 140 countries follow IFRS (or IFRS converged) financial statements. Among the large economies, only three – USA, Japan and India – do not follow IFRS or its converged financials.

Exhibit 5: 140 countries globally follow IFRS

Region	Number of jurisdictions	% of total
Europe	43	31%
Africa	19	14%
Middle East	9	6%
Asia and Oceania	32	23%
America	37	26%
Total	**140**	**100%**

Source: PWC, MOSL

Exhibit 6: IFRS adoption around the world



Source: PWC, MOSL

India Inc. to adopt IFRS converged financials in phased manner

~350+ BSE-500 companies will adopt these new standards effective FY17

- India made a commitment towards the convergence of Indian accounting standards with IFRS at the G20 summit in 2009. In line with this, the Ministry of Corporate Affairs (MCA) issued a roadmap for the implementation of Indian Accounting Standards (Ind-AS) converged with International Financial Reporting Standards (IFRS) beginning April 2011. However, this plan was suspended due to unresolved tax and other issues.
- While presenting the Union Budget 2014–15, the Honorable Minister for Finance, Corporate Affairs and Information and Broadcasting proposed the adoption of Ind-AS.
- India is set to migrate to Ind-AS (the new accounting norm) in a phased manner, with ~350+ BSE-500 companies adopting these new standards effective FY17.

Exhibit 7: Road map for implementation of Ind-AS (Excl. BFSI)

	Phase I	Phase II	Voluntary Adoption
Year of adoption	FY17	FY18	FY16 or thereafter
Comparative year	FY16	FY17	FY15 or thereafter
Companies covered			
Listed companies	Companies with net worth > = INR5b	Companies listed or in the process of being listed	Any company can voluntarily adopt Ind-AS
Unlisted companies	Companies with net worth > = INR5b	Companies having a net worth > = INR2.5b	
Group companies	Applicable to holding, subsidiaries, JVs or associates of companies covered above		

Note: Net worth for the above has to be calculated as on 31st March 2014

Source: ICAI, MOSL

Exhibit 8: Road map for implementation of Ind-AS by BFSI

	Phase I	Phase II
Year of Adoption	FY19	FY20
Comparative year	FY18	FY19
Companies covered		
Banks & Insurance companies	All Scheduled Banks & Insurance companies	NA
NBFC	Companies with Networth >= INR5b	(i) Listed / in process of being listed - All NBFCs
		(ii) Unlisted - Networth more than INR2.5b but less than INR5.0b
Group companies	Applicable to holding, subsidiaries, JVs or associates of companies covered above.	

*Notification for applicability of Ind-AS to HFC's is yet to be announced

Source: MCA, MOSL

Ind-AS is based on the principles of (a) substance over form, (b) fair valuation, and (c) increased disclosures

- The new accounting standards are based on the principles of (a) substance over form, (b) fair valuation, and (c) increased disclosures will bring more appropriate presentation of the financial statements. However, they provide a lot of discretion on the form of management's estimates.
- While India is converging with IFRS and not adopting IFRS, several carve-outs have been created from IFRS to represent the financials of the companies in the most apt manner. We summarize these below.

Exhibit 9: Key carve-outs from IFRS

Mandatory carve-outs

- **Law overrides accounting standard;** however, under M&A, auditors' certificate required
- **FCCBs** - Embedded derivative to be treated as equity
- **Gain on bargain purchase in M&A** to be recognised in capital reserve
- **Loan with covenant breached** can continue to be non current if repayment is not demanded
- **Long term employee benefit** - GSEC rates to be used for discounting (except for foreign operations)
- **Lease rentals** - No straight-lining for escalation

Optional carve-outs

- **Foreign exchange fluctuations** on long term monetray items existing on first time adoption can continue to be accounted as per IGAAPs
- **Accounting policies of JVs/ associates** can be different if adoption of parent's policy is impracticable

Source: MOSL

Return ratios and earnings differ under IFRS

- Among the large cap companies in India, six report their financials both under IGAAP and IFRS. A comparison of their FY15 financials under both GAAPs highlights differences in revenues, EBITDA, PAT, net worth, and borrowings.
- However, we note that India is amongst the first countries to early adopt the new standard on revenue recognition from 1st April 2016, wherein the IFRS mandates its application from annual periods beginning on or after 1st January 2017.

Exhibit 10: Operating metrics varies under different GAAPs

Particulars	Tata Motors			Dr. Reddy			Vedanta		
	IGAAP	IFRS	Diff.	IGAAP	IFRS	Diff.	IGAAP	IFRS	Diff.
Total revenue	2,628	2,625	0%	150	148	-1%	737	738	0%
EBITDA	401	381	-5%	38	33	-13%	280	(291)	-204%
EBITDA (%)	15.3%	14.5%	-1%	25.1%	22.6%	-2%	38.0%	-39.4%	-77%
PAT	140	128	-9%	23	22	-5%	(156)	(128)	18%
Net Worth	563	539	-4%	99	111	11%	539	1,029	91%
Borrowings	736	725	-1%	43	43	-	778	679	-13%
Debt/Equity (x)	1.3	1.3	-	0.4	0.4	-	1.4	0.7	-54%

Source: MOSL, SEC filings

Exhibit 11: Operating metrics varies under different GAAP

Particulars	TCS			Infosys			Wipro		
	IGAAP	IFRS	Diff.	IGAAP	IFRS	Diff.	IGAAP	IFRS	Diff.
Total revenue	946	927	-2%	533	533	-	470	470	-
EBITDA	245	247	1%	149	149	-	103	105	2%
EBITDA (%)	25.9%	26.6%	1%	27.9%	27.9%	-	21.9%	22.3%	0%
PAT	199	193	-3%	124	122	-2%	87	87	1%
Net Worth	506	584	13%	507	548	7%	371	410	10%
Borrowings	3	4	16%	-	-	-	77	79	2%
Debt/Equity (x)	0.0	0.0	-	-	-	-	0.2	0.2	-

Source: MOSL, SEC filings

- Hindustan Unilever (HUVR) recently conducted an analyst conference to highlight the changes in (a) the opening balance sheet, and (b) earnings for 1QFY16 on adoption of Ind-AS. It's net worth as at April 1, 2015 and PAT for 1QFY16 are impacted by 65% and 0.8%, respectively on adoption of Ind-AS.

Exhibit 12: Material Implication on HUL's Net Worth on transition (INR m)

Particulars	Reclassified IGAAP	Ind-AS	Diff
Total revenue	82,137.4	85,570.0	4%
EBITDA	19,785.4	19,928.9	1%
EBITDA (%)	24.1%	23.3%	-1%
PAT	10591.4	10680.3	1%
Net Worth*	37,247.8	61,564.4	65%

* Draft Ind-AS Balance Sheet as on April 1, 2015 Source: Company, MOSL

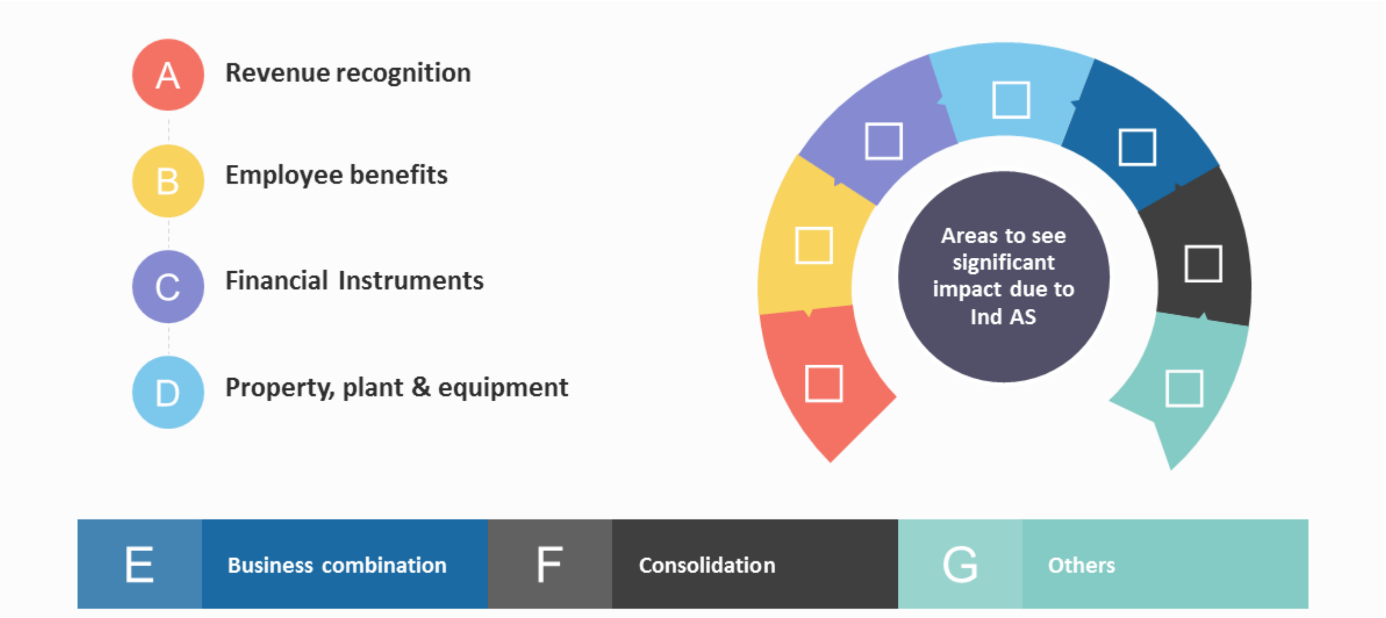
- Refer **Annexure 1** for detailed draft financial of HUL
- In the following sections, we discuss the significant differences between the two GAAPs, implications of transition and first-time adoption, and sector-wise implications on adopting Ind-AS.

Ind-AS: Paradigm shift in financial reporting

Significant changes under the new standards

- Our analysis highlights that significant differences lie in revenue recognition, consolidation, financial instruments, employee benefits, business combinations, property, plant and equipment, among others.
- We believe that generally amongst this Revenue recognition, Business combination and PPE will have a sectorial level impact while Financial Instruments, Employee benefit cost and consolidation will have a more company specific impact. We will now discuss each of these in detail :-

Exhibit 13: Key differences between the two GAAPs



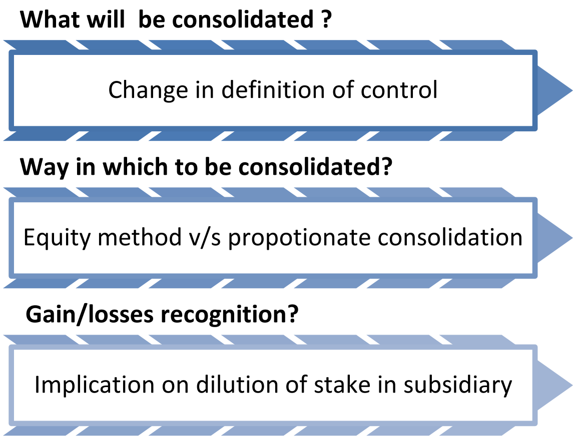
Source: MOSL

Consolidation: Based on new definition of control

Consolidated financials mandatory if an entity has one or more JV or associate or subsidiary.

- IGAAPs require the preparation of financial statements only when a company has one or more subsidiaries. However, Ind-AS requires consolidated financials to be prepared even when an entity has one or more joint ventures or associates and no subsidiaries.
- Further, Ind-AS differs materially from IGAAPs in preparation of consolidated financial statements. The differences are primarily on account of three reasons.

Exhibit 14: Consolidation under Ind AS may be materially different



Source: MOSL

Entities consolidated as subsidiary under Ind-AS may significantly vary from that in IGAAP

- **Change in definition of control to determine subsidiaries:** Under the present IGAAP, consolidation of an entity as subsidiary is based on (a) share of equity held (over 50%), or (b) composition of board of directors. However, Ind-AS, based on substance over form, broadens the definition to identify control and includes (a) veto rights with minority shareholders, (b) potential voting rights, (c) de-facto control, and (d) structured entities to identify subsidiaries. Thus, the universe of entities that get consolidated under Ind AS and IGAAP may vary significantly.
- The change in definition of control leads to improved transparency, better governance and appropriate presentation of financial statements, as:
  - Crossholdings created by certain companies to circumvent the definition of subsidiary will now need to be consolidated.
  - Company having de-facto control over another company has to be consolidated, irrespective of stake. This will be disadvantageous for companies lacking transparency in reporting.
  - In case of an SPV, where there is a private equity or strategic investor involved and has a say in the operations of the SPV, it may be concluded that control over the SPV is shared. Therefore, the assets and liabilities of that SPV may/may not be consolidated in the company's balance sheet.
- This, in our opinion, will impact conglomerates, and companies in the infrastructure and real estate sectors.
- **Treasury shares to be derecognized:** Ind AS does not recognize treasury shares as financial assets and requires the same to be adjusted to the equity. Further, no gains / losses are recognized on the purchase, sale, issue or cancellation of the treasury shares. This will lead to a reduction in the net worth of companies on the one hand and increase in reported EPS on the other.

Derecognition of treasury shares will lead to a reduction in the net worth and increase in reported EPS

Exhibit 15: EPS rise on de-recognition of treasury shares

Company	% Impact on N/W	EPS under IGAAP	EPS under Ind-AS
M&M	-5.6%	53.1	58.4
Tech M	-9.9%	27.5	30.7
United Spirits	-2.4%	NA	NA

Source: Company Annual Report, MOSL

Equity method of consolidating JV will lead to material changes in revenue and EBITDA while, PAT may remain un-impacted.

- **Equity method v/s proportionate consolidation for joint ventures:** Ind AS requires joint ventures to be consolidated using the equity method (as currently done for associates) as against proportionate consolidation currently prescribed by the IGAAPs.
- This will bring in material changes in operating metrics like revenue/ EBITDA for entities that operate through JVs. Valuations of companies currently valued on EV/EBITDA basis may be impacted.

Exhibit 16: Companies having material operations through JVs

Bosch	NCC	Bharti Infratel
Tata Motors	L&T	TV 18
Cummins India	Tata Steel	Idea Cellular
Motherson Sumi	SAIL	ONGC
Ashok Leyland	M&M	Cadila
TCS	Asian Paints	

Source: Company Annual Report, MOSL

Gains/ Loss on partial stake sale in a subsidiary without loss of control is not recognized

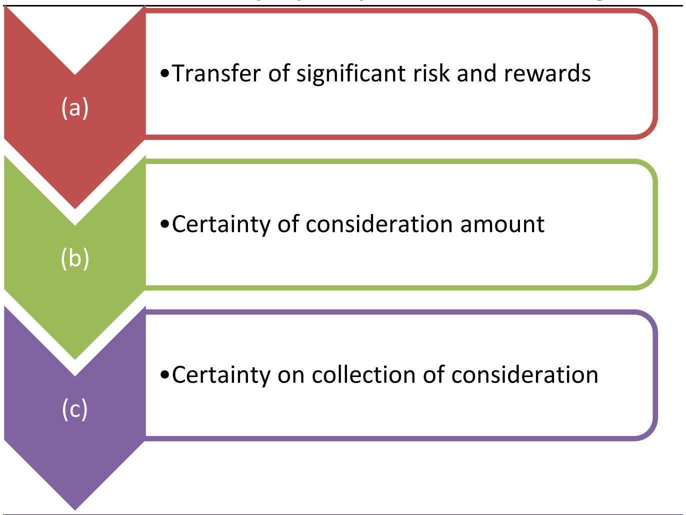
- **Implication of stake sale in subsidiary:** Ind-AS considers all providers of equity capital as the entity's shareholders, even if they are not shareholders in the parent company. Accordingly, in case of change in the parent's ownership interest in a subsidiary without loss of control, the gain/loss on such transaction is not recognized as profit or loss – it is considered as an equity transaction. However, when the sale/disposal transaction results in a loss of control in the investee subsidiary, the gain/loss is recognized in P&L, including the gain/loss resulting from re-measurement of the retained interest, if any in that subsidiary. Under IGAAP, gain/loss on sale/disposal of any interest in the subsidiary is recognized in the income statement. This could result in a significant difference in reported earnings of the entity on partial stake sale in a subsidiary.

Timing and nature of revenue recognition may vary

Difference in principles leads to change in timing and nature of revenue recognition

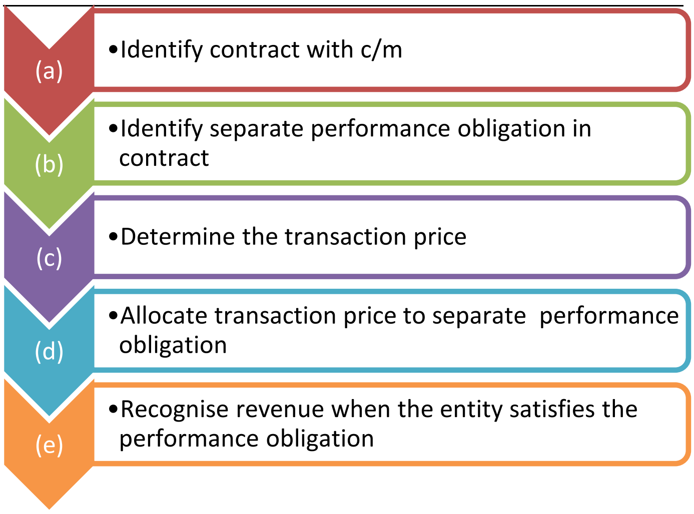
- The principles of revenue recognition under IGAAP and Ind-AS vary significantly. While IGAAP follows a simplistic approach of transfer of risk and reward for a definitive consideration with certainty of collection, the Ind-AS prescribes a more comprehensive approach, which in addition to the above, includes (a) transfer of control, and (b) fair valuation.

Exhibit 17: IGAAP: Simple principles for revenue recognition



Source: MOSL

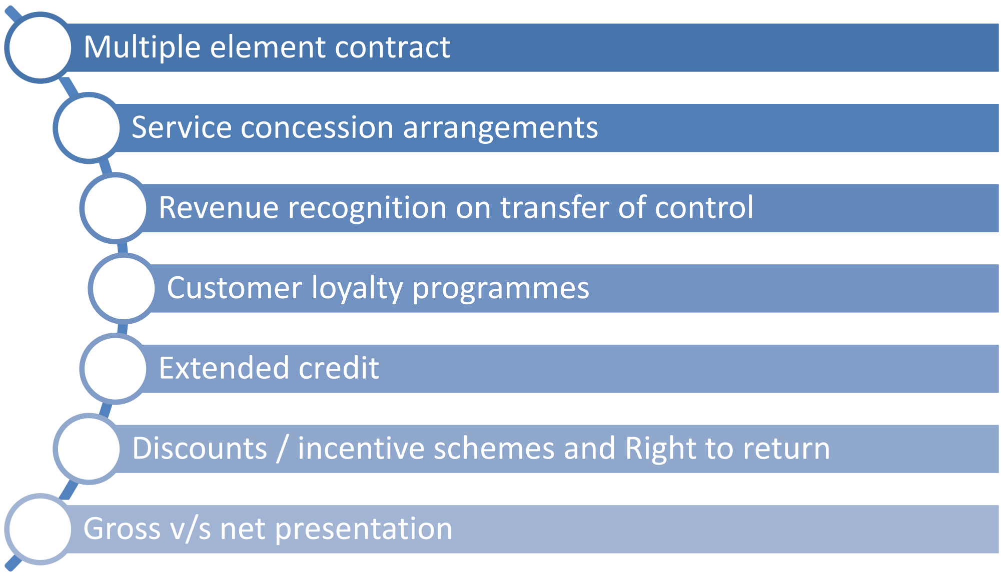
Exhibit 18: Ind-AS: Additional criteria on transfer of control and fair valuation



Source: MOSL

- This difference in principles will lead to a variance in timing, extent and presentation of revenue recognition under Ind AS v/s the current IGAAPs. The instances of variances in revenue recognition can be broadly summarized under the following seven categories.

Exhibit 19: Revenue recognition under Ind-AS will vary under seven key categories



Source: MOSL

Recognition of revenues and earnings may defer under multiple element contracts

- **Multiple element contracts**: Multiple element contracts are composite contracts of related activities that (a) can be executed independently, and (b) consideration is separately determined. Ind AS provides that that the related revenues in multiple element contracts (like free warranty and service offered along with sale of vehicle) should be unbundled and recognized separately at the time of actual rendering of service. This is in divergence to the current GAAP practice, where the entire revenue is recognized upfront.
- This, in our view, will lead to a variation in the timing of recognition of revenues and earnings for sectors like Autos, Media, Capital Goods, Telecom, etc.

- **Service concession arrangements:** In India, to promote private participation in the development of public infrastructure, contracts are being awarded on a build operate and transfer (BOT) basis, commonly known as service concession arrangements (SCA).

Under SCA, revenues and earnings on construction and operating and maintenance will be recognized separately

- The current IGAAPs do not provide any comprehensive guidelines on accounting of SCA. Under IGAAP, companies currently recognize the asset constructed as a fixed asset and depreciate it over the concession period, and recognize (a) annuity payments received from the government, or (b) toll collection from users as revenue. Operating and maintenance expenses are charged to income statements as and when incurred.
- However, under Ind AS, the entity will recognize revenue by splitting the activities separately for (a) construction of assets, and (b) operation and maintenance of assets.
- For construction of the asset, the entity will determine the fair value of the asset. Revenue and profitability during the construction phase will be recognized on a POCM basis over the period of construction.
- For operation and maintenance of the asset, the accounting treatment will vary depending on whether the project is awarded on an annuity basis or on the basis of rights for collecting toll revenues from users over a finite period.
- Under annuity contracts, the entity recognizes a financial asset, while in the latter, an intangible asset is recognized. At the time of revenue recognition on construction activity the entity recognizes (a) financial asset – in case of annuity projects, or (b) Intangibles in case of toll collection method. Accounting for both is explained by an example below.
  - **Accounting under annuity method**

    ABC Limited enters into a BOT agreement with NHAI to build a 100km highway, against which ABC will receive fixed revenue (annuity) of INR5.4b per year (of which INR0.4b can be ascribed towards operations and managements) from NHAI for the next five years irrespective of the vehicular traffic on the constructed highway. ABC is likely to incur total cost of INR10b. Operation and maintenance (O&M) expense would be INR0.2b.

    (Assumptions - Tax: 0%, IRR: ~17%, fair value of construction service after first year: INR16b.)

Exhibit 20: IGAAP: Fixed assets recognized during construction period at cost (INR b)

Particulars	2016	2017	2018	2019	2020	2021	Total
Income statement							
Annuity + O&M received	-	5.4	5.4	5.4	5.4	5.4	27.0
Operating cost	-	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(1.0)
Depreciation	-	(2.0)	(2.0)	(2.0)	(2.0)	(2.0)	(10.0)
Profit	-	3.2	3.2	3.2	3.2	3.2	16.0
Balance Sheet							
Fixed Assets	10.0	8.0	6.0	4.0	2.0	-	
Reserves	-	3.2	6.4	9.6	12.8	16.0	
Cash/(Borrowings)	(10.0)	(4.8)	0.4	5.6	10.8	16.0	
Cash inflow/(outflow)	(10.0)	5.2	5.2	5.2	5.2	5.2	16.0

Source: MOSL

Exhibit 21: Ind-AS: Financial assets recognized during construction period at fair value (INR b)

Particulars	2016	2017	2018	2019	2020	2021	Total
Income statement							
Revenue	16.0	0.4	0.4	0.4	0.4	0.4	18.0
Interest income	-	2.7	2.3	1.9	1.3	0.7	9.0
Total income	**16.0**	**3.1**	**2.7**	**2.3**	**1.7**	**1.1**	**27.0**
Road construction cost	(10.0)	-	-	-	-	-	(10.0)
O&M cost	-	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(1.0)
Profit	**6.0**	**2.9**	**2.5**	**2.1**	**1.5**	**0.9**	**16.0**
Annuity received from NHAI	**-**	**5.0**	**5.0**	**5.0**	**5.0**	**5.0**	**25.0**
Balance Sheet							
Receivables from NHAI	16.0	12.8	9.6	6.4	3.2	-	
Reserves	6.0	8.9	11.4	13.5	15.1	16.0	
Cash/(Borrowings)	(10.0)	5.7	1.8	7.1	11.9	16.0	
Cash inflow/(outflow)	**(10.0)**	**5.2**	**5.2**	**5.2**	**5.2**	**5.2**	**16.0**

Source: MOSL

- **Accounting under right of toll collection**

  In the above illustration, if ABC had agreed to collect revenue in the form of toll collection (assumed INR5.4b per year), there would be no guarantee of minimum payment from NHAI and the revenue would be subject to minimum variation in connection with vehicular traffic. In the books of ABC, the receivables would be recognized as an intangible asset – "toll collection rights" and would be amortized over the period of 'right to collect toll' on the road.

Exhibit 22: Ind-AS: Intangible assets recognized during construction period at fair value (INR b)

Particulars	2016	2017	2018	2019	2020	2021	Total
Income statement							
Revenue	16.0						16.0
Toll collected	-	5.4	5.4	5.4	5.4	5.4	27.0
Total income	**16.0**	**5.4**	**5.4**	**5.4**	**5.4**	**5.4**	**43.0**
Road construction cost	(10.0)	-	-	-	-	-	(10.0)
O&M cost	-	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(1.0)
Amortization	-	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)	(16.0)
Profit	**6.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**16.0**
Balance Sheet							
Toll Collection Rights	16.0	12.8	9.6	6.4	3.2	-	
Reserves	6.0	8.0	10.0	12.0	14.0	16.0	
Cash/(Borrowings)	(10.0)	(4.8)	0.4	5.6	10.8	16.0	
Cash inflow/(outflow)	**(10.0)**	**5.2**	**5.2**	**5.2**	**5.2**	**5.2**	**16.0**

Source: MOSL

- **Revenue recognized on transfer of control:** Ind AS mandates revenue recognition on satisfaction of performance obligation, which includes not only transfer of significant risk and reward, but also the transfer of control. This will lead to Change in timing of revenue and cost recognition of real estate companies depending on the terms of the contracts as against the current guidance on revenue recognition prescribes revenue recognition on POCM basis subject to achievement of stringent threshold criteria.

Upfront fee is recognized over the period of rendering service, leading to satisfaction of performance obligation

- **Non-refundable upfront fees:** In certain contracts, companies charge a non-refundable upfront fee at the commencement of the contract, wherein the fee relates to an activity that the entity is required to undertake at or near contract inception. The current IGAAPs do not prescribe any specific guidance on this. Consequently, accounting of companies varies. However, under Ind-AS, to assess the performance obligation, the entity needs to assess whether the fee relates to transfer of a promised good or service. If the performance obligation criteria in such a case are not met, the entity is required to defer the revenue recognition of upfront fee and recognize it over the period of rendering service or on delivery of goods, leading to satisfaction of performance obligation.
- This would have an impact on companies in the BFSI and vacation ownership, sectors.
- **Variable consideration – Discount/incentive schemes and right to return:** Companies may enter into contracts for sale of goods / rendering of services, where the consideration is variable and dependent on certain future events. These include contracts eligible for volume discounts, sales incentives, refund rights rebates, penalties, sales returns, etc. The current IGAAPs do not provide any specific guidance on the accounting of such contracts. Consequently, most companies recognize the entire revenues upfront and recognize the expenses as and when the contingency is resolved. However, under Ind-AS, the company needs to estimate and provide for the variability in consideration at the inception of the contract. This would imply:

Under Ind-As, sales incentives, discounts, rebates will be netted off from revenue

  - All sales incentives, discounts, rebates (including cash discount) will be netted off from revenue. This will lead to a decline in reported revenues of the companies, which will be compensated by increase in EBITDA margins. This will have an impact on sectors like Autos, Consumer, etc.
  - Timing of revenue recognition will have to factor in several aspects like right of return, dispatch v/s delivery, etc. This will have an impact on companies in Consumer and Pharmaceuticals sectors.
- **Customer loyalty programs:** Currently, there is no specific guideline for accounting of loyalty or reward points offered by various companies. Consequently, companies follow diverse practices of recognizing the entire sales consideration upfront and either (a) expensing the cost of reward / loyalty points when redeemed, or (b) estimating and recognizing a provision for this periodically. However, Ind AS requires estimation and carving out of the fair value of the reward/loyalty points from the initial sales consideration. The revenue so estimated is deferred and recognized on redemption of such loyalty/ reward points.
- This will have an impact on the revenue recognition of companies in Retail, Airlines, Banking, and Hospitality sectors.

- **Extended credit:** Since Ind-AS is based on the fair value approach, it factors in time value of money. It requires the revenues on sales made with a deferred payment consideration to be recognized at fair value. The difference between the fair value and total consideration is recognized as interest income over the tenure of the receipt of the deferred consideration.
- **Gross v/s net presentation:** Revenue under Ind AS is to be recognized at gross value of excise duty, considering the excise component as part of expenses under "materials consumed". This will have a material impact on the presentation of revenue and costs of all manufacturing companies.

Exhibit 23: Excise duty as a % of revenue

> 50%	25%- 50%	10%-25%
United Spirits	United Breweries	Castrol
	ITC	Ramco Cement
		Rel Com
		Ambuja Cement
		Ultratech
		SAIL
		ACC
		Shree Cement
		Supreme Ind
		Grasim

Source: Capital Line, MOSL

Employee cost may vary on fair valuation

- Employee costs under Ind-AS may vary from IGAAPs primarily on account of two counts (a) share-based payments, and (b) long-term employee benefits.

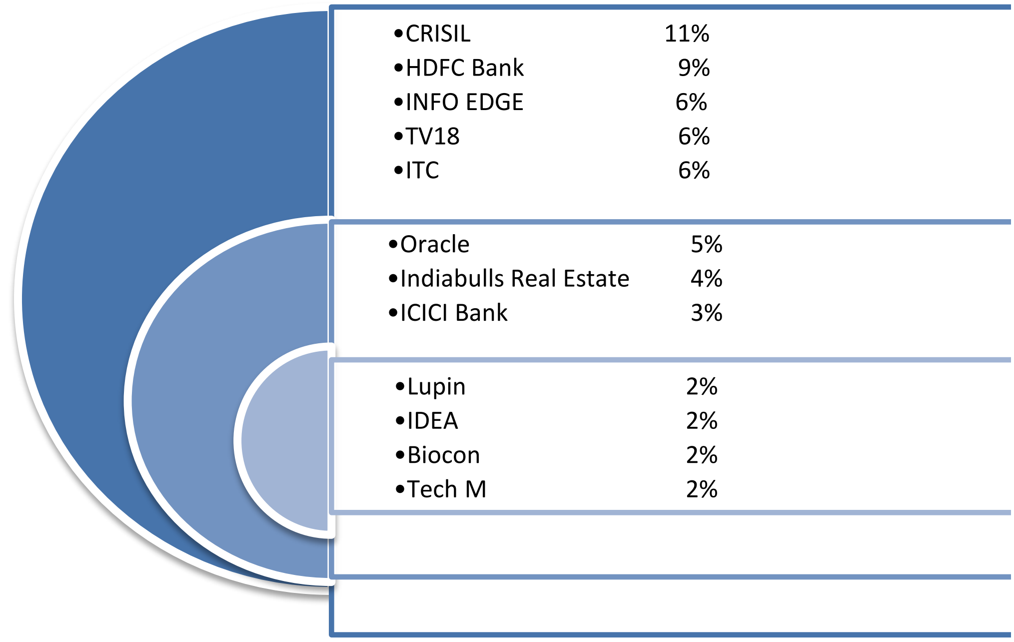
Exhibit 24: Employee cost recognition varies under Ind-AS

Share based payments	•Fair valuation of ESOPs •ESOPs granted by the parent
Long term employee benefits	•Actuarial loss/ gain

Source: MOSL

- **Fair valuation of ESOPs to raise employee costs:** Employee stock options (ESOPs) will be mandatorily accounted using the "fair value" approach in place of the current options of using intrinsic value or fair value approach.
- This will primarily have an impact on companies in the BFSI, Pharmaceuticals, IT, and Consumer sectors, which offer significant ESOPs, generally accounted using intrinsic approach.

Exhibit 25: Fair valuation of ESOPs adversely impact FY15earnings



Dish TV impact of 19% on PBT on account of lower profit base. Source: Company Annual Report, MOSL

- **ESOPs to subsidiaries employee in Parent companies to impact employee cost of subsidiaries:** Many companies (usually MNCs) offer ESOPs to the senior management of their subsidiaries. Under the current practice, cost of ESOPs skirts the income statement of the subsidiary while it is recognized in the books of the parent company. However, Ind-As requires the cost of ESOPs given by the parent company to be recognized in the books of the parent. This we believe will impact the earnings of the subsidiaries which are separately listed.
- **Reduction in P&L volatility on actuarial losses:** Ind AS mandates the actuarial gains and losses on post-employment benefit plans and other long-term employment plans to be adjusted through other comprehensive income. This is in variance with the current practice under IGAAPs, where they are charged through the income statement. We believe that this will lead to a reduction in the volatility of employee cost charged to the income statement.

Actuarial gains/losses on long term employee defined benefit plan to be adjusted through reserves

Exhibit 26: Actuarial losses adversely impacted earnings in FY15

Company	Gains/(losses) as % of PBT
SAIL	-36%
Federal Bank	-7%
United Breweries	-6%
OIL	-5%
Tata Power	-4%
GlaxoSmith C H L	-3%
Gillette India	-3%
Nestle India	-3%
BPCL	-3%
ICICI Bank	-2%
ONGC	-2%
NTPC	-2%
Coal India	3%
Bank of Baroda	17%

Source: Company Annual Report, MOSL

Financial instruments: Classification and measurement undergoes change

- Financial instruments are contracts that give rise to both (a) a financial asset on one entity, and (b) a financial liability or equity instruments of another entity.
- There exist significant differences in the treatment of financial instruments between Ind AS and IGAAP at various stages, which can be summarized as below:

Exhibit 27: Accounting differences at all stages of financial instruments under both GAAPs

Source: MOSL

- **Classification of financial instruments change as substance gains importance over legal form:** Ind AS prescribes that financial instruments should be classified in accordance with the substance of the contractual agreement, rather than its legal form (as is the current practice). This may lead to reclassification of financial instruments.
  - **Non-convertible preference shares (NCPS) to be classified as debt** and the corresponding cost to be recognized as finance cost. This will lead to (a) decline in the earnings of companies having preferential shares, as the preferential dividend paid as an appropriation of profit will now be classified as finance cost, and (b) increase in the debt-equity.

Considering preference dividend on NCPS as finance cost will adversely impact reported earnings

Exhibit 28: Earnings decline considering NCPS as debt

Company	% impact on PAT
Zee Entertainment	-5.7%
JSW Steel	-0.2%

Note: Only companies with significant impacts are highlighted Source: Company, MOSL

  - **Perpetual debentures / compulsorily convertible debentures** to be classified as equity with finance cost accounted in statement of equity.
  - **Embedded derivatives to be accounted separately** if the economic characteristics of the derivative are not closely related to the economic characteristics of host contracts. This will particularly apply to optionally convertible instruments, where the derivatives would be recognized separately and the instrument (debt) would be accounted separately.

Fair valuation principle to impact measurement of financial instruments

IGAAP follows conservatism principle and recognizes the financial instruments at historical costs while the Ind-AS following fair valuation principle measures financial instruments using the time value of money. This will lead to material difference in the measurement and impairment of financial instrument under the two GAAPs

Measurement/impairment of financial instruments

- **Investments**
  - Equity: Fair valued with gains either in P&L or OCI
  - Debt : Carried at amortized cost or fair valued with gains either in P&L or in OCI
- **Derivatives :** Fair valued with MTM in P&L or treated as per hedge accounting
- **Loans and receivables :** Impairment as per expected credit loss model

- **Net worth boost on Fair Value of investments:** Ind-AS requires recognition of financial investments at fair value. This is in divergence with the current practice, where investments are classified as current and long term. Current investments are valued at cost or market price, whichever is lower and long-term investments are carried at cost less permanent diminution in the value of investment. Fair valuation of investments is likely to boost the net worth of companies and adversely impact return ratios. Investments can be categorized as (a) debt, or (b) equity.

Exhibit 29: Fair Value based measurement & recognition of Investments in Ind-AS

Classification	Amortized cost	FVTOCI (Debt)	FVTPL	FVTOCI(Equity)
Instrument type	**Debt**	**Debt**	**All (Debt, Equity, Derivative)**	**Equity**
Balance sheet Measurement	Amortized cost	Fair Value	Fair Value	Fair Value
Transaction Cost - Initial recognition	Added to initial recognition amount	Added to initial recognition amount	Charged to P&L	Added to initial recognition amount
Transaction cost - Subsequent accounting	Amortized through P&L using EIR*	Trf to OCI and amortized in P&L using EIR*	NA	Transferred to OCI
Recognition on fair value (Gain/ Loss)	NA	OCI	P&L	OCI
Interest and Dividend	P&L using EIR*	P&L using EIR*	NA	Dividend in P&L
Impairment losses	P&L	P&L	NA	OCI
Forex Gain / Loss	P&L	P&L	NA	OCI
Gain / Loss on sale or de-recognition	P&L	Gain/ Loss and Amount parked in OCI are transferred to P&L	NA	OCI recycling is not allowed

Source: MOSL

- **Fair valuation of debt instrument to smoothen earnings:** Ind-AS requires the fair valuation of debt instrument at the time of preparation of financial statements. The debt instruments are classified into three categories (depending on the business model test), which will determine the accounting for difference in the fair value since the last measurement:

  (a) Solely for the purpose of principal and interest (SPPI): Here, the financial instruments are a carried at amortized cost and the gains are recognized in the income statement.

(b) Either SPPI or sale: Here, the instruments are fair valued and MTM is recognized through other comprehensive income (OCI). The gains so accumulated are transferred to the P&L on sale/ maturity of the instrument.

(c) Residual: Here, the instruments are fair valued and the MTM is charged through the income statement.

- This, in our view, will lead to a significant smoothening of profit recognition of instruments like FMPs, where entire gains are currently recognized on maturity.

Exhibit 30: Companies with significant investments in Mutual Fund Units (% of net worth)

More Than 50%

Tata Communication	Just Dial	MCX	Info Edge
Bajaj auto	Vedanta	Maruti	Idea

26-50%

Voltas	CRISIL	Eicher	Indiabulls Housing Fin
Emami	Britania	Thermax	Hero Moto Corp
Bharti Infra	Asian paints	AIA Engg	MphasiS

20-25%

Tata Motors	Indian hotels	MRF	Mindtree	UltraTech Cem
Grasim Inds	Dr Reddy's Labs	Divi's Lab.	Ambuja Cem.	Reliance Inds.

Source: Capital Line, MOSL

- **Equity instruments fair valuation to boost net worth:** Equity instruments under Ind AS are required to be fair valued, with change in fair valuation adjusted in OCI or P&L. The MTM changes on fair valuation are charged to OCI, if (a) the instrument is classified as not held for trading and, (b) the company has exercised an option for accumulating the fair valuation changes through OCI. In all other cases, the change in fair valuation is adjusted through the P&L. We highlight that equity investments are in subsidiaries, JVs and associates, which as per the option provided under Ind-AS, can be carried at cost or accounted at fair value with MTM gains / losses adjusted through OCI while preparing the standalone financial statements.

- **Derivatives – fair valuation will lead to low volatility in income statement:** Under Ind-AS, all derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting. This is in variance with the current accounting practice wherein companies are either required to follow hedge accounting (AS30) or only the MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored. This will reduce volatility in income statements of companies currently not following hedge accounting, as the MTM gains will be recognized, offsetting the adverse impact of the underlying.

- Refer **Annexure 2** for companies currently not following hedge accounting

- **Early recognition of impairment losses on loans extended using expected credit loss model**: Ind-AS prescribes the recognition of impairment losses using the 'expected credit losses' (ECL) model. Our discussions with experts suggest that this will lead to earlier recognition of impairment loss vis-à-vis the incurred loss model traditionally used. The ECL model contains a 'three stage' approach based on the change in credit quality of financial assets since initial recognition:
  - **Stage 1:** Includes financial instruments that have not had significant increase in credit risk since initial recognition or those having low credit risk on the reporting date. For these assets, 12-month expected credit losses (resulting from default events possible within 12 months) are recognized and interest revenue is calculated on the gross carrying amount of the asset.
  - **Stage 2:** Includes financial instruments that have had a significant increase in credit risk since initial recognition but where there is no objective evidence of impairment. For these assets, lifetime ECLs are recognized, but interest revenue is still calculated on the gross carrying amount of the asset. Expected credit losses are the weighted average credit losses with the probability of default (PD) as the weight.
  - **Stage 3:** Includes financial assets where there is objective evidence of impairment on the reporting date. For these assets, lifetime ECLs are recognized and interest revenue is calculated on the net carrying amount (that is, net of credit allowance).

  Further, for trade receivables, Ind-AS mandates the use of lifetime ECL model.

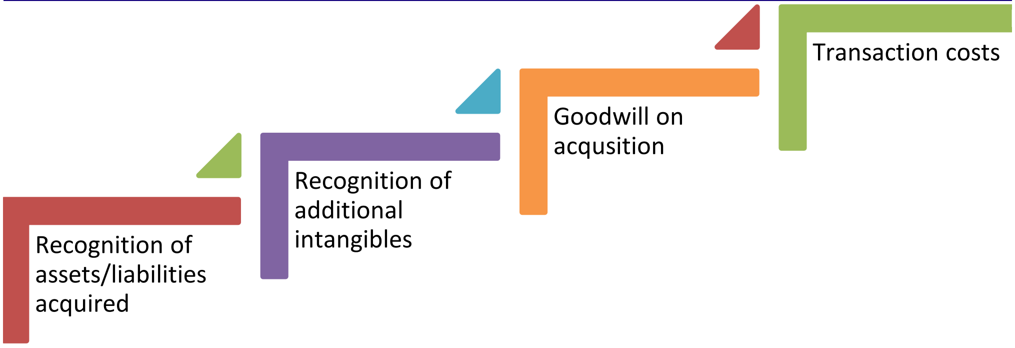
Ind-AS will lead to early recognition of NPA provisioning

- This in our view will adversely impact the BFSI sector where the credit loss provisioning will get preponed.

Business combination: Fair valuation mandatory

- IGAAPs currently provide for separate guidance on (a) acquisition of business unit or group of assets (under AS14), and (b) acquisition of shares of company (under AS21). Ind AS, on the other hand, prescribes a consistent guidance for accounting of all business combinations. Further, accounting for business combinations under Ind AS significantly varies with the current IGAAPs primarily on four counts:

Exhibit 31: Business combination: Differs under Ind-AS and IGAAPs



Source: MOSL

Exhibit 32: Business combination: Differs under Ind-AS and IGAAPs

Accounting standard	IGAAP			Ind-AS
	AS14		AS21	Ind-AS103
Method of accounting	**Pooling of Interest**	**Purchase**	**Consolidation**	Business combination
Applicability	Acquisition of business unit / group of assets + satisfying requisite condition	Acquisition of business unit / group of assets	Acquisition of shares in a company	Acquisition of any business
Recognition of assets / liabilities	Book value	Optional - Book value or fair value	Book value	Fair value
intangible recognition (other than in Books)	No	Rarely as no guidance available	No	Mandatory - at fair value
Consideration paid - Net assets recognized	Adjusted in reserves	Goodwill	Goodwill on consolidation	Goodwill
Goodwill treatment	NA	Amortized over 5 years	Tested for impairment	Tested for impairment
Overall amortization / depreciation cost	Low	High	Low	Medium
Transaction cost	Capitalized	Capitalized	Capitalized	Expensed

Source: MOSL

- **Mandatory fair valuation of assets/liabilities acquired:** Ind AS requires mandatory use of fair value approach (except in acquisition of companies under the common control) for recognition of assets/ liabilities acquired under M&A transactions.
- However, under IGAAP, M&A transactions using AS14 are accounted either using (a) pooling of interest method (when some conditions are satisfied) using book value and no recognition of goodwill, or (b) by purchase method, wherein the company has an option to recognize assets/liabilities either at book value or fair value. While, under AS21 the net assets are recorded at book value while the difference between book value and consideration paid is recorded as goodwill on consolidation.
- **Recognition of intangibles acquired:** Ind AS prescribes guidance for identification and recognition of intangible assets such as brands, trademarks, customer relationships, etc, which are not provided by the current IGAAPs. Consequently, companies will be required to recognize and disclose the valuation of intangibles acquired on acquisition.

Case study: In FY09, when Tata Motors acquired JLR, it recognized brand value and trade (intangibles) of INR51.6b, with indefinite life under its IFRS financials. However, it did not recognize such intangibles under IGAAP financials.

- **Amortization charge to increase on lower recognition of goodwill:** Currently, IGAAPs mandate the goodwill recognized under acquisitions (AS14)to be amortized over a period of five years unless a higher tenure can be justified; while, goodwill on consolidation under AS21 is only tested for impairment. Consequently, under the current practice corporates prefer to structure M&A deal as acquisition of company under AS21. Ind-AS, on the other hand requires goodwill to be only tested annually for impairment.

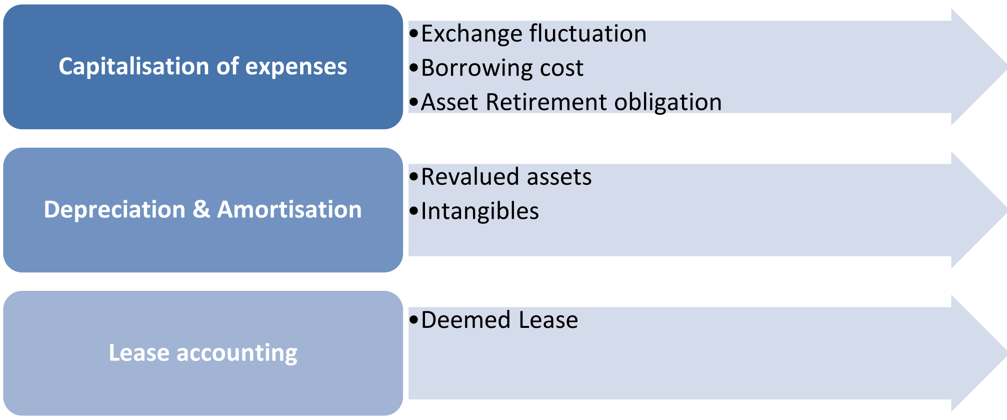
Higher amortization costs expected for companies are growing via inorganic acquisitions.

- Ind As on the other hand only requires the goodwill to be annually checked for impairment. However, since the goodwill recognized under Ind AS is generally lower than that recognized under consolidation (AS21) the amortization charge (primarily due to fair valuation of assets). This, in our view, may lead to an overall increase in amortization/depreciation charge for the companies.
- **Expensing transaction cost of M&A:** Cost incurred on mergers and amalgamation is required to be charged through income statement under Ind-AS against the current practice of capitalizing it.
- These changes will particularly impact sectors like Pharmaceuticals, IT, Automobiles and Consumer, where companies are growing via inorganic acquisitions.

Property, plant and equipment, intangibles: Material changes here!

- Accounting of property, plant and equipment under Ind AS has various departures from the current IGAAPs. These differences will impact not only the net worth of companies but also the quantum and quality of earnings. The differences are primarily on account of (a) capitalization of expenses, (b) depreciation / amortization of the asset, and (c) lease accounting.

Exhibit 33: Areas on differences in PPE under the GAAPs



Source: MOSL

- **No capitalization of exchange fluctuation:** Following the amendments made in AS11, several companies have opted to capitalize the exchange fluctuation on long-term monetary assets/liabilities either in (a) the value of assets, or (b) foreign currency monetary item translation difference account (FCMITDA), which is then amortized through the income statement either over the life of the loan/asset or till FY20, whichever is earlier. Ind AS requires the exchange fluctuation to be expensed and does not permit capitalization except as an adjustment in the borrowing cost.

- However, transition provision permits the companies currently following amended AS11 to continue the capitalization on existing loans.
- This is likely to affect companies in the Automobiles, Telecom and Metals sector which currently rely of forex borrowing and capitalize exchange fluctuation in the balance sheet.
- Refer **Annexure 3** for list of companies following amended AS11

- **Capitalization of borrowing cost may increase:** Currently, several companies capitalize borrowing costs of specific loans, but exclude borrowing costs on many general borrowings (for example, working capital loans). Under Ind-AS, in the absence of sufficient specific borrowings, all general borrowings need to be considered for the purpose of capitalization. Our discussions with various experts indicate that this would result in additional amounts being capitalized.
- This, in our view, will impact sectors like Telecom, Metals & Mining and Power which have high assets under capitalization.
- **Capitalization of asset retirement obligation may increase:** Asset retirement obligations (AROs) should factor both constructive and contractual obligations on present value basis against the erstwhile practice of IGAAPs, where the AROs are factored only for constructive obligations. This would negatively impact the profitability of companies, as they would be required to make higher provisioning on account of constructive obligations partially mitigated by discounting of obligations to present value.
- This, in our view, will impact sectors like Metals, Telecom, Power and Oil & Gas.

Depreciation on revalued assets needs to be factored through the income statement

- **Depreciation of revalued assets to impact earnings:** Ind AS does not permit selective revaluation of assets but prescribes for the entire class of assets. Further, while revaluation gains are adjusted in reserves, depreciation on revalued assets needs to be factored through the income statement as against the current IGAAP practice of charging through revaluation reserves. We do not expect companies to opt revaluation of assets under Ind-AS.
- **Amortization costs to be lower on intangibles with indefinite life:** Under Ind-AS, intangibles like trademarks/brands can have indefinite useful life and may not be amortized but need to be periodically tested for impairment. This is in variance with the current IGAAPs, where the intangibles are generally amortized over a period not exceeding ten years. We believe that this may lead to lower amortization of intangibles for companies, and hence, lead to higher earnings.
- This may impact companies in the Pharmaceuticals, Consumer and Agriculture sector, where acquisitions may lead to recognition of brands and trademarks, which may have indefinite useful life.

Exhibit 34: Companies with significant intangibles currently amortized

Company	% of FY15 Net Worth
Torrent Pharma.	71%
Pfizer	17%

Source: Capital Line, MOSL

- **Deemed lease may have material impact on debt and return profile of corporates:** While Ind-AS and IGAAP are consistent in accounting of lease, they differ significantly in identifying transactions that need to be classified as lease. Ind-AS is based on 'substance over form' and looks beyond the legal form (as used by IGAAP) to identify arrangements that are in the nature of lease.
- Ind-AS prescribes the fulfillment of the following conditions for any transaction to be classified as a deemed lease:
  - Requires the use of specific asset, and
  - Convey to the counterparty right to use the asset while it takes significant proportion of the output/utility of the asset as evidenced by any of the following:
    - (i) The purchaser has the right or ability to operate the asset or direct others to operate the asset in the manner it determines, or
    - (ii) The purchaser has the right and the ability to control the physical access to the underlying asset, or
    - (iii) The price that the purchaser pays for the output is neither contractually fixed per unit nor is the current market price per unit.
- The arrangements that may fall under the scope of deemed lease will include (a) outsourcing arrangements, (b) take-or-pay contracts, (c) arrangements in the Telecom industry, in which the supplier of network capacity enters into contract to provide purchasers with the right to capacity, etc.
- Under deemed lease, the assets so determined to qualify for deemed lease will be transferred from the books of the seller of goods to the books of the purchaser of goods at fair value. Further, the payments received from the purchaser of goods will be accounted for as (a) payments towards operations for manufacturing of goods/services, and (b) payments towards financial lease, which will be further broken down as (i) repayment of financial liability, and (ii) payment of interest.

Exhibit 35: Books of seller – IGAAPs

Revenue recognition	•Sale of goods
Payment Received	•Recognised towards receipt from debtors
Assets	•Tangibles assets-depreciated periodically

Source: MOSL

Exhibit 36: Books of seller – Ind-AS

Revenue recognition	•Profit on sale of assets •Operations and maintenance •Interest on Financial lease
Payments received	•Operations and maintence costs •Repayment of financial lease
Assets	•Financial assets - Receivable from financial lease

Source: MOSL

Exhibit 37: Books of purchaser - IGAAPs

Asset	•No assets
Liabilities	•No liabilites
Expenses	•Purchase price of goods
Payments	•Purchase of goods

Source: MOSL

Exhibit 38: Books of purchaser – Ind-AS

Assets	•Tangiable assets
Liabilities	•Lease obligation
Expenses	•Depeciation of intangibles •Operating/ Mfg cost
Payments	•Lease rentals •Operating and Mfg costs

Source: MOSL

- Example: XYZ Limited (power producer) enters into an agreement in 2016 with ABC Limited (power purchaser) to sell all the units of power produced at a specified plant at a rate of INR500m p.a (of which INR100m is towards annual operating expenses) for four years. Further, the construction of plant will cost INR1,000m and operating cost of power generation and other operating expenses are INR60m per year.
- Assumptions – interest rate: 10%, depreciation method: straight line, Fair Value of assets: INR1268m.

Exhibit 39: Allocation of lease payments (INR m)

Year	Opening balance	Total payment (Int. + Principal)	Interest	Principal	Closing balance
2016					1,268
2017	1,268	400	126	274	994
2018	994	400	100	300	694
2019	694	400	70	330	364
2020	364	400	36	364	-

Source: MOSL

Exhibit 40: Financials of ABC Limited (Lessee; INR m)

Particulars	2016	2017	2018	2019	Total
Income Statement					
Operating expense	100	100	100	100	400
Depreciation	317	317	317	317	1,268
Interest	126	100	70	36	332
Net income/(loss)	(543)	(517)	(487)	(453)	(2,000)
Balance Sheet					
Fixed assets (gross)	1,268	1,268	1,268	1,268	
Accumulated depreciation	317	634	951	1,268	
Fixed assets (net)	951	634	317	-	
Lease obligation	994	694	364	-	
Cash flow from financing activities	(500)	(500)	(500)	(500)	(2,000)

Source: MOSL

Exhibit 41: Financials of XYZ Limited (Lessor; INR m)

Particulars	2016	2017	2018	2019	Total
Income Statement					
Income from operating activities	100	100	100	100	400
Interest income	126	100	70	36	332
Gain on sale of asset	268				268
Operating expense	(60)	(60)	(60)	(60)	(240)
Net income /(loss)	434	140	110	76	760
Balance Sheet					
Lease receivable	994	694	364	-	
Cash flow					
Cash flow from operations	440	440	440	440	1,760
Cash flow from investing activities	(1,000)	-	-	-	(1,000)
Total cash flow	(560)	440	440	440	760

Source: MOSL

Will era of high RoCE be behind for few sectors impacted by deemed lease?

Companies may redraft arrangements to circumvent deemed lease provision. However, sourcing cost may rise.

- Automobiles, Pharmaceuticals, Consumer, and Power Purchasers enjoyed high RoCE, as they operated with asset-light models, where manufacturing was outsourced, with take-or-pay contracts. With the introduction of Ind-AS, such contracts may qualify for deemed lease. This will entail recognition of additional tangible assets and financial liabilities in the books of the purchaser, adversely impacting return ratios.
- While the companies in these sectors will try to modify agreements to skirt the definition of deemed lease, we believe that (a) this might be difficult, where the government is a counterparty, and (b) even when the arrangements are entered into with other companies, there might be an increase in cost implications, as demand risk will legally shift to the seller under the new arrangements.

Other differences

- **Foreign exchange fluctuations –** Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. However, in the current IGAAPs, an option has been provided to companies to capitalize the exchange fluctuation on long term monetary assets to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or a specified period.
- It may, however, be read along with the carve-outs proposed, where the companies have been given an option to continue their existing accounting policy of long term monetary asset/liability that existed on the date of migration (end of FY16 for Phase I companies).
- **Deferred taxation –** Under Ind AS, deferred taxes are computed using balance sheet approach for temporary differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Under IGAAP, taxes are computed using profit/loss statement approach for timing differences in respect of recognition of items of profit or loss for the purposes of financial reporting and for income taxes.
- This will lead to recognition of (a) deferred tax on unrealized inter-company profit eliminated on consolidation, and (b) deferred tax on undistributed profits of subsidiaries and associates.

- **Proposed dividend –** Under the current practice, the liability for dividend payments is recognized in the period in which it is declared. However, under Ind AS, it is recognized when approved by the shareholders. This, in our view, will have a positive impact on the net worth of entities paying high dividends on the one hand, while it dampens return ratios on the other.
- **Government grants –** Ind AS prescribes for accounting for government grants as follows, which is different from the current IGAAPs:
  - **(a) Below market rate loan:** Benefit of government loans with below market rate of interest should be accounted for as government grant, measured as the difference between the initial carrying amount of the loan and fair value of the loan on initial recognition. The value of this benefit is then recognized on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate. Under the current IGAAPs, no benefits are separately recognized.
  - **(b) Grants of non-monetary assets:** Benefit of government grants of non-monetary assets have to be accounted at fair value. Under the current practice, the same is recorded at acquisition cost.
  - **(c) Grants related to fixed assets:** These are to be treated as deferred income, which is recognized in the income statement on a systematic basis over the useful life of the asset. This is in variance with the current practice, wherein the grants value is reduced from the carrying value of the asset.
  - **(d) Grants in the nature of promoters' contribution:** Under Ind AS, these are recognized as income over the period on a systematic basis to match the related cost that it intends to compensate. Under IGAAPs, it is recognized as part of capital reversal.
- **Barter transactions –** When goods or services are exchanged for obligations of similar value other than money, the exchange is regarded as barter. Currently, there is no specific guidance under IGAAP to record barter transactions. However, under Ind AS, such transactions are to be recorded at fair value adjusted by any sum or cash transferred. This will lead to higher recognition of revenues and operating expenditure while earnings remain un-impacted.
- **Extraordinary items –** Disclosure of items as extraordinary items, either on the face of profit/loss statement or in notes is prohibited under Ind AS. However, to provide investors with greater clarity on the recurring nature of incomes/expenses, the management at its own discretion can exhibit such extraordinary items in Management Discussion & Analysis in the annual report.

Extensive disclosure requirements – a boon for investors

Ind-AS comes with a lot of additional disclosures in line with global standards. Not only will this help enhance transparency but will also provide vital information to various stakeholders.

- **Segmental disclosures made more robust:** Ind-AS requires segmental information to be provided on how the chief operating decision-maker (CODM) evaluates financial information for allocating resources and assessing performance. This may require certain companies to change segment disclosures consistent with the internal reporting.

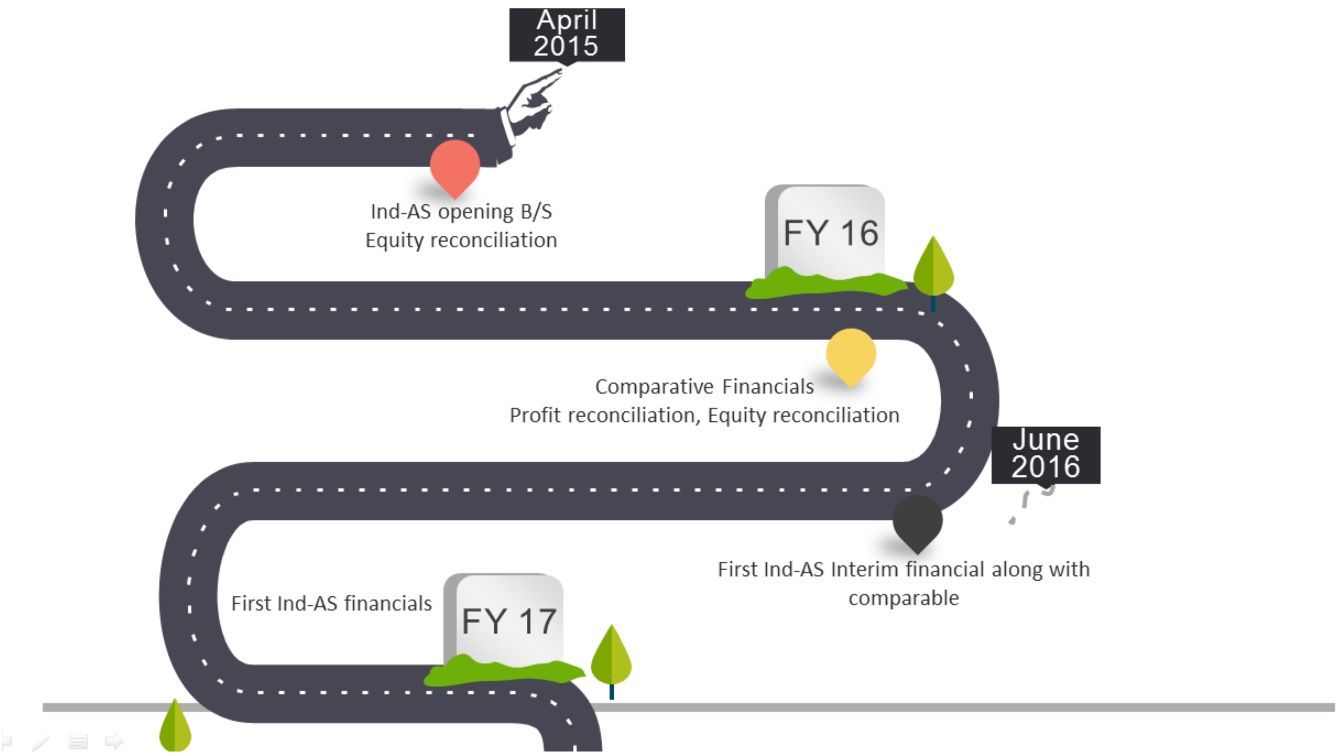
- **Related party definition broadened:** The definition of what constitutes a "related party" has been broadened under Ind-AS to include increased number of relationships. Post-employment benefits too have been included as benefits to employees.
- **Detailed disclosures on management estimates:** Ind-AS requires a company to disclose the judgments and estimates that the management has made in the process of applying the company's accounting policies and that have significant effect on the amounts recognized in the financial statements.
- **Risk assumptions to be spelt out:** Ind-AS also requires disclosure of key assumptions about the future that can result in a situation of risk, which may require adjustments to carrying amount of assets and liabilities (within the next financial year).
- **Focus on detailed discourse on capital management:** Currently, there are no disclosure requirements with regards to capital management. However, Ind-AS requires disclosures that would enable users of the financial statements to evaluate the company's objectives, policies and processes for managing capital.
- **EPS**: IGAAP mandates disclosure of standalone EPS (earnings per share). However, Ind-AS mandates EPS disclosure of consolidated profits too.
- **Reconciliation of Income taxes to be made available:** Ind-AS will also require extensive disclosures in the area of income taxes. This includes a reconciliation of effective tax expense with the actual tax expense, deferred tax assets not recognized on losses, movement in deferred tax assets and liabilities balances, etc.
- **Contingent Assets** to be disclosed along with contingent liability.
- **Transition disclosures**: Extensive disclosures are required to explain the transition to the shareholders for every change in estimate, accounting policy, reclassification or recognition/de-recognition of assets and liabilities, qualitative description of factors that constitute goodwill, and pro-forma revenues and profit and loss of the combined company as if the acquisition was done at the beginning of the reporting period.
- **Reconciliation of Networth:** The first time adopter needs to provide a reconciliation statement of impact of adopting Ind-AS on
  - Equity – as at the transition date and at the end of comparable year, and
  - Profits – of the comparative period.

Transition and first time adoption of Ind-AS

Road map for first time adoption

- Transitioning to Ind-AS will be a mammoth task, as it will require companies to
  - (a) Prepare an opening balance sheet using Ind-AS principles,
  - (b) Prepare a comparative financial statement using Ind-AS, and
  - (c) Give adequate disclosures on reconciliation of profit and net worth on first time adoption
- For an entity transiting to Ind-AS from FY17, the timelines will be as follows:

Exhibit 42: Timelines for preparation of financials under Ind-AS in Phase I

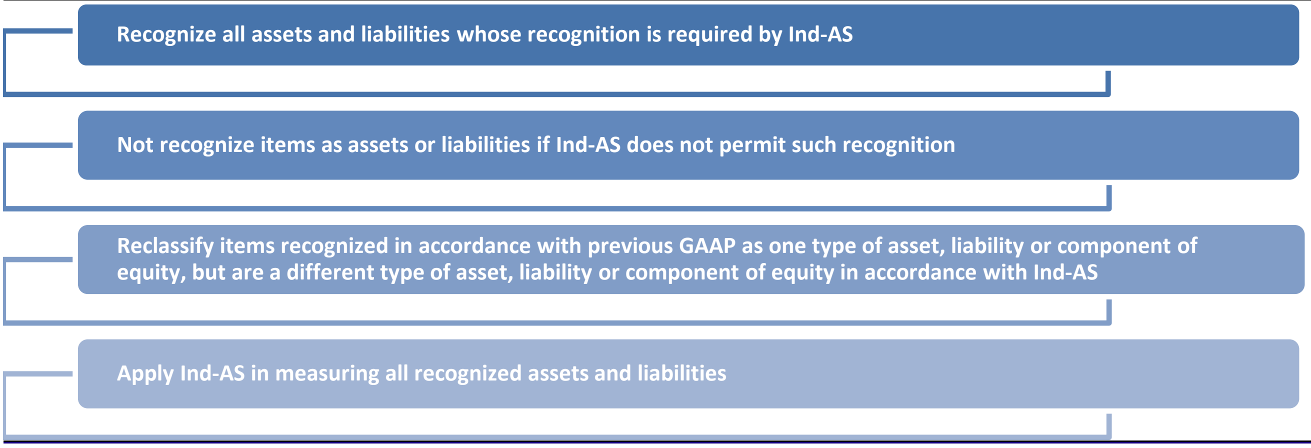


Source: MOSL

Preparing an opening balance sheet

- An entity is required to make the opening Ind-AS balance sheet on the date of transition as an initiating measure to adopt Ind-AS. The entity shall follow the following process for preparation of first time balance sheet; the difference arising shall be adjusted through reserves.

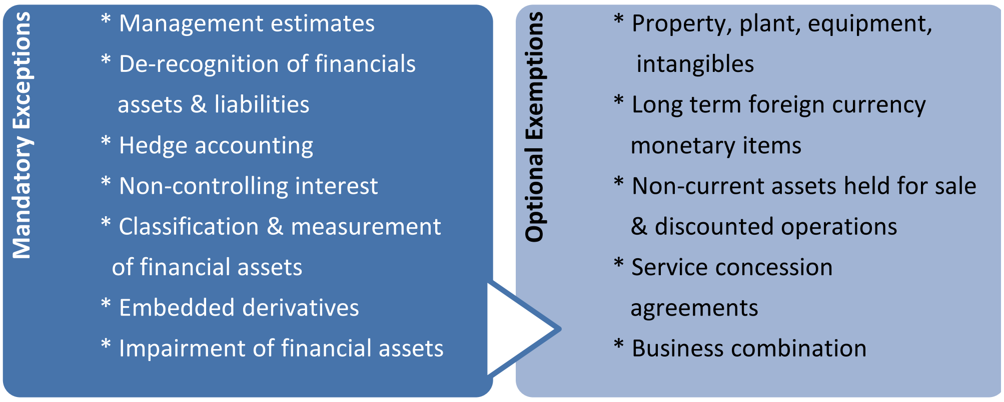
Exhibit 43: Process of preparing an opening balance sheet



Source: MOSL

- Ind-AS provides certain exemptions from retrospective applicability of provisions for preparation of opening balance sheet. While some of these are mandatory, others are optional. The significant exemptions are illustrated below:

Exhibit 44: Exemptions on first time adoption



Source: MOSL

Mandatory exemptions

- **Management estimates:** Estimates made by the management under IGAAP should not be changed by using subsequent information at the Ind-AS transition date (i.e. not to use any hindsight). These estimates should be changed only if there is an error, or the estimates were not required under IGAAP but are now required under Ind-AS.
- **De-recognition of financial asset / liability:** If non-derivative financial assets or non-derivative financial liabilities are de-recognized in accordance with previous GAAP as a result of a transaction that occurred before the date of transition to Ind-AS, the entity shall not recognize those assets and liabilities in accordance with Ind-AS unless they qualify for recognition as a result of a later transaction or event.
- **Hedge accounting:** All derivatives are required to be carried at fair value through profit and loss account unless they meet the hedge accounting

requirements under Ind-AS. Retrospectively designating derivatives and qualifying instruments as hedges is not permitted.

- **Non-controlling interest:** Ind-AS provides that on transition the non-controlling interest (NCI) cannot have a deficit balance unless it pertains to a business combination considered retrospectively while applying first time adoption.
- **Classification and measurement of financial assets:** The classification and measurement of financial assets will be made considering whether the conditions specified under the standard are met based on facts and circumstances existing at the date of Ind-AS transition.
- **Impairment of financial assets**: The transition provision provides operational simplification to apply for impairment requirement. On first time adoption, it is required to approximate the credit risk on initial recognition of financial instrument. The entity will use this credit risk so determined at the date of transition for determining whether a 12-month ECL or a lifetime ECL should be used. If the entity is unable to determine whether there is increase in significant credit risk, then lifetime ECL is used.

Optional exemptions

MAT paying may fair Value assets on first time adoption to benefit from lower tax outflow

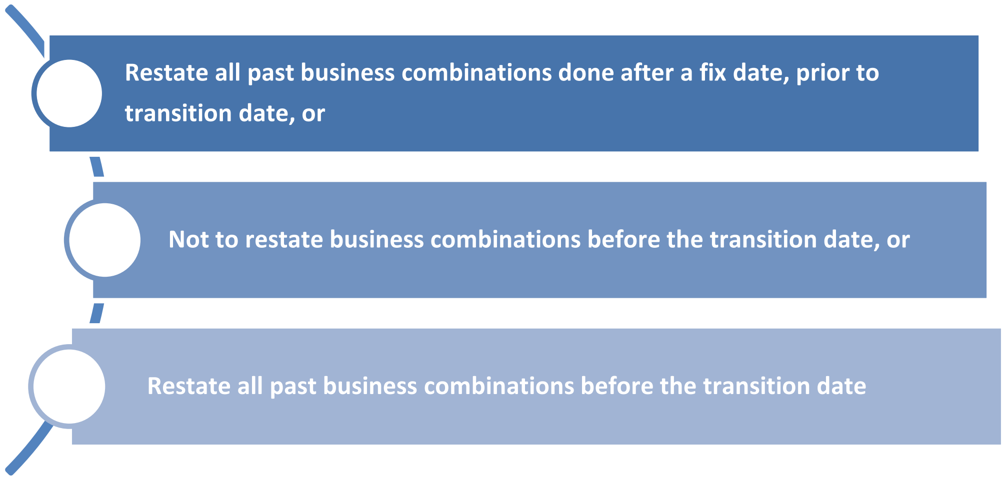
- **Property, plant and equipment:** Entities have been given an additional option to use IGAAP carrying values of PPE and intangibles as on the transition date as deemed cost under Ind-AS. Further, for lease arrangements, transitional relief has been given to use transition date facts and circumstances to assess the classification of each element as a financial or an operating lease.
- We believe MAT-paying companies might opt to fair value the PPE at first time adoption, as the upward revaluation of assets will lead to higher depreciation and lower book profits. This in turn will lead to lower outflow of MAT.

Companies permitted to account for fluctuation on existing loans as per their current policy. However, on new loans forex losses are charged to P&L.

- **Foreign exchange difference on long-term monetary items:** Entities under IGAAP had a one-time option to capitalize exchange fluctuation on long term monetary items to the carrying cost of fixed assets or to reserves and then depreciate / amortize over a period of time as specified or charge it to income statement. Under the transition provision, an exemption has been provided to account for the exchange fluctuations on long term monetary assets/liabilities that existed till the date of migration (FY16-end for Phase I) to account for exchange differences arising from translation of long-term foreign currency monetary items recognized in the financial statements as per previous GAAP.
- However, the exchange difference on long-term monetary items accounted for the first time after implementation of Ind-AS has to be routed through income statement only.
- **Non-current assets held for sale; discontinued operations:** On first-time adoption, an entity can measure such assets at the lower of carrying value and fair value less cost to sell (at the date of transition) and recognize the difference directly in retained earnings.
- **Service concession agreement:** Ind-AS provides optional relief from retrospective application of the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognized in the financial statements in previous financial reporting period as per IGAAP.

- **Business combination:** A company has the following three options in relation to the business combination transactions before the transition date:

Exhibit 45: Options to account for business combinations

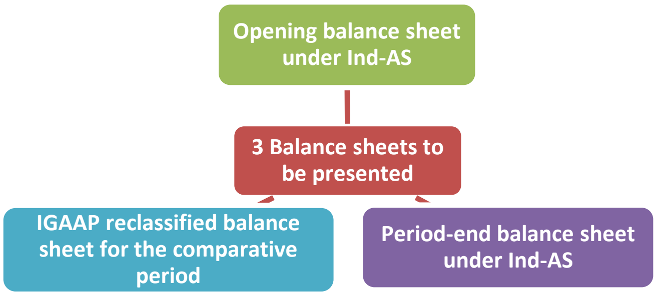


Source: MOSL

Comparative financials

- After transition to Ind-AS, companies are required to present comparative information as previously reported under IGAAP. Hence, three Balance sheets would be presented at the end of the first year of transition.

Exhibit 46: Three balance sheets to be prepared on first time presentation



Source: MOSL

Disclosure requirements

- Extensive disclosures are required to explain the transition to the shareholders for every change in estimate, accounting policy, reclassification or recognition/de-recognition of assets and liabilities.
- Further, companies are required to present the profit and loss account, cash flow statement and notes to accounts for the current transition period under Ind-AS and comparatives as previously reported under IGAAP reclassified in prescribed Ind-AS format.

First time adoption may facilitate cleaning up of balance sheet for a few

- We believe that the first time adoption of Ind-AS will lead to material changes in the net worth of entities, as assets and liabilities will be reassessed for recognition and measured as per Ind-AS with the differences being adjusted directly in the reserves. We believe that this may be used by companies for cleaning up the balance sheet.

Implications for sectors

As India Inc. transitions to Ind-AS, it is likely to witness many changes in financial reporting. While it is difficult to quantify the impact or even gauge its direction in several instances in the absence of adequate disclosures, we have tried to identify the BSE200 companies likely to be impacted materially. We have classified the impact in three categories (high, medium and low) based on the FY15 financials reported by the respective companies.

Exhibit 47: Implication of Ind-AS on various sectors

Sector	Overall	Revenue Recognition	Financial Instruments	Employee benefit	Consolidation	PPE	Business Combination	Others
Banking	●●●	●●	●●●	●●				
Telecom	●●●	●			●●	●		●●●
Media	●●	●	●●	●●	●			●
Automobile	●●	●	●●		●●	●	●	
Consumer	●●		●●	●●	●	●	●	
Technology	●●		●●	●	●		●	
Power	●●	●●	●	●				
Healthcare	●●		●●	●		●	●	
Metals	●●		●	●		●●		●●●
Oil & Gas	●●		●●	●	●	●	●	●
Real Estate	●●	●●	●		●●			
Agriculture	●●		●●		●			●
Cement	●		●					●
Capital Goods	●	●	●		●			

Impact: Low ●| Medium ●●| High ●●● Source: MOSL

Our analysis of the differences between the two GAAPs suggests material impact on the operating metrics of:

(a) **BFSI** – earlier recognition of NPAs, fair valuation of ESOPs, deferment in recognition of fee income, and routing actuarial losses/gains through reserves,

(b) **Telecom** – expensing forex gains/losses on loans and consolidation of joint ventures,

(c) **FMCG and IT** – fair-valuing ESOPs, increased amortization post business combinations and accrual-based recognition of income on MF,

(d) **Auto** – consolidation of JVs / treasury shares, classification of take-or-pay contracts as deemed lease,

(e) **Power** – arrangements with government classified as service concession arrangements,

(f) **Media** – fair-valuing ESOPs, classifying redeemable preference shares as debt, and

(g) **All sectors** – timing and quality of revenue recognition.

We now discuss the sector-wise implications of migration to Ind-AS and highlight the companies we believe will be materially impacted.

Banking and financial services

Exhibit 48: Snapshot

Area	IGAAP	IND AS	Impact due to Ind-AS
Revenue Recognition			
Fee income on (a) loans extended , and (b) guarantee services rendered	▪ No specific guidelines. Generally recognized on receipt	▪ Fee income is recognized over the life of the loan/period of service.	▪ Deferral of revenue recognition leading to impact on margin and earnings.
Investment income	▪ Instruments classified as (a) HTM: carried at amortized cost ; (b) AFS/ HFT: with MTM losses in P&L and gains being ignored till realized	▪ Instruments classified as (a) HTM: carried at amortized cost; (b) FVTOCI: With MTM gains / Losses in reserve and (c) FVTPL: with MTM gains / losses in P&L.	▪ This will lead to a reduction in the volatility of treasury income reported by the banks and will also lead to an increase in the net worth (in a falling rate scenario) with consequent decline in ROE's
Financial instruments			
NPA recognition	▪ NPA recognition as per RBI guidelines which is more on lines with the incurred loss model	▪ NPA recognition as per expected credit loss method	▪ NPA recognition will get proponed
Borrowing cost on deep discount bond/ redemption premium payable on maturity	▪ Discount on issue / premium on redemption charged through reserves	▪ Charged through Income statement on EIM method	▪ Decrease in NII
Preference dividend on redeemable preference shares	▪ Preference dividend is shown as appropriation to profits	▪ Redeemable Preference shares are treated as debt while preference dividend as finance cost	▪ Decrease in NII
Employee benefits			
ESOPs	▪ Optional to account for ESOP cost on intrinsic basis or fair valuation	▪ Mandatory to account for ESOPs cost on fair valuation	▪ Increase in the employee costs.
Long term employee benefit plans	▪ Gains/ losses on change in actuarial assumptions charged to the income statement	▪ Gains/ losses on change in actuarial assumptions charged to the reserves	▪ Reduction in volatility of Income statement.
Others			
Loan origination expenses	▪ No specific guidelines. Companies follow different approaches. However, generally recognized on accrual basis	▪ Transaction costs on loan origination expenses is amortized over the life of the loan.	▪ Deferral of cost recognition

Source: MOSL

Notification for applicability of Ind-AS to HFC's is yet to be announced

- We highlight below the principles that may affect BFSI companies due to the transition to Ind-AS. We believe the impact of these provisions will be felt across the sector and that it is difficult to detail the impact on individual companies due to limited public information on Ind-AS implementation.

Revenue recognition

- **Fee income on** loans **and guarantees to be deferred:** Banks derive significant proportion of their earnings through fees. In the absence specific guidelines, different banks follow different methods to recognize fee income. Ind-AS requires fee income (a) on guarantees to be recognized over the period rendering of service, and (b) on loan origination to be recognized over the tenure of the loan on the basis of effective interest yield method. This will lead to a time deferment in recognition of revenues. Further, loan origination costs (DSA payments), which are charged to income statement on actuarial basis, will be amortized over the life of the loan.

Deferral of fee income to impact private sector banks

- **Private** sector **banks** derive higher proportion of their profitability through fee income than state-owned banks. The impact of deferment of fee income will be higher on private sector banks. Further, the impact will be offset by amortization of loan origination expenses (higher in retail loans), which are currently being expensed.
- Among private sector banks HDFC bank, Axis bank, Kotak Mahindra bank and ICICI bank have higher exposure to retail loans. **HDFC Bank** derives most of its fee income from liabilities and has significant DSA payouts on retail loans. We believe it will be positively impacted. **Axis Bank** currently recognizes fee income on guarantees over the tenure; hence, it will see minimal impact. Other private sector banks have fee income of 1.3-2.3% of average assets. They are likely to be impacted on deferral of fee income, though the impact is difficult to ascertain due to limited disclosures on the composition of fee income.
- NBFCs are usually more focused on retail loans and have high loan originating expenses, which partially offset fee income. For Bajaj Finance, the average tenure of the loan is low – deferment of fee income may not have a material impact. Among the HFCs, the impact on IndiaBulls Housing Finance might be higher, given its higher exposure to corporate loans.
- Private sector banks derive substantial portion

Exhibit 49: Private banks derive significant proportion of income from fees (% of avg assets)

Private Banks derive significant portion of their income via fees

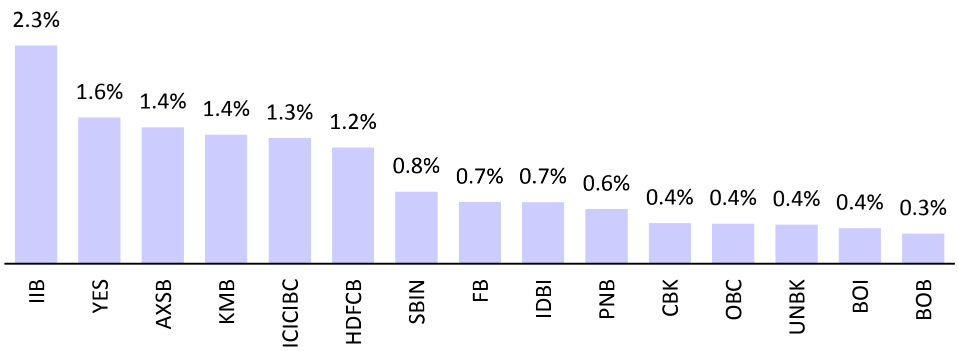
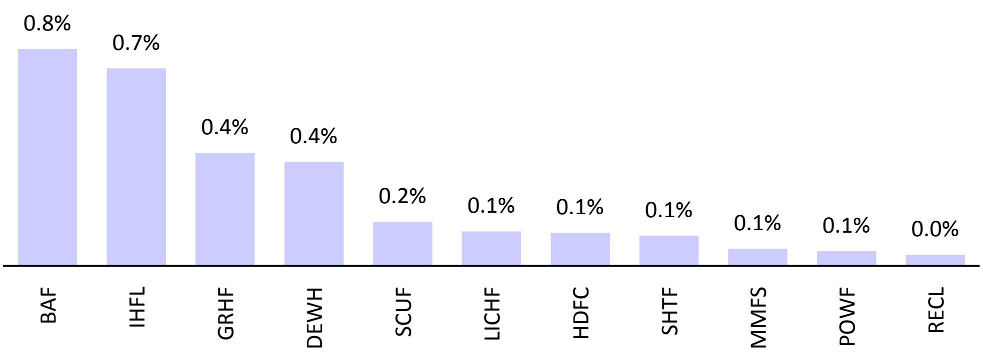


Exhibit 50: Fee income for NBFCs relatively low



Source: Company Annual Report, MOSL

Volatility in recognition of investment income to increase

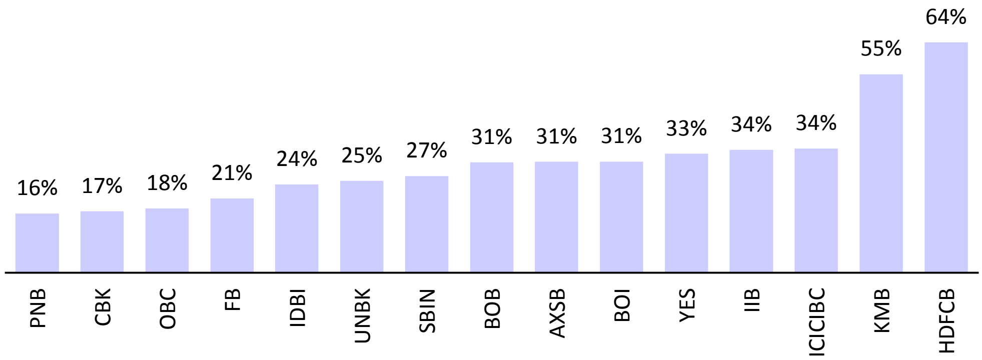
- **Higher** volatility **in recognition of investment income:** Banks have investments in government bonds and treasury notes. Treasury incomes for banks have been lumpy, primarily due to AFS and HFT investments, wherein MTM losses are charged to the income statement while gains are ignored until realized. Recoup of only provisions (MTM for price going above cost does not take place in a falling interest rate scenario) happens. However, Ind-AS requires all investments (excluding HTM) to be marked to market at the end of each financial period, with gains / losses being recognized in the income statement / OCI as per the classification. We believe this will increase the volatility in recognition of treasury income and net worth.
- Currently, private sector banks hold investment books with lower time duration. They will face limited volatility in income and reserves on interest rate changes. State-owned banks' investment books are of higher duration; they will face higher volatility in treasury income and reserves.

Financial instruments

- **NPA recognition – more judgmental and likely to happen earlier:** Currently, banks follow the incurred credit loss method for NPA recognition, in line with RBI guidelines. They make (a) general provisions on their entire loan portfolio at rates specified by the RBI from time to time, and (b) specific provisions on the basis of days overdue. Under Ind-AS, loan loss provisioning will be in the form of expected credit loss method, which is more stringent than the incurred credit loss method. Under the new norms, provisioning will not just be based on predetermined rates. Banks will be required to evaluate all significant exposures individually and all smaller exposures collectively to determine the change in risk profile and evaluate the need for and quantum of impairment.
- It is difficult to quantify the increase in provisions due to migration to the expected credit loss model, as a lot is left to management discretion. Directionally, companies with lower PCR (on overall stress loans) will suffer higher adverse impact than peers.
- Among other NBFCs, companies in different asset financing follow different norms for recognizing NPAs. Directionally, companies with high NNPA as % of net worth – Mahindra finance, Shriram Transport, REC, PFC – will be impacted more.

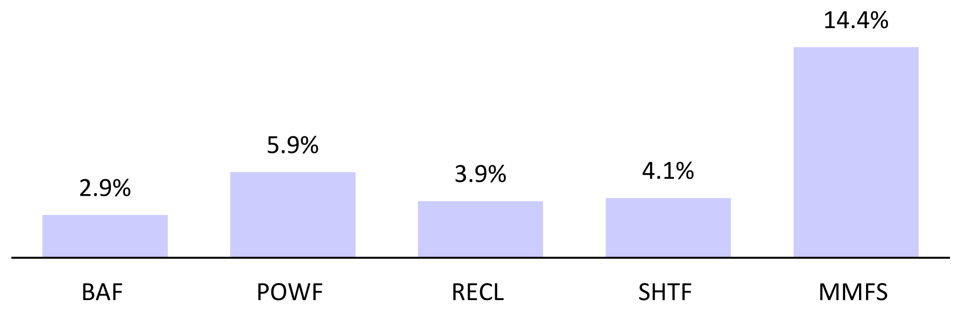
State-owned banks have a relatively lower PCR

Exhibit 51: PCR lower for state-owned banks



Source: Company, MOSL

Exhibit 52: NBFCs: NNPA as a % of net worth



Source: Company, MOSL

- **NII to be impacted on factoring discount on issue / redemption premium payable as interest cost:** Few NBFCs issue deep discount / low coupon bonds redeemable at a premium. Currently, the discount and redemption premium are charged directly through reserves. Ind-AS requires the discount/ premium payable on such bonds to be charged off as an interest cost, impacting NII.

Exhibit 53: NBFCs: Interest cost on ZCCB to impact earnings

Company	ZCCBs (INR m)	PAT Impact
HDFC	6440	3.4%
Indiabulls Housing Finance	2100	7.8%
Dewan Housing Finance	3118.9	5.8%

Source: Company, MOSL

- **NII lower on classifying redeemable preference shares as debt:** Few NBFCs issue redeemable preference shares (banks do not issue these any longer), which are currently treated as AT1 for banks and T2 capital for NBFCs. The redemption premium payable is treated as an appropriation to profit. However, Ind-AS requires classification of such preference shares as debt and the dividend payable as finance cost. This will lead to higher interest cost and lower NII.

Employee benefits

- **Fair valuation of ESOPs to impact earnings:** Most private sector banks grant ESOPs to employees. Generally, companies have opted to account for ESOP cost using intrinsic cost method. Ind-AS requires mandatory use of fair valuation method, which is likely to increase employee cost.

Exhibit 54: Fair valuation of ESOPs to impact earnings

Companies	% of PAT
HDFC bank	8.9
Federal Bank	2.5
ICICI Bank	2.5
Indusind Bank	2.2
Yes Bank	1.8

Company Annual Report, MOSL

- **Actuarial loss-led volatility in employee cost to reduce:** State-owned banks have significant long-term employee benefit schemes. Currently, the actuarial losses/gains on these schemes are charged through the income statement, which leads to volatility in earnings. Ind-AS requires the actuarial losses to be charged to reserves and will help to contain the volatility in earnings.

Exhibit 55: Defined benefit plan to be routed through reserves

Companies	% of PBT Loss/(gain)
Punjab National Bank	56%
State bank of India	12%
Federal Bank	7%
ICICI Bank	2%
Bank of Baroda	-17%
IDBI	25%
Union Bank	35%
Bank of India	14%
Oriental Bank	23%

Company Annual Report, MOSL

Rating: Major impact due to NPA recognition and fee income

Companies	Overall	Revenue Recognition	Financial Instruments	Employee benefit expenses
HDFC Bank	●●	●	●	●●●
Axis Bank	●●	●	●●	●
ICICI Bank	●●	●●	●●	●
Indusind bank	●●●	●●●	●●	●
Yes bank	●●●	●●●	●●	●
Kotak Mahindra Bank	●●	●●	●	
Federal Bank	●●●	●●●	●●●	●●●
State Bank of India	●●●	●●●	●●●	●●●
Bank of Baroda	●●●	●●	●●	●●●
Punjab National Bank	●●●	●●●	●●●	
IDBI Bank	●●●	●●●	●●●	●●●
Canara Bank	●●●	●●●	●●●	●●●
Union Bank	●●●	●●●	●●●	
Bank of India	●●●	●	●●	●●●
Oriental Bank	●●●	●●●	●●●	●●●
HDFC	●●	●	●●	●
Bajaj Finance	●●	●	●●	●
Indiabulls housing finance	●●●	●●	●●●	●
LIC Housing Finance	●	●		
Power Finance Corporation	●●●	●	●●●	
Rural Elec Corporation	●●●	●	●●●	
Shriram Transport	●●●	●	●●●	
Mahindra finance	●●●	●	●●●	
Gruh finance	●	●	●	
Dewan Housing Finance	●●●	●	●●●	

Impact: Low ● l Medium ●● l High ●●●

Source: MOSL

* For the purpose of our analysis we have considered the standalone financials of all banks (except SBI)

Telecom

Exhibit 56: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Consolidation			
Joint venture	■ Consolidation on proportion-nate basis.	■ Consolidated as per equity method.	■ Decline in revenues and EBITDA. However, earnings remain unaffected. Also, leverage profile of companies may change.
Others			
Capitalization of exchange fluctuation	■ Can be capitalized to value of asset	■ To be charged to income statement	■ Reduces asset value and earnings
Property, plant & equipment			
Asset retirement obligation (ARO)	■ Companies recognize absolute contractual obligation for ARO as part of asset cost.	■ Companies recognize present value of both contractual and constructive obligation as part of asset cost.	■ Profitability in initial years will decline, as base for amortization increases on recognition of constructive obligation. However, this will be partially compensated, as obligations are recognized at present value rather than absolute value.
Employee benefits			
ESOPs	■ Option to account for ESOP cost on intrinsic basis or fair valuation.	■ Mandatory to account for ESOP cost on fair valuation.	■ Increase in employee costs.
Revenue recognition			
Multiple element contracts	■ No specific requirement on unbundling of services.	■ Composite sale of handsets, sim-card, packages, etc to be unbundled and recognized separately.	■ Revenue recognition may get deferred.
Infrastructure sharing agreements (barter transactions)	■ In the absence of specific guidelines, companies generally do not record these in the financial statements.	■ Prescribes specific guidance to recognize the transactions at fair value.	■ Revenue and operational expenditure will be higher. However, it will have no impact on earnings.
Financial Instruments			
Derivatives	■ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	■ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	■ Reduce volatility in income statements of companies currently not following hedge accounting

Source: MOSL

Consolidation

- **JV consolidation under new norms to impact operating earnings:** Bharti Airtel, Idea Cellular, Bharti Infratel and Vodafone have a JV (Indus Towers), which contributes substantial revenues to the consolidated financials of these companies. Ind-AS requires JVs to be consolidated by equity method (as currently done for associates) as against the IGAAP-prescribed proportionate consolidation. This will bring material changes in operating metrics like revenue / EBITDA and debt profile, while earnings may remain unimpacted. However, as

Bharti Airtel consolidates JVs using equity method, no impact is expected on its financials.

Exhibit 57: Significant operation from JV's

Particulars	% of Revenue	% of EBITDA
Bharti Infratel	54%	52%
Idea Cellular	8%	10%

Source: Company Annual Report, MOSL

Others: Foreign exchange fluctuation

RCom & Idea Celluar currently follow amended AS11, likely to see impact on earnings

- **Exchange fluctuation on long-term monetary assets/liabilities to impact earnings:** Oil companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. The current IGAAPs, however, provide an option to capitalize the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or the specified period. This change will increase the volatility of earnings of companies currently following the option of capitalizing exchange fluctuation. It may, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy of long-term monetary assets/liabilities.
- Expensing foreign exchange fluctuation recognized through income statement would adversely impacted FY15 PBT of (a) RCom (FY15: ~69%) (b) Idea Cellular (~2%).

Property, plant and equipment

- **Recognition of constructive Asset retirement obligations (ARO) to impact earnings:** Telecom companies have asset retirement obligations (AROs) for the infrastructure they lay for rendering services. They usually account for the contractual obligation for the AROs either by (a) charging it on recurring basis to the income statement, or (b) capitalizing the end obligation to the value of asset and amortizing it over the period. However, Ind-AS requires companies to capitalize both "constructive" and "contractual" obligations on present value basis and then amortize it over the life of the asset. In our view, this will negatively impact the profitability of companies in the telecom sector in the initial part due to high amortization on recognition of constructive obligation. However, it will be partially mitigated by discounting of obligation to present value.
- Overall, we expect this to have a low impact on the sector. The impact on Bharti Infratel, which has significant revenue from infrastructure lay-down business, is likely to be higher.

Exhibit 58: Companies having significant infrastructure rental revenue

Particulars	FY15
Bharti Infratel	61%
Idea Cellular	8%

Source: Company Annual Report, MOSL

Employee benefits

- **Fair Valuation of ESOPs to impact earnings:** Few telecom companies offer ESOPs, which are accounted using the intrinsic value method. Ind-AS will require fair valuation of ESOPs, which may lead to higher employee costs.
- Idea Cellular's PAT to be adversely impacted by 1.7% for FY15.

Revenue recognition

- **Revenue recognition on "Multiple element contracts" to be deferred:** Telecom companies sometimes enter into sales arrangements wherein a sim card, voice/data packages, and value-added services (VAS) are sold with the handsets. Under the current practice, the companies recognize the entire revenues upfront and do not ascribe any revenues towards the services that will be rendered subsequently. Ind-AS requires the revenues to be unbundled and recognized separately – revenue from sale of handset to be recognized on date of sale and revenues on services to be systematically distributed over the period of rendering the services. In India, the practice of selling composite deals is low, and hence, this change is likely to have low impact on the companies.
- **Mandatory revenue & cost recognition for infrastructure sharing agreements:** Many telecom companies enter into infrastructure sharing agreements on barter basis, where services are provided on reciprocal basis and no cash transactions are involved. Under the current practice, in the absence of any specific guidance, the companies generally do not record such transactions. However, Ind-AS mandates the recognition of such transactions. This will lead to higher recognition of revenue and operational expenditure, though earnings may remain unchanged.

Financial instruments

- **Earnings volatility to reduce for companies not following hedge accounting:** Indian telecom companies have significant exposure to foreign currency borrowings. To hedge the exchange fluctuation risk, they enter into various derivative contracts. Under Ind-AS, all derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting. Under the current accounting practice, companies are either required to follow hedge accounting (AS 30) or only the MTM losses on derivative contracts are charged through the income statement (while the MTM gains are ignored). This change will reduce the volatility in the income statement of companies currently not following hedge accounting. Idea does not follow hedge accounting and has derivatives outstanding of INR35.8b (16% of FY15 Networth).

Rating: Consolidation likely to have significant impact on Telecom companies

Company	Overall	Revenue Recognition	Financial Instruments	Employee cost	Consolidation	PPE	Others
Bharti Infratel	●●●				●●●	●	
Idea Cellular	●●	●	●	●	●●	●	●●
Reliance Communication	●●●	●				●	●●●
Tata Communication	●	●				●	

Impact: Low ● I Medium ●● I High ●●●

Source: MOSL

- **Bharti Airtel** presently reports consolidated financial statements in accordance with IFRS. Hence, we believe the transition to Ind-AS will not have any meaningful impact on its financials.

Media

Exhibit 59: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Financial instruments			
Derivatives	■ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	■ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	■ Reduce volatility in income statements of companies currently not following hedge accounting
Redeemable preference shares	■ Forms part of share holders' funds.	■ Classified as debt. Dividend on preference shares is treated as a finance cost.	■ Increase in finance cost leading to decline in reported EPS. Debt/Equity to rise.
Employee benefits			
ESOPs	■ Option to account for ESOP cost on intrinsic basis or fair valuation.	■ Mandatory to account for ESOP cost on fair valuation.	■ Increase in the employee costs.
Others			
Exchange fluctuation	■ Can be capitalized to value of asset	■ To be charged to income statement	■ Reduces asset value and earnings
Consolidation			
Joint venture	■ Consolidated on proportionate basis	■ Consolidated as per equity method	■ Decline in revenues and EBITDA. However, earnings remain unaffected. Also, leverage profile of companies may change
Revenue recognition			
Bonus/free advertising slots	■ Entire revenues are recognized on initial broadcast. No separate revenues booked for bonus/free slots.	■ Revenue to be apportioned between initial and bonus/free slots and recognized separately on broadcast.	■ Deferment of revenue.
Barter transactions	■ Not recorded.	■ Revenues and costs recognized at fair value.	■ Revenue and operational expenditure to be higher. However, earnings not impacted.

Source: MOSL

Financial instruments

- **Finance cost to increase on classification of redeemable preference shares as debt:** Under Ind-AS, preference shares (redeemable and non-convertible) are to be classified as debt. This reclassification also leads to preference dividend (which is currently shown as appropriation to profit) being expensed as finance cost. This will lead to a decline in reported EPS on the one side and increase in debt/equity on the other.

Zee's D/E to rise from 0x to 0.6x on classification of redeemable pref shares as debt

- Zee Entertainment had INR20.2b of 6% redeemable preference shares outstanding as at FY15 end. Expensing the preference dividend as finance cost would lead to a 5.7% decline in FY15 earnings. Debt/Equity will increase from 0x to 0.6x. The adjusted FY15 RoE increases to 23.5% v/s 17.6%.

Employee benefits

- **Fair valuation of ESOPs to impact earnings:** Some media companies have granted ESOPs. Generally, they have opted to account for ESOP cost using intrinsic cost method. Ind-AS requires mandatory use of the fair valuation method, which is likely to increase employee cost. We believe this is likely to have a negative impact on the earnings of Dish TV and TV18. However, we note that the impact on Dish TV appears significant, since the company has recently turned profitable with low PAT. The impact on its EBITDA is -0.1%.

Exhibit 60: Impact on earnings upon fair valuation of ESOPs

Particulars	% impact on PAT
Dish TV	-19%
TV18 Broadcast	-6%

Source: Company Annual Report , MOSL

Others: Foreign exchange fluctuation

- **Exchange fluctuation on long-term monetary assets/liabilities to impact earnings:** Media companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. The current IGAAPs, however, provide an option to capitalize the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or the specified period. This change will increase the volatility of earnings of companies currently following the option of capitalizing exchange fluctuation. It may, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy of long-term monetary assets/liabilities.
- Dish TV has opted to follow amended AS 11, wherein it capitalizes the exchange fluctuation on long-term monetary assets/ liabilities in the value of assets. Ind-AS requires the exchange fluctuation to be expensed. During FY15, it capitalized foreign exchange loss of INR4.1b to the value of assets.

Consolidation

- **JV consolidation under new norms to impact operating earnings:**
  Ind-AS requires JVs to be consolidated by equity method (as currently done for associates) as against the IGAAP-prescribed proportionate consolidation. This will bring material changes in operating metrics like revenue / EBITDA and debt profile, while earnings may remain unchanged.
- TV18 has 9 JVs, which together contribute 44% of its total consolidated revenue.

Revenue recognition

- **Revenue recognition for bonus/free slots may lead to deferment:** Several broadcasters guarantee minimum viewership to their customers while selling adverting slots. For shortfalls in agreed conditions, customers are compensated with bonus/free slots. Currently, the entire revenue is booked at the time of initial advertisement broadcast. However, under Ind-AS, revenue (and cost if any) need to be split between initial and bonus slots and recognized over the period of broadcast. This may lead to deferment in revenue recognition. However, we believe this will have an insignificant impact for Zee Entertainment, Sun TV and TV18.
- Revenues and costs **to increase for pay TV broadcasters and distributors:** Pay TV distributors and broadcasters enter into barter arrangements. Broadcasters

offer free placement and advertisement services in lieu of lower content cost. Under the current IGAAPs, such transactions are recorded on net basis. Ind-AS, however, mandates recognition of such transactions on gross basis. This will lead to an increase in the revenue and operational expenditure for both parties. However, there will be no impact on earnings.

Rating: Employee benefit & financial instruments to have impact on Entertainment companies

Company	Overall	Revenue Recognition	Financial Instruments	Employee Benefit	Consolidation	Others
Zee Entertainment	●●●		●●●			
Dish TV	●●●	●		●		●●●
TV18 Broadcast	●●●			●●●	●●●	

Impact: Low ● l Medium ●● l High ●●●

Source: MOSL

Automobiles

Exhibit 61: Snapshot

Area	IGAAP	IND AS	Impact due to Ind AS
Consolidation			
Entities to be consolidated	▪ Based on legal ownership	▪ Based on control	▪ Certain entities may be consolidated/ unconsolidated
Joint venture	▪ Accounted on Proportionate basis	▪ Accounted on equity method	▪ Decline in revenues and EBITDA. However, earnings remain unaffected
Treasury Shares	▪ Not consolidated	▪ Adjusted from equity on consolidation	▪ Increase in EPS, Decline in net worth and increase in the ROCE/ROE
PPE			
Assets given to auto ancillaries	▪ No guidance available and hence not accounted.	▪ Considered as a deemed sale.	▪ **OEM:** Asset base will reduce, operating expenses will increase on fair valuing goods purchased which will be offset by recognizing revenues from lease rentals.
Take or pay contracts with ancillaries	▪ Recognized as a sales/ purchase transaction	▪ Considered as a deemed lease	▪ **OEM: Balance sheet**: Higher asset base and debt. **P&L:** Higher depreciation and interest payment and lower component cost. EBITDA will improve while ROCE will deteriorate ▪ **Auto Ancillary:** Lower operating income , and higher interest income
Financial Instruments			
Investments	▪ Investment classified between (a) current : carried at lower of cost or market value and (b) non-current: Carried at cost less any permanent diminution in value of asset	▪ Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b)FVOCI or (c) FVTPL	▪ Earnings on investments will smoothen and recognized over the holding period. Increase in net worth will however lead to decline in the return ratios
Derivatives	▪ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	▪ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	▪ Reduce volatility in income statements of companies currently not following hedge accounting
Receivable discounting	▪ Debtors derecognised and shown as part of contingent liability if risk is retained	▪ Debtors are derecognised only if significant control and risk are transferred	▪ Increase in debt and debtors. Decline in ROCE.
Business Combination			
Mergers and Acquisitions	▪ Separate guidance for acquisition of business unit (under As14) and acquisition of shares (under AS14). Assets/Liabilities acquired can be recognized at book value or fair market value depending on methodology used. Goodwill recognized under AS14 is amortized while under AS21 is only tested for impairment	▪ Mandatory (a) fair valuation of assets and liabilities acquired on acquisition, (b) recognition of intangibles even when not recorded in the books of seller. Excess of consideration paid over net asset acquired is treated as goodwill and tested for annual impairment, while the deficit is adjusted in reserves	▪ Appropriate representation of assets/ liabilities. Goodwill will be carried at lower value. Depreciation & amortization cost will vary from current levels.
Others			
Capitalization of exchange fluctuation	▪ Can be capitalized to value of asset	▪ To be charged to income statement	▪ Reduces asset value and earnings

Area	IGAAP	IND AS	Impact due to Ind AS
Revenue Recognition			
Sale of vehicle along with free service and warranties	▪ No specific requirement for unbundling of services. Entire revenue recognized upfront.	▪ Revenue for sale of vehicle, services, warranties etc to be unbundled and recognized separately at the time of performance	▪ Deferral of revenue and earnings
Discounts/ incentives	▪ Expensed in P&L account	▪ Revenues recognized net of incentives/ discounts	▪ Reduction in revenue, increase in operating margins while earnings remain un-impacted

Consolidation

- **Consolidation of JVs to have limited impact:** Some Auto companies operate through joint ventures (JVs). Ind-AS requires the JVs to be consolidated by using equity method (as currently done for associates) against the IGAAP-prescribed proportionate consolidation. This will impact operating metrics like revenue / EBITDA while earnings remain un-impacted.
- Companies having substantial **JVs:** Ashok Leyland, Motherson Sumi, Tata Motors, M&M, Bosch

- **Treasury share elimination to boost EPS and return ratios**: Ind-AS does not recognize treasury shares as financial assets and requires their adjustment from equity. Further, no gains / losses are recognized on the purchase, sale, issue or cancellation of treasury shares. This will lead to a reduction in net worth on the one hand and increase in reported EPS on the other.
- **M&M** has 8.3% of shares held by M&M Benefit Trust. Under Ind-AS, its EPS will increase and net worth will reduce, resulting in a boost to return ratios.

Exhibit 62: EPS increases on treasury share elimination…

Particulars	No of shares ('000)	EPS
Shares held as at FY15	621,092	
Less: Shares in ESOP Trust	-29,700	
Reported Number of Shares	**591,392**	**53.1**
Less: M&M Benefit trust	-51,835	
Less: Employee Welfare Trust	-2,031	
Adjusted Shareholding and EPS	**537,526**	**58.4**

Source: Company Annual Report, MOSL

Exhibit 63: …Net worth decline will boost ROE's (FY15)

Particulars	INR m	%
Reported net Worth	258,564	
Less: Carrying value of M&M Benefit trust	-14,598	5.6%
Adjusted Net Worth	**243,966**	

Source: Company Annual Report, MOSL

- **Entities consolidated under Ind-AS may vary:** Conglomerates usually have complex organization structures. With the change in the definition of control to determine subsidiaries under Ind AS the universe on entities getting consolidated may vary significantly then under the IGAAP. This may bring changes in the critical operating metrics for the company.
- **Companies to be impacted**: M&M

Plant, property and equipment

- **Take or pay contracts with auto ancillaries may qualify as deemed lease**: OEMs and auto ancillaries enter into long-term take-or-pay contracts for supply of components, usually covering the life of the plants. Under Ind-AS, such contracts that fulfill certain criteria might qualify as deemed lease (**refer page 28 for details**). Consequently, there will be downward pressure on OEMs' RoCE due to recognition of additional assets. We believe OEMs have significant bargaining power and will try to modify agreements to skirt the definition of deemed lease. However, there may be cost implications, as under the new arrangements, demand risk will legally shift to the auto ancillaries.
- We believe amongst the automobile sector such arrangements are more prevalent in four wheelers. Consequently, on a relative basis Maruti will have higher impact.

- **Free transfer of PPE by OEM to ancillary treated as deemed sale:** OEMs generally transfer assets (molds, dies, etc used to manufacture components) to suppliers without consideration. In return, they receive auto components at concessional rates. Under Ind-AS, such transactions will fall under the category of barter **(refer page 28 for details).** This will lead to higher revenues for OEMs in the year of sale of PPE (property, plant and equipment) and higher component cost and lower depreciation in subsequent years. For auto ancillaries, it will lead to recognition of PPE at fair value, with corresponding notional debt in the year of transfer, with higher (a) revenue from sale of component, (b) interest cost, and (c) depreciation in the subsequent years.

Financial instruments

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Being cash rich, auto companies deploy money in investments. As explained on **page 23, Ind-AS** requires recognition of all investments at fair value, with MTM gains recognized in P&L or OCI as per the classification. In the current practice, gains are only booked when realized. We believe that this will lead to smoothening of earnings for the companies over the medium term while return ratios will be adversely impacted on transition.

Exhibit 64: Smoothening of earning for companies with higher Mutual fund exposure, FY15

Particulars	% of NW
Bajaj Auto	56
Maruti Suzuki	53
Eicher Motors	42
Hero Motocorp	38
Bosch	30
MRF	24
Bharat Forge	13
M & M	7

Source: Capital line, MOSL

Offloading of discounted receivable not permitted

- **Receivables may remain in books even after discounting:** Several Auto companies use discounting / factoring arrangements for receivables. Under IGAAPs, receivables post discounting/ factoring are de-recognized and form part of contingent liabilities. However, de-recognition norms of financial assets under Ind-AS are stringent **(refer page 23 for details)**. This may lead to some of the debtors factoring arrangements where risk and rewards or control are retained not to qualify for de-recognition. Consequently, companies will continue to recognize debtors in their books while the money received from the banks will be treated as debt. This might lead to increase in capital employed and debtor days, impacting RoCE.

Exhibit 65: Receivable discounting to impact ROCE, working capital cycle

Particulars	% of Net Worth
Bharat Forge	25%
TVS Motor Co.	11.3%
Tata Motors	1.3%
Eicher Motors	1.1%

Source: Capital line, MOSL

- **Earnings volatility to reduce for companies not following hedge accounting:** To hedge exchange fluctuation risk, companies enter into various derivatives contracts. Under Ind-AS, all derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting. This is in variance with the current accounting practice, where the companies are either required to follow hedge accounting (AS 30) or only the MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored. This change will reduce volatility in the income statements of companies currently not following hedge accounting
- **Companies to be** impacted: MRF

Business combination

- In the recent past, we have seen Indian automobile companies adopting the inorganic route to accelerate their growth. We believe that the following companies have been acquisitive in the recent past: Motherson Sumi, Apollo tyres, Bharat Forge, M&M.

Others: Foreign exchange fluctuation

- **Exchange fluctuation on long-term monetary assets/ liabilities to impact earnings:** Automobile companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. This is in variance with the current IGAAPs, which provide an option to the companies either (a) expense (b) capitalize, the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or specified period. This will lead to increase in volatility of earnings of companies that currently capitalize the exchange fluctuation. It should, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy for exchange fluctuation on long-term monetary asset/ liability that existed on the date of migration.
- **Companies currently following amended AS 11**: Tata Motors, M&M, Hero Moto, Bharat Forge.

Revenue recognition

- **Revenue recognition to be deferred**: Auto companies usually bundle arrangements such as service support, maintenance, warranty, insurance, etc with vehicle sales. IGAAPs permit these to be recognized at the time of initial sale of vehicle. However, Ind-AS requires unbundling of these multiple element arrangements and recognizing revenues of each activity separately. This will lead to deferral – service revenue will be recognized over the period of rendering the service. We believe the impact of this on OEMs will be low.
- **Revenue representation on gross basis to optically impact margins**: Currently, companies report revenues net of indirect tax levies. Ind-AS will require reporting of revenue on gross basis, with indirect tax being recognized as an expense. This will lead to an optical reduction in operating margins while absolute EBITDA remains un-impacted.

Exhibit 66: Impact due to presentation change of excise

Company	Excise (% sales)	Impact on sales
MRF	10%	11%
Maruti Suzuki	9%	10%
Exide Inds.	8%	8%
Apollo Tyres	7%	8%
TVS Motor Co.	7%	7%
Eicher Motors	7%	7%
Hero Motocorp	6%	6%
Ashok Leyland	6%	6%
M & M	5%	5%
Bajaj Auto	4%	4%
Bharat Forge	2%	2%
Motherson Sumi	2%	2%
Tata Motors	1%	1%

Source: Capital line, MOSL

- **Netting incentives / discounts from revenue to optically boost margins**: Automobile companies offer discounts and incentives to their dealers on achieving certain targets. Ind-AS requires such revenues to be recognized and reported net of these discounts and incentives instead of the current practice of showing these as expenses. This will lead to lower revenue and higher operating margins while absolute EBITDA remains unaltered.

Rating: Ind-AS likely to have a significant impact on Auto sector

Companies	Overall	Revenue Recognition	Financial Instruments	Consolidation	Business Combination	PPE	Others
Amara Raja Batt.	●	●					
Apollo Tyres	●	●			●		
Ashok Leyland	●●●	●		●●●		●	
Bajaj Auto	●●	●	●●	●		●	
Bharat Forge	●●●		●●●		●		
Bosch	●●		●●	●●			
Eicher Motors	●●	●	●●			●	
Exide Inds.	●	●					
Hero Motocorp	●●	●	●●			●	
M & M	●●●	●		●●●	●	●	
Maruti Suzuki	●●	●	●●	●		●●	
Motherson Sumi	●●●	●		●	●●●		
MRF	●●	●	●●				
Tata Motors	●●●	●	●	●●		●	●
TVS Motor Co.	●●	●	●●			●	

Impact: Low ● I Medium ●● I High ●●●

Source: MOSL

Consumer

Exhibit 67: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Financial instruments			
Investments	▪ Investments classified as(a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less any permanent diminution in value of asset.	▪ Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI, or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in return ratios.
FCCB	▪ Recognized as Debt ▪ Premium on redemption is either charged to reserves or forms part of contingent liability	▪ Split accounting followed. Interest cost on liability portion to be provided through income statement	▪ Increase in finance cost
Discounting of receivables	▪ Debtors derecognized and shown as part of contingent liability if risk is retained	▪ Debtors are derecognized only if significant control and risk are transferred	▪ Increase in debt and debtors. Decline in ROCE.
Treasury shares	▪ Not consolidated.	▪ Adjusted from equity on consolidation.	▪ Increase in EPS, decline in net worth, and increase in RoCE/RoE.
Employee benefits			
ESOPs	▪ Optional to account for ESOP cost on intrinsic basis or fair valuation.	▪ Mandatory to account for ESOP cost on fair valuation.	▪ Increase in employee costs.
PPE			
Take or pay contracts with suppliers	▪ Recognized as a purchase transaction.	▪ Considered as a deemed lease on satisfaction of few conditions.	▪ **Balance sheet**: higher asset base and debt. ▪ **P&L:** Lower RM input cost ▪ Higher depreciation & interest payment. EBITDA will improve. ▪ RoCE will deteriorate.
Business combination			
Mergers and Acquisitions	▪ Separate guidance for acquisition of business unit (under As14) and acquisition of shares (under AS14). Assets/Liabilities acquired can be recognized at book value or fair market value depending on methodology used. Goodwill recognized under AS14 is amortized while under AS21 is only tested for impairment	▪ Mandatory (a) fair valuation of assets and liabilities acquired on acquisition, (b) recognition of intangibles even when not recorded in the books of seller. Excess of consideration paid over net asset acquired is treated as goodwill and tested for annual impairment, while the deficit is adjusted in reserves	▪ Appropriate representation of assets/ liabilities. Goodwill will be carried at lower value. Depreciation & amortization cost will vary from current levels.
Consolidation			
Joint venture	▪ Consolidated on proportionate basis	▪ Consolidated as per equity method.	▪ Decline in revenue and EBITDA. However, earnings remain unaffected.
Treasury shares	▪ Not consolidated.	▪ Adjusted from equity on consolidation.	▪ Increase in EPS, decline in net worth, and increase in RoCE/RoE.
Revenue recognition			
Discounts / incentives	▪ Expensed in P&L account.	▪ Revenues recognized net of incentives / discounts.	▪ Reduction in revenue, increase in operating margins. Earnings to remain unimpacted.

Source: MOSL

Financial instruments

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Consumer companies deploy money in investments. As explained on **page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, gains are only booked when realized. We believe that this will lead to smoothening of earnings for the companies over the medium term while the return ratios will be adversely impacted on transition.

Exhibit 68: High exposure to Mutual Fund will boost

Companies	% of net Worth
Emami	40%
Britannia Inds.	39%
Asian Paints	31%
Pidilite Inds.	15%
Marico	13%
ITC	13%
Jubilant Food.	12%
Kansai Nerolac	11%
Berger Paints	11%

Source: Capital Line, MOSL

- **Discounting of receivables:** Several consumer companies use discounting/ factoring arrangements for receivables. Under IGAAPs, receivables post discounting/ factoring are de-recognized and form part of contingent liabilities. However, de-recognition norms of financial assets under Ind-AS are quite stringent (refer page 23 for details). This may lead to some of the debtors factoring arrangements where risk and rewards or control are retained may not qualify for de-recognition. Consequently, the companies will continue to recognize debtors in their books while the money received from banks will be treated as debt. This may lead to increase in capital employed and debtor days, adversely impacting RoCEs. Bills discounted by **United Spirits** stood at **4.5%** of FY15 net worth.

Employee benefit

- **Fair valuation of ESOPs to impact earnings:** Some consumer companies grant ESOPs to employees. Generally, companies have opted to account for ESOP cost using intrinsic cost method. Ind-AS mandates the use of fair valuation method, which is likely to increase employee cost.
- Impact on companies: Jubilant Food (6.6% of FY15 PAT), ITC (5.5% of FY15 PAT) and GCPL (1.3% of FY15 PAT).

Property, plant and equipment

- **Deemed Leases to put pressure on return ratios or margins? :** Contract manufacturing is common practice, where consumer companies outsource part of their product manufacturing to vendors. Under Ind-AS, such arrangement could fall under the definition of deemed lease subject to fulfillment of certain condition **(refer page 28 for details)**. This may put pressure on return ratios of consumer companies due to recognition of additional assets. We believe that consumer companies will try to modify agreements to skirt the definition of deemed lease. However, there may be cost implications, as under the new arrangements, the demand risk will legally shift to the vendors.
- We believe amongst BSE 200 companies, Nestle, Britannia, United Spirits and United Breweries have material outsourcing arrangements and hence may be impacted more versus the peers

Exhibit 69: Fair valuation of ESOPs to impact earnings

Company	% of FY15 PAT
Jubilant Food	6.6
ITC	5.5
Godrej Consumer	1.3

Source: Company Annual Report , MOSL

- **Actuarial loss-led volatility in employee cost to reduce:** Some consumer companies offer long-term employee benefit schemes. Currently, the actuarial losses/gains on these schemes are charged through the income statement, which leads to volatility in earnings. Ind-AS requires the actuarial losses/gains to be charged to reserves and will help to contain the volatility.

Exhibit 70: Actuarial loss impacted earnings in FY15

Company	% of FY15 PBT
United Breweries	6.2
GlaxoSmith C H L	3.2
Gillette India	3.1
Nestle India	3.1
Titan Company	1.5
P & G Hygiene	1.4
United Spirits	NM*

*Note: Actuarial loss of INR1.1b

Source Company Annual Report , MOSL

Business combination

- We believe that the following companies have been acquisitive in the recent past: GCPL, Dabur.

Consolidation

- **JV consolidation will have limited impact:** Companies in the consumer space have small operations through JVs. Ind-AS requires the JVs to be consolidated by using equity method (as currently done for associates) as against the IGAAP-prescribed proportionate consolidation. This will impact operating metrics like revenue / EBITDA, while earnings will remain unchanged. **Asian Paints** derives 4.4% of its revenues from JVs.
- **Treasury share elimination to boost EPS and return ratios**: IND As does not recognize treasury shares as financial assets and hence requires their adjusted from equity. Further, no gains / losses are recognized on the purchase, sale, issue or cancellation of the treasury shares. This will lead to a reduction in the Net worth of companies on one hand and increase in the reported EPS on the other.
- **United spirits** has 2.4% of shares held by benefit trust resulting in an increase in EPS and reduction of Net worth resulting in a boost to return ratios.

Exhibit 71: Treasury share elimination will put pressure on Net worth & boost ROE's (FY15)

Particulars	INR m	%
Reported net Worth	6,595	
Less: Carrying value benefit trust	(1,238)	18.8%
Adjusted Net Worth	**5,357**	

Source: Company annual Report, MOSL

Revenue recognition

- **Netting incentives / discounts from revenue to optically boost margins**: Consumer companies offer discounts and incentives schemes. Ind-AS requires the revenues to be recognized and reported net of these discounts and incentives instead of the current practice of showing these as expenses. This change will lead to lower revenue and higher operating margins, while absolute EBITDA remains unaltered.
- **However, grossing up of excise will put pressure on margins**: Consumer companies (especially cigarettes and alcoholic beverages) pay significant amount of excise duty. Ind-AS requires presenting sales at gross value and expensing excise duty as an operating cost. This will lead to an increase in revenues and decline in operating margins, while operating profits remain unimpacted.

Exhibit 72: Gross-up of excise duty to optically put pressure on margins (FY15)

Company	Excise (% of sales)
United Spirits	58.3%
United Breweries	43.1%
ITC	26.9%

Source: Capital line, MOSL

Rating: Impact on consumers due to employee benefit expense recognition

Companies	Overall	Financial Instruments	Consolidation	Business Combination	Employee benefit expenses	PPE
Hind. Unilever	●					●
Nestle India	●●	●			●●	●●
Dabur India	●			●		●
Godrej Consumer	●●			●●	●	●
Britannia Inds.	●●	●●				●●
Marico	●	●				
GlaxoSmith C H L	●●				●●	
Emami	●●	●●				●
ColgatePalm.	●					●
P & G Hygiene	●				●	●
Gillette India	●●				●●	
Asian Paints	●●	●●	●			
Berger Paints	●	●				
United Spirits	●●●	●	●●		●●●	●●
United Breweries	●●●				●●●	●●
ITC	●●●	●			●●●	●
Titan Company	●				●	
Pidilite Inds.	●	●				
Jubilant Food.	●●●	●			●●●	
Tata Global	●	●				

Impact: Low ● l Medium ●● l High ●●●

Source: MOSL

Technology

Exhibit 73: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Financial instruments			
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less permanent diminution in value of asset.	▪ Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in return ratios.
Derivatives	▪ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	▪ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	▪ Reduce volatility in income statements of companies currently not following hedge accounting
Consolidation			
Joint Venture	▪ Consolidation on proportionate basis.	▪ Consolidation using equity method.	▪ Revenues and EBITDA will decline. However, earnings will be unaffected.
Treasury Shares	▪ Not consolidated	▪ Adjusted from equity on consolidation	▪ Increase in EPS, Decline in net worth and increase in the ROCE/ROE
Business combination			
Mergers and Acquisitions	▪ Separate guidance for acquisition of business unit (under As14) and acquisition of shares (under AS14). Assets/Liabilities acquired can be recognized at book value or fair market value depending on methodology used. Goodwill recognized under AS14 is amortized while under AS21 is only tested for impairment	▪ Mandatory (a) fair valuation of assets and liabilities acquired on acquisition, (b) recognition of intangibles even when not recorded in the books of seller. Excess of consideration paid over net asset acquired is treated as goodwill and tested for annual impairment, while the deficit is adjusted in reserves	▪ Impact on migration to Ind AS Appropriate representation of assets/ liabilities. Goodwill will be carried at much lower value. Depreciation & amortization cost will vary from current levels.
Employee benefits			
ESOPs	▪ Optional to account for ESOP cost on intrinsic basis or fair valuation.	▪ Mandatory to account for ESOP cost on fair valuation.	▪ Increase in employee costs.
Long term employee benefit plans	▪ Gains losses on change in actuarial assumptions charged to the income statement.	▪ Gains/losses on change in actuarial assumptions charged to the reserves.	▪ Reduction in volatility of income statement.

Source: MOSL

Financial instruments

- **Fair valuation of** investments **to smoothen earnings while RoEs decline:** Being cash rich, IT companies deploy money in investments. As explained **on page 23,** Ind-AS requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. In the current practice, gains are only booked when realized. We believe this will lead to smoothening of earnings over the medium term while the return ratios will be adversely impacted on transition.

Exhibit 74: High exposure to Mutual Fund will boost Net Worth on transition (FY15)

Particulars	% of net Worth
MphasiS	26%
Mindtree	23%
Hexaware Tech.	14%

Source: Capital line, MOSL

Reduced volatility for companies not following hedge accounting

- **Earnings volatility to reduce for companies not following hedge accounting:** Indian IT companies have significant exposure to foreign exchange receivable from exports. To hedge the exchange fluctuation risk, they enter into various derivatives contracts. Under Ind-AS, all derivative instruments are required to be fair valued and the gains/losses are recognized through the income statement unless the company adopts hedge accounting. Under the current accounting practice, companies are required to either follow hedge accounting (AS 30) or only the MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored. This change will reduce volatility in the income statements of companies currently not following hedge accounting.
- **Companies not following hedge accounting**: Oracle, Tata Elxsi

Consolidation

- **JV consolidation will have limited impact:** Some IT companies have small operations through joint ventures (JVs). Ind-AS requires the JVs to be consolidated by using equity method (as currently done for associates) as against the IGAAP-prescribed proportionate consolidation. This will impact operating metrics like revenue / EBITDA, while earnings will be unaffected.
- **Companies operating though JVs**: **TCS** (3% of revenue).

- **Treasury share elimination to boost EPS and return ratios**: Ind AS does not recognize treasury shares as financial assets and hence requires their adjusted from equity. Further, no gains/losses are recognized on the purchase, sale, issue or cancellation of the treasury shares. This will lead to a reduction in the Net Worth of companies on one hand and increase in the reported EPS on the other.
- **TechM** has 9.9% of shares held by benefit trust resulting in an increase in EPS and reduction of Net Worth which will boost return ratios.

Exhibit 75: EPS increases on treasury share elimination…

Particulars	No of shares ('000)	EPS
Reported Number of Shares	960,827	**27.5**
Less: Shares in TML Benefit trust	(96,000)	
Adjusted Shareholding and EPS	**864,827**	**30.7**

Exhibit 76: …Net worth decline will boost ROE's (FY15)

Particulars	INR m	%
Reported net Worth	122,486	
Less: Carrying value of Benefit trust	12,071	9.9%
Adjusted Net Worth	**110,415**	

Source: Company Annual Report, MOSL

Business combination

- In the recent past, we have seen Indian IT companies adopting the inorganic route to accelerate their growth. We believe that the amortization cost under IND AS will rise for more acquisitive companies **refer page 26** for details.
- **I**n last year: **Infosys, Wipro, TechM** and **Mindtree** have done four acquisitions each.

Employee benefits

- **Fair valuation of ESOPs to impact earnings:** Some IT companies in India grant ESOPs to their employees. Generally, the companies have opted to account for ESOPs using intrinsic cost method. Ind-AS requires mandatory use of fair valuation method, which is likely to increase employee cost.
- **Impact on companies: Oracle** (5.4% of FY15 PAT); **TechM** (1.5% of FY15 PAT)

- **Reduced volatility in earnings on change in actuarial assumption**: Currently, the actuarial losses/gains on these long term employee benefit scheme are charged through the income statement which leads to volatility in the earnings. Ind-AS, requires the actuarial gain/loss to be charged to the reserves. This will help to contain the volatility in the earnings.
- Actuarial loss of **Tata Elxsi** was 1.5% of FY15 PBT.

Rating: Acquisitive nature of IT companies may be the major area impacted by Ind-AS

Companies	Overall	Financial Instruments	Consolidation	Business Combination	Employee benefit expenses
TCS	●		●		
Infosys	●			●	
Wipro	●			●	
Tech Mahindra	●●●		●●●	●	●
Oracle Fin.Serv.	●●●	●			●●●
Mindtree	●●	●●		●	
MphasiS	●●	●●			
Hexaware Tech.	●	●			
Tata Elxsi	●	●			●

Impact: Low ● l Medium ●● l High ●●● Source: MOSL

Power

Exhibit 77: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Revenue recognition			
BOT arrangements	▪ No specific guidelines available under IGAAP for accounting of these arrangements.	▪ Arrangements that satisfy certain criteria will be accounted using service concession arrangements.	▪ Revenue and profitability of companies on construction activities will be advanced. This will be compensated by lower profits during the operation phase.
Financial instruments			
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less any permanent diminution in value of asset.	▪ Investments carried at fair value, with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI, or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in return ratios.
Employee cost			
Long-term employee benefit plans	▪ Gains/losses on change in actuarial assumptions charged to income statement.	▪ Gains/losses on change in actuarial assumptions charged to the reserves.	▪ Reduction in volatility of income statement.
PPE			
PPA arrangements	▪ Treated as sales/service contracts.	▪ Arrangements satisfying certain criteria will qualify as deemed lease.	▪ For power producers, it will lead to a declining trend in profits. For power purchasers, it will lead to an increasing trend in profits. RoCEs for power purchasers will decline initially due to recognition of power assets.
Decommissioning costs	▪ Recognizes absolute contractual obligation for decommissioning as a part of asset cost.	▪ Recognizes present value of both contractual and constructive obligations as part of asset cost.	▪ Profitability in the initial years will decline, as the base for amortization increases on recognition of constructive obligation. However, this will be partially compensated on recognizing the obligation at present value rather than absolute value.

Source: MOSL

Revenue recognition

- **Revenue and earnings to be advanced on BOT arrangements:** Under Ind-AS**,** certain BOT projects awarded can qualify for accounting under service concession arrangements if they meet certain conditions (**Refer page 17 for details)**. Under the service concession arrangements, revenue and profitability on the construction of the asset will be recognized upfront during the construction phase, which will be compensated by lower profitability during the operation and maintenance phase.

Property, plant and equipment

- **PPA arrangements may get accounted as deemed lease:** Under Ind-AS, the PPA arrangements that fulfill certain criteria will be treated as finance lease **(Refer page 28 for details)**. Consequently, for power producers, fixed assets will be de-recognized from the books, with the recognition of the financial assets at fair value. The power producers will earn interest on financial assets and revenue from operation and maintenance of plants. Profitability and return ratios will be on a declining trend. However, for power purchasers, the asset will be recognized with a corresponding financial liability. The earnings for the power purchasers will be on an increasing trend. However, return ratios will be subdued due to recognition of the asset.
- In absence of adequate details on PPA's it is difficult for us to highlight which PPA's may qualify for SCA or deemed lease. However, directionally we believe it will have a higher impact on companies which have higher capacities signed towards PPA's.

Exhibit 78: Power companies with significant PPA's

Companies	% of capacity
NTPC	100%
Power Grid Corp	100%
NHPC Ltd	100%
Tata Power Co.	100%
JSW Energy	>50%
CESC	100%

Source: Company, MOSL

- **Profitability to be impacted on recognition of constructive decommissioning cost:** Power projects usually have decommissioning cost, attributable at the time of abandonment of the project. Ind-AS requires constructive liability in addition to contractual liability (as required currently) for decommissioning of the asset to be factored in the cost of the asset and depreciated over its estimated life. In the initial stage of the project, this is likely to increase depreciation cost and consequently be an earnings dampener. However, this will partially be compensated on recognition of the liability at present value rather than absolute value.
- NTPC, Tata Power and JSW Energy have captive mines. However, the impact on their financials would be low.

Financial instruments

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Power companies deploy money in investments. As explained on **page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, the gains are only booked when realized. We believe that this will lead to smoothening of earnings over the medium term while the return ratios will be adversely impacted on transition.

Exhibit 79: Companies with significant investment in Mutual Fund

Companies	% of Net Worth
JSW Energy	18%

Source: Capital Line, MOSL

Employee benefits

- **Actuarial loss-led volatility in employee cost to reduce:** Public sector undertakings have significant long-term employee benefit schemes. Currently, the actuarial losses/gains on these schemes are charged through the income statement, which leads to volatility in earnings. Ind-AS requires actuarial losses to be charged to reserves and will help contain the volatility in earnings.

Exhibit 80: Actuarial loss in few power companies

Companies	% of PBT
Tata Power	4%
NTPC	2%

Source: Company Annual Report, MOSL

Others

- **Exchange fluctuation on long-term monetary assets / liabilities to impact earnings:** Power companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. This is in variance with the current IGAAPs, which provide an option to capitalize the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or specified period. This will lead to increase in volatility of earnings of companies that currently capitalize the exchange fluctuation. It should, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy of long-term monetary asset/ liability.

  Companies currently following amended AS 11: Power Grid

Rating agreements to have significant impact on power companies: Service concession agreements to have significant impact on power companies

Companies	Overall	Revenue Recognition	Financial Instruments	Employee benefit expenses	PPE	Others
NTPC	●●	●●		●	●	
Power Grid	●●	●●				●
NHPC	●●	●●				
Tata Power	●●	●●		●●	●	
JSW Energy	●●	●●	●		●	
CESC	●●	●●				

Impact: Low ● I Medium ●● I High ●●●

Source: MOSL

Healthcare

Exhibit 81: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
PPE			
Intangibles	▪ Life of intangibles is definite	▪ Life of intangibles can be indefinite.	▪ Amortization expenses will be lower.
Outsourcing arrangements	▪ No guidance	▪ Considered as a deemed lease.	▪ Put pressure on return ratios
Financial instruments			
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less any permanent diminution in value of asset.	▪ Investments carried at fair value, with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI, or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, leads to decline in return ratios.
Derivatives	▪ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	▪ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	▪ Reduce volatility in income statements of companies currently not following hedge accounting
Receivable discounting	▪ Debtors derecognised and shown as part of contingent liability if risk is retained	▪ Debtors are derecognised only if significant control and risk are transferred	▪ Increase in debt and debtors. Decline in ROCE.
Redeemable preference shares	▪ Forms part of share holders' funds.	▪ Classified as debt. Dividend on preference shares is treated as a finance cost.	▪ Increase in finance cost leading to decline in reported EPS. Debt/Equity to rise.
Others			
Capitalization of exchange fluctuation	▪ Can be capitalized to value of asset	▪ To be charged to income statement	▪ Reduces asset value and earnings
Employee benefits			
ESOPs	▪ Optional to account for ESOP cost on intrinsic basis or fair valuation.	▪ Mandatory to account for ESOP cost on fair valuation.	▪ Increase in employee costs.
Consolidation			
Joint venture	▪ Consolidated on proportionate basis.	▪ Consolidated using equity method.	▪ Decline in revenue and EBITDA. However, earnings remain unaffected.
Business combination			
Mergers and Acquisitions	▪ Separate guidance for acquisition of business unit (under As14) and acquisition of shares (under AS14). Assets/Liabilities acquired can be recognized at book value or fair market value depending on methodology used. Goodwill recognized under AS14 is amortized while under AS21 is only tested for impairment	▪ Mandatory (a) fair valuation of assets and liabilities acquired on acquisition, (b) recognition of intangibles even when not recorded in the books of seller. Excess of consideration paid over net asset acquired is treated as goodwill and tested for annual impairment, while the deficit is adjusted in reserves	▪ Appropriate representation of assets/ liabilities. Goodwill will be carried at lower value. Depreciation & amortization cost will vary from current levels.

Source: MOSL

Property, plant and equipment

- **Deemed Leases to put pressure on return ratios or margins? :** Contract manufacturing is a common practice in the pharmaceuticals industry. MNCs like **GSK** and **Pfizer** outsource part of their Indian drug manufacturing to CRAMs companies like **Divi's Lab** and **Biocon**. Under Ind-AS, such arrangements could fall under the definition of deemed lease, subject to fulfillment of certain conditions **(refer page 28 for details)**. This may put pressure on the return ratios of the MNCs due to recognition of additional assets and financial liabilities. Pharma companies could try to modify agreements to skirt the definition of deemed lease. However, there may be cost implications.
- **Increased life of intangibles to boost profits:** Pharma companies have significant intangible assets (excluding goodwill), primarily comprising of Brands, Patents trademarks etc. Under the current rebuttable presumption, these are amortized over a period not exceeding 10 years. However, under Ind-AS, there is no such rebuttable presumption and intangibles are permitted to have an indefinite economic life. We believe this will result in lower amortization expenses.

Exhibit 82: High intangibles may lead to lower amortization

Company	% of Net Worth
Torrent Pharma.	71%
Pfizer	17%
Aurobindo Pharma	6%
Strides Shasun	4%

Source: Capital Line, MOSL

Financial instruments

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Being cash rich, pharma companies deploy money in investments. As explained on **page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, gains are only booked when realized. We believe this change will smoothen earnings for the companies over the medium term while the return ratios will be adversely impacted on transition.

Exhibit 83: Significant investment in Mutual fund units

Companies	% of NW
Strides Shasun	38%
Dr Reddy's Labs	21%
Divi's Lab.	21%
Lupin	19%
Torrent Pharma.	11%

Source: Capital line, MOSL

- **Earnings volatility to reduce for companies not following hedge accounting:** Indian pharma companies have significant exposure to foreign exchange receivable from exports. To hedge exchange fluctuation risk, they enter into various derivatives contracts. Under Ind-AS, all derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting. This is in variance with the current accounting practice, where the companies are either required to follow hedge accounting (AS 30) or only the MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored. This change will reduce volatility in the income statements of companies currently not following hedge accounting.

Reduced volatility for companies not following hedge accounting

- **Companies to be impacted**: Sun Pharma, Cipla, Piramal Enterprise, Biocon, Jubiliant Life.

- **Discounting of receivables:** Some pharma companies use discounting/ factoring arrangements for receivables. Under IGAAPs, receivables post discounting/ factoring are de-recognized and form part of contingent liabilities. However, de-recognition norms of financial assets under Ind-AS are quite stringent **(refer page 23 for details)**. This may lead to some of the debtors factoring arrangements where risk and rewards or control are retained may not qualify for de-recognition. Consequently, the companies will continue to recognize debtors in their books while the money received from the banks will be treated as debt. This might lead to increase in capital employed and debtor days, adversely impacting RoCEs.
- **Impact on companies:** IPCA Labs discounted receivables of 8% of net worth during FY15.

- **Dividend on redeemable preference shares to impact earnings:** Under Ind-AS, preference shares (redeemable and non-convertible) are to be classified as debt in place of equity. This re-classification will lead to preference dividend (currently shown as appropriation from profit) being expensed as finance cost, in turn leading to a decline in reported EPS and an increase in debt/equity.

Redeemable preference shares to be classified as debt

- **Impact on company:** Wockhardt has INR2.38b of 0.01% Non-Convertible Cumulative Redeemable Preference Shares outstanding, redeemable at a premium of 20% along with cumulative dividend in FY19. Premium on these preference shares will have to be expensed in the P&L at FV over the term of the preference share Shares

Others: Foreign exchange fluctuation

- **Exchange fluctuation on long-term monetary assets/ liabilities to impact earnings:** Pharma companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. This is in variance with the current IGAAPs, which provide an option to the companies either (a) expense (b) capitalize, the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or specified period. This will lead to increase in volatility of earnings of companies that currently capitalize the exchange fluctuation. It should, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy for exchange fluctuation on long-term monetary asset/ liability that existed on the date of migration.
- Companies currently following amended AS 11: **Biocon**

Employee benefits

- **Fair valuation of ESOPs to impact earnings:** Pharma companies offer ESOPs to employees. They usually account for ESOPs cost using the intrinsic cost method.

Ind-AS requires mandatory use of the fair valuation method, which is likely to increase employee cost.

- **Impact on companies: Lupin** (1.9% of FY15 PAT); **Biocon** (1.7% of FY15 PAT)

Consolidation

- **JV consolidation will have limited impact:** Some pharma companies operate through joint ventures (JVs). Ind-AS requires the JVs to be consolidated using equity method (as currently done for associates) as against proportionate consolidation currently prescribed by the IGAAPs. This will impact operating metrics like revenue / EBITDA while earnings will remain unchanged.
- **Companies having substantial** JVs: Cadila

Business combination

- In the recent past, we have seen Indian pharma companies adopting the inorganic route to accelerate growth. We believe that the amortization cost under IND AS will rise for more acquisitive companies **refer page 26** for details.

Rating: Acquisitive nature of pharma companies may be the major area impacted by Ind-AS

Companies	Overall	Financial Instruments	Consolidation	Employee benefit expenses	PPE	Business Combination	Others
Aurobindo Pharma	●				●	●	
Biocon	●●●	●		●			●●●
Cadila Health.	●		●				
Cipla	●	●				●	
Divi's Lab.	●●	●●					
Dr Reddy's Labs	●●	●●				●	
Glaxosmit Pharma	●●				●●		
Ipca Labs.	●	●					
Jubilant Life	●	●					
Lupin	●	●		●		●	
Pfizer	●				●		
Piramal Enterp.	●	●				●	
Strides Shasun	●●	●●			●	●	
Sun Pharma	●	●				●	
Torrent Pharma.	●●●	●			●●●	●	
Wockhardt	●●	●●					

Impact: Low ● I Medium ●● I High ●●● Source: MOSL

- Glenmark presently reports consolidated financial statements in accordance with IFRS principles. Hence, we believe the transition to Ind-AS would only have negligible impact on its financials.

Metals & Mining

Exhibit 84: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Financial Instruments			
Derivatives	▪ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	▪ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	▪ Reduce volatility in income statements of companies currently not following hedge accounting
Redeemable preference shares	▪ Classified as capital	▪ Classified as debt. Dividend on preference shares is treated as a finance cost	▪ Increase in finance cost leading to decline in reported EPS; while, Debt/Equity rise
Perpetual debentures	▪ Classified as debt	▪ Classified as capital, interest on debentures is treated as dividend	▪ Reduces Debt/Equity, reduces interest cost hence earnings positive
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less any permanent diminution in value of asset	▪ Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in the return ratios.
Others			
Capitalization of exchange fluctuation	▪ Can be capitalized to value of asset	▪ To be charged to income statement	▪ Reduces asset value and earnings
Employee Cost			
Long term employee benefit plans	▪ Gains/ losses on change in actuarial assumptions charged to the income statement	▪ Gains/ losses on change in actuarial assumptions charged to the reserves	▪ Reduction in volatility of Income statement.
Property, Plant & Equipment			
Asset retirement obligation	▪ Companies recognize absolute contractual obligation for ARO as a part of asset cost.	▪ Companies recognize present value of both contractual and constructive obligation as a part of asset cost	▪ Profitability in the initial years will decline as the base for amortization increases on recognition of constructive obligation. However, this will be partially compensated, as obligations are recognized at present value rather than absolute value.
Revenue recognition			
Gross v/s net revenue recognition	▪ Revenue showed as net of excise duty.	▪ Revenue to be shown as gross of excise duty and excise is treated as an operating expense	▪ Increase in revenue and operating cost while earnings remain unaffected.

Source: MOSL

Financial instruments

- **Finance cost to increase on classifying redeemable preference shares as debt:** Under Ind-AS, preference shares (redeemable and non-convertible) are to be classified as debt in place of equity. This reclassification also leads to preference dividend (which is currently shown as appropriation to profit) to be expensed as a finance cost. This will lead to a decline in the reported EPS on the one side and increase in Debt/Equity on the other.

JSW Steel's Debt/Equity to rise upon reclassification of redeemable preference shares as debt

- JSW Steel has preference shares of INR2.8b and shift to Ind-AS will result in its earnings declining 0.2% and Debt/Equity increasing from 1.6x to 1.7x. However, there will be no significant impact on adjusted RoE.

Exhibit 85: JSW Steel - impact of reclassification of Preference shares as debt (INR b)

Particulars	IGAAP	Ind-AS
Equity	230.5	227.8
Debt	379.9	382.7
Debt/Equity	1.6x	1.7x
PBT	25.9	25.6

Source: Company Annual Report, MOSL

- **Classifying perpetual debentures as capital to reduce finance cost:** Perpetual debentures do not have any fixed maturity; hence give the security of equity to the issuer. Since Ind-AS relies on the concept of “substance over legal form”, thereby classifying perpetual debentures as equity in place of debt. Consequently interest cost being reclassified as dividend and reduction in Debt/Equity.
- Tata Steel has issued perpetual debentures of INR22.8b which will be reclassified as capital in place of borrowings.

Tata Steel’s Debt/Equity reduces upon reclassification of perpetual debentures as shareholder’s fund

Exhibit 86: Tata Steel – impact of reclassification of Perpetual debentures (INR b)

Particulars	IGAAP	Ind-AS
Capital	313.5	336.2
Debt	805.9	783.2
Debt/Equity	**2.6x**	**2.3x**
PBT (Before exceptional items)	**25.4**	**28.1**

Source: Company Annual Report, MOSL

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Some companies deploy money in investments. As explained on **page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, gains are only booked when realized. We believe this change will lead to smoothening of earnings over the medium term while the return ratios will be adversely impacted on transition.

Exhibit 87: Significant investments in Mutual Funds

Particulars	% of Networth
Hindalco	11%

Source: Company Annual Report, MOSL

Others: Foreign exchange fluctuation

- **Exchange fluctuation on** long-**term monetary assets/liabilities to impact earnings:** Oil companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. The current IGAAPs, however, provide an option to capitalize the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or the specified period. This change will increase the volatility of earnings of companies currently following the option of capitalizing exchange fluctuation. It may, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy of long-term monetary assets/liabilities.

- Among the companies in the metals sector, Jindal Steel, JSW Steel and Tata Steel currently follow amended AS 11. The impact on Vedanta will be relatively lower than others as its foreign currency borrowings are low.

SAIL to see significant impact of change in actuarial assumptions

Employee benefits

- **Reduced volatility in earnings on change in actuarial assumption**: Most companies in the metals and mining sector offer significant long-term employee benefit schemes. Currently, the actuarial losses/gains on these schemes are charged through the income statement, which leads to volatility in earnings. Ind-AS requires the actuarial gains/losses to be charged to reserves. This will help to contain the volatility in the earnings.

Exhibit 88: Actuarial gains/(losses) impact earnings

Particulars	% of PBT
S A I L	-36%
Cairn India	3%

Note: PBT of all companies before exceptional items Source: Company Annual Report, MOSL

Property, plant and equipment

- **Recognition of constructive Asset retirement obligations (ARO) to impact earnings:** Mining companies have asset retirement obligations (AROs) for the infrastructure they lay for rendering services. They usually account for the contractual obligation for the AROs either by (a) charging it on recurring basis to the income statement, or (b) capitalizing the end obligation to the value of asset and amortizing it over the period. However, Ind-AS requires companies to capitalize both “constructive” and “contractual” obligations on present value basis and then amortize it over the life of the asset. In our view, this will negatively impact the profitability of companies in the telecom sector in the initial part due to high amortization on recognition of constructive obligation. However, it will be partially mitigated by discounting of obligation to present value.
- The impact on NMDC, Hindustan Zinc, and Coal India, which have significant mining operations, will be medium, while the impact on Tata Steel, SAIL, Hindalco, and Nalco will be low.

Revenue recognition

- **Grossing up of excise will lead to optical reduction in margins:** Currently, revenues are presented as net of excise duty. Ind-AS requires presenting revenues as gross of excise while excise duty is recognized as an operating cost. Consequently, revenues and operating expenses will rise, while EBITDA remains unimpacted.

Exhibit 89: Impact due to presentation change of Excise

Company	Excise (% sales)	Impact on sales
S A I L	11%	12%
Coal India	8%	9%
JSW Steel	8%	9%
Hindustan Zinc	8%	9%
Jindal Steel	6%	7%
NALCO	6%	7%
Vedanta	5%	5%
Tata Steel	3%	3%
Hindalco Inds.	2%	2%

Source: Capital Line, MOSL

Rating: Exchange capitalization to have significant impact on metal companies

Company	Overall	Financial Instruments	Employee benefit expenses	PPE	Others
Coal India	●●		●	●●	
Hind. Zinc	●●			●●	
NMDC	●●			●●	
JSW Steel	●●●	●			●●●
Tata Steel	●	●●●		●	●●●
Vedanta	●				●
S A I L	●●●		●●●	●	
Hindalco Inds.	●	●		●	
Natl. Aluminium	●			●	
Jindal Steel	●●●				●●●

Impact: Low ● I Medium ●● I High ●●●

Source: MOSL

Oil & Gas

Exhibit 90: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Financial instruments			
Perpetual debentures	▪ Treated as borrowings.	▪ Treated as equity.	▪ Reduces debt/equity and icreases earnngs since interest on debentures gets reclassified as preference dividend.
Derivatives	▪ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	▪ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	▪ Reduce volatility in income statements of companies currently not following hedge accounting
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less any permanent diminution in value of asset	▪ Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in the return ratios.
Others			
Capitalization of exchange fluctuation	▪ Can be capitalized to value of asset	▪ To be charged to income statement	▪ Reduces asset value and earnings
Employee cost			
Long term employee benefit plans	▪ Gains losses on change in actuarial assumptions charged to the income statement.	▪ Gains/losses on change in actuarial assumptions charged to the reserves.	▪ Reduction in volatility of income statement.
Property, plant & equipment			
Asset retirement obligation	▪ Companies recognize absolute contractual obligation for ARO as a part of asset cost.	▪ Companies recognize present value of both contractual and constructive obligation as a part of asset cost	▪ Profitability in the initial years will decline as the base for amortization increases on recognition of constructive obligation. However, this will be partially compensated, as obligations are recognized at present value rather than absolute value.
Revenue recognition			
Gross v/s net revenue recognition	▪ Revenue showed as net of excise duty.	▪ Revenue to be shown as gross of excise duty and excise is treated as an operating expense	▪ Increase in revenue and operating cost while earnings remain unaffected.

Source: MOSL

RIL & Cairn India have significant investments in Mutual Funds

Financial instruments

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Some oil companies deploy money in investments. As explained on **page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, gains are only booked when realized. We believe this will lead to smoothening of earnings over the medium term while the return ratios will be adversely impacted on transition.

Exhibit 91: Companies with significant investments in Mutual Fund

Particulars	as % of net worth
Reliance Industries	20%
Cairn India	15%

Source: Capital Line, MOSL

RIL's Debt/Equity to reduce on account reclassification of perpetual debentures

- **Classifying perpetual debentures as capital to reduce finance cost:** Perpetual debentures do not have any fixed maturity; hence give the security of equity to the issuer. Since Ind-AS relies on the concept of "substance over legal form", thereby classifying perpetual debentures as equity in place of debt. Consequently interest cost being reclassified as dividend and reduction in Debt/Equity.
- Reliance Industries has issued perpetual debentures of INR50.0b which will be classified as equity under Ind-AS. Consequently leading to higher earnings by INR2.9b since interest on debentures will be classified as dividend and reduction in Debt/Equity from 0.8x to 0.7x.

Exhibit 92: RIL – impact of reclassification of Perpetual debentures as shareholders' fund (INR b)

Particulars	IGAAP	Ind-AS
Capital	2,184.8	2,234.8
Loan Funds	1,682.5	1,632.5
Debt/Equity	0.8x	0.7x
PBT	311.1	314.1

Source: Company Annual Report , MOSL

- **Earnings volatility to reduce for companies not following hedge accounting:** Companies in the oil & gas sector have significant exposure to foreign exchange payable on borrowings. To hedge the exchange fluctuation risk, they enter into various derivative contracts. Under Ind-AS, all derivative instruments are required to be fair valued and the gains and losses recognized through the income statement unless the company adopts hedge accounting. Under the current accounting practice, companies are either required to follow hedge accounting (AS 30) or only the MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored. This will reduce volatility in the income statement of companies currently not following hedge accounting. HPCL and Castrol currently do not follow hedge accounting. HPCL which has higher exposure to hedges will be impacted more than Castrol.

Others: Foreign exchange fluctuation

- **Exchange fluctuation on long-term monetary assets/liabilities to impact earnings:** Oil companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. The current IGAAPs, however, provide an option to capitalize the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or the specified period. This change will increase the volatility of earnings of companies currently following the option of capitalizing exchange fluctuation. It may, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy of long-term monetary assets/liabilities.

- Reliance Industries currently capitalizes the amount of foreign exchange fluctuation to the carrying value of asset.

Employee benefits

- **Reduced volatility in earnings on change in actuarial assumption:** Public sector companies in the oil & gas sector offer significant long-term employee benefit schemes. Currently, the actuarial losses/gains on these schemes are charged through the income statement, which leads to volatility in earnings. Ind-AS requires the actuarial gains/losses to be charged to reserves. This will help to contain the volatility in the earnings.

Public sector oil & gas companies to have significant impact of change in actuarial assumptions

Exhibit 93: Companies with significant actuarial gain/(loss) as % of PBT

Particulars	Actuarial gain/(loss) % to PBT
Oil India	-5%
BPCL	-3%
ONGC	-2%

Source: Company Annual Report, MOSL

Property, plant and equipment

- **Recognition of constructive Asset retirement obligations (ARO) to impact earnings:** Oil exploration companies have asset retirement obligations (AROs) for the infrastructure they lay for rendering services. They usually account for the contractual obligation for the AROs either by (a) charging it on recurring basis to the income statement, or (b) capitalizing the end obligation to the value of asset and amortizing it over the period. However, Ind-AS requires companies to capitalize both "constructive" and "contractual" obligations on present value basis and then amortize it over the life of the asset. In our view, this will negatively impact the profitability of companies in the telecom sector in the initial part due to high amortization on recognition of constructive obligation. However, it will be partially mitigated by discounting of obligation to present value.
- We believe the impact on Cairn India, ONGC and Oil India due to this change will be low.

Recognition of constructive ARO may impact Cairn India, ONGC & OIL

Revenue recognition

- **Grossing up of excise will lead to optical reduction in margins:** Currently, revenues are presented as net of excise duty. Ind-AS requires presenting revenues as gross of excise while excise duty is recognized as an operating cost. Consequently, revenue and operating expenses will rise while the EBITDA remains unimpacted.
- We believe HPCL, BPCL, IOCL and Indraprastha Gas will be significantly impacted, while Reliance Industries will be moderately impacted.

Excise grossing up to optically reduce margins

Exhibit 94: Excise as % of total revenue

Company	Excise (% of sales)	Impact
I O C L	7%	8%
B P C L	6%	7%
H P C L	6%	6%
Reliance Inds.	3%	3%
O N G C	3%	3%
GAIL (India)	1%	2%

Source: Capital Line, MOSL

Consolidation

- **Jointly controlled Assets may not have any impact**: Ind-AS requires Joint Ventures to be consolidated by using equity method (as currently done for associates) as against the proportionate consolidation currently prescribed by the IGAAPs. This will impact the operating metrics like revenue/ EBITDA for the entities while the earnings will remain same. However if companies have entered into agreements to jointly control the assets in place of creating an SPV, there would be no impact on accounting of revenue from such assets.

Jointly controlled assets will have no impact from change in accounting of JVs

- **Cairn India** has Jointly Controlled Assets with **ONGC** for Barmer assets which contribute significant proportion of operating revenue and profitability. We highlight that JCAs will continue to account for revenue and expenses on a proportionate basis as is being done presently and will have no impact from change in accounting of Joint Ventures.

Rating: Financial instruments & forex capitalization to have material impact on Oil & Gas companies

Company	Overall	Financial Instruments	Employee benefits	Consolidation	PPE	Business Combination	Others
ONGC	●		●		●		
Cairn India	●	●			●		
Oil India	●●		●●		●		
Reliance Industries	●●●	●●		●		●	●●●
HPCL	●●●	●●●					
BPCL	●		●				
Castrol	●●	●●					

Impact: Low ● l Medium ●● l High ●●●

Source: MOSL

Agriculture

Exhibit 95: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Consolidation			
Joint venture	▪ Consolidated on proportionate basis	▪ Consolidation as per Equity method	▪ Decline in revenues and EBITDA. However, earnings remain unaffected. Also, leverage profile of companies may change
Financial Instruments			
FCCB	▪ Treated as debt. Premium on redemption is either charged to reserves or forms part of contingent liability	▪ Split accounting followed. Interest cost on liability portion to be provided through income statement	▪ Increase in finance cost
Derivatives	▪ Optional either to follow hedge accounting or MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored	▪ Derivative instruments are required to be fair valued and the gains and losses are recognized through the income statement unless the company adopts hedge accounting	▪ Reduce volatility in income statements of companies currently not following hedge accounting
Others			
Capitalization of exchange fluctuation	▪ Can be capitalized to value of asset	▪ To be charged to income statement	▪ Reduces asset value and earnings
Revenue recognition			
Gross v/s net revenue recognition	▪ Revenue showed as net of excise duty.	▪ Revenue to be shown as gross of excise duty and excise is treated as an operating expense	▪ Increase in revenue and operating cost while earnings remain unaffected.

Source: MOSL

Consolidation

JV consolidation under new norms to impact operating earnings:

- Ind-AS requires JVs to be consolidated by equity method (as currently done for associates) as against the IGAAP-prescribed proportionate consolidation. This will bring material changes in operating metrics like revenue / EBITDA and debt profile, while earnings may remain unchanged.
- Tata Chemicals has 5 JVs, which contributes 4% of its consolidated revenue.

Financial Instruments

UPL and Tata Chemicals may see reduced volatility in earnings on account of hedges

- **Earnings volatility to reduce for companies not following hedge accounting:** Several agriculture allied companies have significant foreign exchange borrowings. To hedge the exchange fluctuation risk they enter into various derivatives contracts. Under Ind-AS, all derivative instruments are required to be fair valued and the gains and losses recognized through the income statement unless the company adopts hedge accounting. This is in variance with the current accounting practice, wherein the companies are either required to follow hedge accounting (AS30) or only the MTM losses on derivative contracts are charged through the income statement while the MTM gains are ignored. This change will reduce the volatility in the income statements of companies currently not following hedge accounting.

- Among the agriculture allied companies that do not follow hedge accounting, the impact will be high on UPL (FY15: ~171% of NW) and low on Tata Chemicals (FY15: ~22% of NW).

Jain Irrigation may see increase in finance cost upon redemption of FCCBs

- **Redemption premium on FCCBs to increase finance cost:** Several Indian companies raise funds for operations through FCCBs. Under IGAAP, the FCCBs are usually accounted at face value and interest expense is recognized as per the stated coupon rate, if any. Certain companies amortize premium payable on redemption over the period of FCCBs, while others treat the same as a contingent liability. The redemption premium is charged to the securities premium account, bypassing the impact on income statement. Ind-AS treats FCCBs as compounded financial statement; hence, split accounting is followed. The company will have to recognize (a) the issuer's obligation to pay interest, and potentially, to redeem the bond in cash (financial liability), and (b) the right to call for shares of the issuer – put option available to the debenture-holder (equity) separately. This will lead to increase in finance cost of the company.

Exhibit 96: Finance cost of Jain irrigation to rise on account of FCCBs

Company	Year of issue	Maturity period	Issuing currency	Issue size ($m)	FCCB outstanding (INR m)	Conversion Price (INR)	Redemption premium Provided till date (INR m)
Jain Irrigation	FY 13	Sep-17	USD	50	3129.5	115	190.6

Source: Company Annual Report, MOSL

Others: Foreign exchange fluctuation

Exchange fluctuation on long-term monetary items may have high impact on Tata Chemicals

- **Exchange fluctuation on long-term monetary assets/liabilities to impact earnings:** Agriculture allied companies have exposure to long-term foreign currency monetary items. Ind-AS requires the exchange fluctuation on translation or settlement of the foreign currency monetary items to be recognized in the income statement. The current IGAAPs, however, provide an option to capitalize the exchange fluctuation to the carrying cost of fixed assets / reserves as the case may be and amortize it over the life of the asset or the specified period. This change will increase the volatility of earnings of companies currently following the option of capitalizing exchange fluctuation. It may, however, be noted that under the optional exception provided on first-time adoption, the companies are permitted to continue their existing accounting policy of long-term monetary assets/liabilities.
- During FY15, Tata Chemicals capitalized foreign exchange loss of ~14% of PBT while PI Industries capitalized foreign exchange loss of ~1% of PBT.

Revenue Recognition

- **Grossing up of excise will lead to optical reduction in margins:** Currently, revenues are presented as net of excise duty. Ind-AS requires presenting revenues as gross of excise while excise duty is recognized as an operating cost. Consequently, revenue and operating expenses will rise while EBITDA remains unaffected.

Exhibit 97: Impact due to presentation change of excise (FY15)

Company	Excise (% of sales)	Impact
Bayer Crop Sci.	9%	10%
P I Inds.	4%	4%
Jain Irrigation	2%	2%
Tata Chemicals	2%	2%
Godrej Inds.	1%	1%

Source: Capital Line, MOSL

Rating: Classification of financial instruments to impact Agri companies

Company	Overall	Financial Instruments	Consolidation	Others
UPL	●●	●●		
Tata Chemicals	●●●	●	●	●●●
Jain Irrigation	●●●	●●●		

Impact: Low ● I Medium ●● I High ●●●

Source: MOSL

Real Estate

Exhibit 98: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Revenue recogntion			
Rcognition criteria	▪ On transfer of risk and rewards	▪ On transfer of control	▪ Timing of revenue and profitability recognition may change.
Deferred payment condition	▪ No specific guidance. Generally, companies recognize entire consideration as revenue from sales and the outstanding payments are shown as receivables.	▪ Revenues for sale are recognized on present value (PV) basis. The difference between absolute value and PV is recognized as interest income over the period of extended credit.	▪ (a) Lower recognition of operating revenues, (b) higher recognition of interest income, and (c) delay in recognition of earnings.
Financial instruments			
Put option given to PE investors	▪ Money invested by PE investor is considered sale of equity to minority shareholder	▪ Equity/preference share investment by PE with put option treated as debt.	▪ Increase in leverage profile of companies.
Consolidation			
Consolidation of SPV	▪ Based on legal ownership.	▪ Based on control.	▪ Certain entities may be consolidated/ unconsolidated.

Source: MOSL

Revenue recognition

- **Revenue and profitability recognition may get delayed**: Under the current practice, revenue for a pre-sales property transaction is recognized on the basis transfer of risk and rewards – revenue is recognized on POCM basis on meeting certain norms laid out in ICAI's guidance note. However, under IND-AS, revenue recognition is additionally based on transfer of control. For revenue to be recognized on POCM basis, the developer's performance should not create an asset with alternative use and the developer should have enforceable right to payment for work completed till date. Consequently, under Ind-AS, revenue recognition can happen on POCM bais or on completed contract basis. Under completed contract basis, revenue and profit recognition could be lumpy and delayed.
- Extended payment terms may lead to delayed recognition of earnings: As it is based on fair value approach, Ind-AS factors in time value of money. It requires revenues on sales made with deferred payment consideration to be recognized at fair value. The difference between the fair value and total consideration is recognized as interest income over the tenure of the receipt of the deferred consideration. This will lead to (a) lower recognition of operating revenues, (b) higher recognition of interest income, and (c) delay in the recognition of earnings.
- We believe in the current scenario all the developers are offering deferred credit schemes to generate sales and hence the quality of earnings will change.

Financial instruments

- **Change in leverage profile on classification of PE investments with put option as debt:** Real estate companies raise funds from PE investors by issuing them equity / preference shares with a put option. Under IGAAPs, such investors are treated as minority shareholders or as preference shareholders depending on the arrangement. Under Ind-AS, such financial instruments with a put option can be classified as debt, leading to change in the leverage profile of the companies.

Consolidation of JV/subsidiaries

- **Consolidation of entities may be materially different than under IGAAPs.** Real estate developers operate through various SPVs and subsidiaries. Ind-AS requires consolidation of all entities under a company's significant control as subsidiaries. The universe of entities being consolidated under Ind-AS may materially differ from that under IGAAP **(refer page 14 for details)**. This may lead to change in the revenue, earnings (due to elimination of transactions with subsidiaries) and debt profile of companies.

Rating: Revenue recognition likely to impact real estate companies

Companies	Overall	Revenue Recognition	Financial Instruments	Consolidation
DLF	●●	●●	●	
H D I L	●	●●		
Indbull Realestate	●●	●●		●●

Impact: Low ● I Medium ●● I High ●●●

Source: MOSL

Cement

Exhibit 99: Snapshot

Area	IGAAP	Ind-AS	Impact due to Id-AS
Others Government grants			
Sales tax deferred loans	▪ Amount collected from customer is recognized as a loan on absolute value.	▪ Amount collected from the customer is recognized as a loan, which is carried at the present value (PV). The difference between the PV and absolute value is (a)treated as the finance cost on one side, and (b) deferred revenue income on the other	▪ Increase in EBITDA and finance cost, while earnings may remain unimpacted.
Financial instruments			
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less permanent diminution in value of asset.	▪ Investments carried at fair value with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI or (c) FVTPL.	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in return ratios.

Source: MOSL

Others – Government grants

- **EBITDA and finance cost to rise on accounting of VAT/sales tax deferred loans**: Cement companies that have set up plants in notified areas and are eligible for sales tax deferral loans wherein companies collect VAT/ sales tax from customers but pay to the government after a few years without any interest. Under the current practice, the amount so collected is accounted as an interest-free loan. However, Ind-AS requires such loans to be recognized at the present value of future cash flows, The difference between PV and nominal value is recognized as deferred revenue grant on one hand and interest cost on the other hand and are recognized over the period of the loan. This would lead to an increase in other operating revenue on the one hand and finance cost on the other.
- **Ramco** has sale tax deferral loan of INR3.9b (14% of FY15 net worth)
- **Revenue recognition on gross basis to optically impact margins:** Currently, cement companies report revenues net of indirect tax levies. Ind-AS will require gross reporting of revenue with indirect tax being recognized as an expense. This will lead to an optical reduction in operating margins, while absolute EBITDA remains unimpacted.

Exhibit 100: Impact on sales due to change in presentation of excise (FY15)

Company	Excise (% of sales)	Impact on sales
The Ramco Cement	12.8%	15%
Ambuja Cem.	11.2%	13%
UltraTech Cem.	11.2%	13%
ACC	10.5%	12%
Shree Cement	10.1%	11%

Source: Capital line, MOSL

Financial instruments

- **Fair valuation of investments to smoothen earnings while RoEs decline:** Some cement companies deploy surplus money in investments. As explained **on page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, gains are only booked when realized. We believe this change will smoothen earnings over the medium term while the return ratios will be adversely impacted on transition.
- Companies with significant **investments in MF units** – Ultra Tech – 23% of Net worth, Ambuja – 21% of Net worth

Rating: Impact of Ind-AS on Cement companies

Companies	Overall	Others	Financial Instruments
UltraTech Cem.	●●		●●
Ambuja Cem.	●●		●●
The Ramco Cement	●	●	

Impact: Low ● l Medium ●● l High ●●●

Source: MOSL

Capital Goods

Exhibit 101: Snapshot

Area	IGAAP	Ind-AS	Impact due to Ind-AS
Financial instruments			
Investments	▪ Investments classified as (a) current: carried at lower of cost or market value, and (b) non-current: carried at cost less permanent diminution in value of asset	▪ Investments carried at fair value, with gains in P&L or OCI as per the classification (a) HTM, (b) FVOCI or (c) FVTPL	▪ Earnings on investments will smoothen and be recognized over the holding period. Increase in net worth will, however, lead to decline in return ratios.
FCCB	▪ Recognized as debt ▪ Premium on redemption is either charged to reserves or forms part of contingent liability	▪ Split accounting followed. Interest cost on liability portion to be provided through income statement	▪ Increase in finance cost
Others			
Capitalization of exchange fluctuation	▪ Can be capitalized to value of asset	▪ To be charged to income statement	▪ Reduces asset value and earnings
Consolidation			
Preparation of consolidated financial statements	▪ Mandatory only when they have one or more subsidiaries.	▪ Mandatory if there is any subsidiary, JV or associate	▪ It will present a more comprehensive and contemporary position of financial statements.
Entities to be consolidated	▪ Based on legal ownership	▪ Based on control	▪ Certain entities may be consolidated/ unconsolidated
Employee benefits			
ESOPs by parent	▪ Not accounted.	▪ Mandatory to account for ESOP cost on fair valuation.	▪ Increase in employee costs.
Revenue recognition			
Agreements for equipment sale, installation and maintenance services	▪ No specific requirement for unbundling of services. Entire revenue is recognized on sale of equipment.	▪ Revenue for each component of agreement to be recognized separately.	▪ Deferral of revenue and earnings.
Discounts / incentives	▪ Expensed in P&L account.	▪ Revenues recognized net of incentives / discounts.	▪ Reduction in revenue, increase in operating margins. Earnings will remain un-impacted.

Source: MOSL

Financial instruments

- **Redemption premium payable on FCCB's to increase finance cost:** FCCB are recognized as compound financial instruments wherein proceeds are split into debt and equity component. The borrowing cost on debt component will be charged through the income statement as against the erstwhile practice of adjusting it through reserves. Refer **page 23** for details
- **Suzlon** has FCCB worth INR22.4b outstanding as at FY15.
- **Fair valuation of investments to smoothen earnings while RoEs decline:** Auto companies deploy money in investments. As explained on **page 23, Ind-AS** requires all investments to be recognized at fair value, with MTM gains recognized in P&L or OCI as per the classification. Under the current practice, gains are only booked when realized. We believe this will lead to smoothening of earnings for the companies over the medium term while the return ratios will be adversely impacted on transition. **Thermax** has invested 38% of its net worth in MF units.

Others: Foreign exchange fluctuation

- **Exchange fluctuation on long term monetary assets/ liabilities to impact earnings:** Suzlon has availed foreign currency borrowings and currently capitalises forex fluctuations in the balance sheet as per the provisions of amended AS 11. Ind-AS requires exchange fluctuations on all new loans availed to be expensed through the income statement. **Refer page 32 for details.**

Consolidation

- **Consolidation of JVs in absence of subsidiaries:** Under IGAAP, consolidation is necessary only when there is a subsidiary. However, Ind-AS requires consolidated financial statements even when there are no subsidiaries but there are associates or JVs. Currently, **Cummins India** does not have subsidiaries and does not present consolidated financials. Under Ind-AS, consolidation of JVs will be required.
- Cummins has four JVs generating ~4% of standalone revenue.

- **Entities consolidated by conglomerates may vary:** Conglomerates usually have complex organization structures. With the change in the definition of control to determine subsidiaries under Ind AS the universe on entities getting consolidated may vary significantly then under the IGAAP. This may bring changes in the critical operating metrics for the company.
- **Companies to be** impacted: L&T

Employee stock option

- **Employee cost to increase to factor ESOP offered by parent:** Stock options are provided to employees of Alstom India by its parent Alstom France and thus no cost is booked by the Indian entity. Ind-AS will require ESOP cost on fair valuation of these ESOP to be recognized as an expense by the Indian entity.

Revenue recognition

- **Revenue on corporate contracts to be recognized separately:** Capital goods companies usually enter into composite contracts for sale, installation and maintenance of equipment. IGAAPs permit the entire revenues to be recognized at the time of initial sale. However, Ind-AS requires unbundling of these multiple element arrangements and recognition of the revenues of each activity separately. This will lead to deferring and recognizing the service revenue over the period of rendering the service.
- **Netting incentives / discounts from revenue to optically boost margins**: Light electrical goods companies offer discounts and incentives to dealers on achieving certain targets. Ind-AS requires the revenues to be recognized and reported net of these discounts and incentives instead of the current practice of showing these as expenses. This will lead to lower revenue and higher operating margins while absolute EBITDA remains unaltered.
- **Revenue representation on gross basis to optically impact margins:** Currently, revenues for companies are reported net of indirect tax levies. Ind-AS requires gross reporting of revenue, with indirect tax recognized as an expense. This will lead to an optical reduction in operating margins, while absolute EBITDA remains unimpacted.

Exhibit 102: Impact due to presentation change of excise (FY15)

Company	Excise (% of sales)	Impact on sales
Cummins India	9%	10%
Alstom T&D India	6%	6%
A B B	6%	6%
Havells India	3%	4%
Siemens	3%	3%
B H E L	3%	3%
Thermax	3%	3%
Crompton Greaves	3%	3%

Source: Capital line, MOSL

Note: L&T has several BOT projects in the power and road space. However, in the absence of any specific guidance in IGAAPs, it had adopted the accounting of BOT contracts as per IFRS, which is in line with Ind-AS. Consequently, there will be no impact on migrating to Ind-AS on that count.

Rating: Impact of Ind-AS on Capital Good companies

Companies	Overall	Financial Instruments	Consolidation	Employee benefit expenses	Others
Cummins India	●●		●●		
Alstom T&D India	●			●	
Thermax	●●	●●			
Suzlon Energy	●●●	●●●			●●●
L&T	●	●	●		

Impact: Low ● | Medium ●● | High ●●●

Source: MOSL

Opportunities and key challenges

New financials to present a more contemporary picture

- **More appropriate representation:** Ind-AS, based on the principles of (a) substance over form, and (b) fair valuation will present a more contemporary picture of the state of affairs for India Inc. as against IGAAPs, which are based on the principle of conservatism.
- **Increased transparency:** Further, the new standards lay more stringent norms for detailed disclosures, which will help enhance the transparency and governance standards.
- **Facilitate comparability:** Ind-AS will present a more comparable picture of the peer set, as it addresses various areas where the current IGAAPs do not offer any specific guidance, and hence, corporates follow different policies, which makes their financials incomparable.
- **Appealing to foreign investors**: While Ind-AS is not the same as IFRS, it will bring the accounting standards in India much closer to international standards that investors are familiar with and have confidence in, and in turn, should improve the appeal of Indian companies to foreign investors.

Few anomalies remain, however

- **Exchange fluctuations on intra-group transactions:** One of the few things that the new accounting standards do not address is the recognition of exchange differences on intra-group balances. We highlight that while the intra-group balances are eliminated on consolidation, the exchange difference continues to be recognized in the income statement. This is because the monetary items represent a commitment to convert one currency to another and expose the reporting currency to a gain or loss through currency fluctuation.
- **Example:** An Indian entity has a USD receivable from its US subsidiary. The Indian entity translates the USD receivable to INR at the year-end exchange rate and recognizes exchange difference as income or expenses in profit or loss. In the consolidated financial statement, the intra-group balances are eliminated. However, the exchange gain / loss continue to be recognized in profit and loss, which gets balanced off by translation reserves.

Several challenges as we migrate

- **Corporate preparedness:** A February 2016 survey by "PWC India" highlighted that ~39% of the corporates surveyed are yet to prepare for the implementation of Ind-AS.
- **First time adoption**: Though first time adoption of Ind-AS is an opportunity for all entities to align their accounting policies to best practices, it is also offers room for cleaning up of books, the interpretation of which is a challenge for investors.
- **Extensive disclosures:** These are required to explain the transition to the shareholders for every change in estimate, accounting policy, reclassification or recognition/de-recognition of assets and liabilities. However, companies will have to decide how much to disclose so as to meet the regulatory requirements at the same time maintain a competitive edge.

- **Financial covenants**: "Key performance indicators" and ratios used by businesses to measure performance are also closely tied to the financial covenants a company may have in its contracts. A complete review of and modification to contracts containing financial covenants might be required.
- **Valuations**: Due to financial rejig under Ind-AS, the financials will undergo a tangible shift, impacting revenue, EBITDA, earnings and net worth, as the case may be. Hence, the matrices and multiples on which companies are being valued may be required to be revisited.
- **Dividend distribution policies**: Companies may need to review and, if necessary, amend dividend distribution policies in light of their changed financial situation after applying Ind-AS.
- **Income tax**: The current attempt is to delink accounting profit with computation of taxable income. The government has proposed new tax accounting standards **(ICDS)** for computation of taxable income of businesses. Hence, transition to IND-AS will not have significant impact on computation of taxable income except for computation of minimum alternate tax (MAT).
- **Management estimates**: A lot of accounting in Ind-AS is based on management estimates. It would be challenging in initial periods to maintain accuracy and consistency in estimates.
- **Fair value:** Use of fair value approach will bring in a lot of volatility in accounting. Also, we believe that since this concept is new to India, there is lack of knowledge and technical expertise to determine fair value.
- **Regulatory capital:** For companies operating in a regulated environment (for example insurance companies, banks, etc) and where the Ind-AS financial statements will be the basis for regulatory reporting, conversion to Ind-AS might have an impact on regulatory capital. This might require additional capital and, where regulated subsidiaries are involved, restrict distribution to the parent.

Annexure 1: HUL's draft IGAAP vs Ind-AS

Exhibit 103: HUL's draft Ind AS balance sheet as on April 1, 2015 (INR m)

INR m	Reclassified IGAAP	IND-AS Adjustment	IND-AS
Equity and Liabilities			
Equity			
Equity Share Capital	2,163.5	-	2,163.5
Other Equity	35,084.3	24,316.6	59,400.9
Non-current liabilities			
Financial Liabilities - Others	180.5	-	180.5
Long-Term provisions	8,285.9	(3,652.6)	4,633.3
Other non-current liabilities	1,520.7	(189.2)	1,331.5
Current liabilities			
Financial Liabilities			
Trade payables	52,523.0	-	52,523.0
Other financial liabilities	2,063.1	17.4	2,080.5
Other current liabilities	7,783.0	-	7,783.0
Short-Term Provisions	25,391.4	(23,508.4)	1,883.0
Liabilities for current tax	1,345.2	-	1,345.2
Total Equity and Liabilities	**136,340.6**	**(3,016.2)**	**133,324.4**
Assets			
Non-Current Assets			
Property, Plant and equipment	24,355.0	-	24,355.0
Capital work in progress	4,790.1	-	4,790.1
Intangible assets	220.3	-	220.3
Financial assets			
Non-current investments	6,541.1	(3,500.0)	3,041.1
Long-term loans and advances	1,797.7	-	1,797.7
Others	1,422.4	-	1,422.4
Deferred tax assets	1,959.6	(478.3)	1,481.3
Other non-current assets	90.0	-	90.0
Current Assets			
Inventories	26,026.8	-	26,026.8
Financial assets			
Current investments	43,860.9	938.7	44,799.6
Trade Receivables	7,829.4	-	7,829.4
Cash and cash equivalent	7,207.3	6.0	7,213.3
Short term loans and advances	2,881.9	-	2,881.9
Others	943.9	17.4	961.3
Assets for current tax (net)	2,524.6	-	2,524.6
Other current assets	3,795.8	-	3,795.8
Non-current assets classified as held for sale	93.8	-	93.8
Total Assets	**136,340.6**	**(3,016.2)**	**133,324.4**

Source: Company, MOSL

Exhibit 104: Hindustan Unilever's draft Ind-AS 1QFY15 restated P&L (INR m)

	Reclassified IGAAP	IND-AS Adjustment	IND-AS
Revenue from Operations	81,051.3	3,289.1	84,340.4
Other Income	1,086.1	143.5	1,229.6
Total Revenue	**82,137.4**	**3,432.6**	**85,570.0**
EXPENSES			
Cost of Raw Materials Consumed	28,377.8	5,845.7	34,223.5
Purchases of stock-in-trade	10,222.4	-	10,222.4
Changes in Inventories of Finished Goods, Work-in-Process and Stock-in-Trade	419.7	-	419.7
Employee Benefits Expense	3,635.0	(55.8)	3,579.2
Finance Costs	0.7	63.4	64.1
Depreciation and Amortization Expense	749.3	-	749.3
Other Expenses	23,332.1	(2,556.6)	20,775.5
Total Expenses	**66,737.0**	**3,296.7**	**70,033.7**
Profit before Tax & Exceptional Items	**15,400.4**	**135.9**	**15,536.3**
Exceptional Items	97.6	-	97.6
Profit before Tax	**15,498.0**	**135.9**	**15,633.9**
Tax Expense:			
Current Tax Expense	(4,914.9)	-	(4,914.9)
Deferred Tax (net)	8.3	(47.0)	(38.7)
Profit for the year	**10,591.4**	**88.9**	**10,680.3**
Other comprehensive Income			
Items that will not be reclassified to P&L			
Re-measurement of net defined benefit plans			
Income tax relating to items that will not be classified to P&L			
Re-measurement of net defined benefit plans (tax)			
Items that will be reclassified to P&L			
Debt instruments through OCI	-	-9.7	(9.7)
Income tax relating to items that will be classified to P&L			
Debt instruments through OCI (tax)	-	3.4	3.4
Other Comprehensive income for the period	**-**	**-6.3**	**-6.3**
Total Comprehensive income for the period	**10,591.4**	**82.6**	**10,674.0**

Source: Company, MOSL

Annexure 2: Companies not following hedge accounting

Exhibit 105: Companies not following hedge accounting

A B B	Blue Dart Exp.	Multi Comm. Exc.	SPARC
ACC	Bosch	Natco Pharma	Sun Pharma.Inds.
Adani Enterp.	Britannia Inds.	NCC	Sun TV Network
Adani Ports	Cipla	NHPC Ltd	Supreme Inds.
Adani Power	Colgate-Palm.	O N G C	Suzlon Energy
Ajanta Pharma	Container Corpn.	Oil India	Tata Chemicals
Alembic Pharma	Cummins India	Oracle Fin.Serv.	Tata Comm
Alstom T&D India	Dish TV	P & G Hygiene	Tata Elxsi
Amara Raja Batt.	Divi's Lab.	Petronet LNG	Tata Power Co.
Ambuja Cem.	DLF	Pfizer	Tata Steel
Asian Paints	Emami	Pidilite Inds.	The Ramco Cement
Aurobindo Pharma	Engineers India	Piramal Enterp.	Torrent Power
B P C L	Exide Inds.	Power Grid Corpn	TV18 Broadcast
Bayer Crop Sci.	Gillette India	Rajesh Exports	United Breweries
Bharat Electron	Glaxosmit Pharma	Rel. Comm.	United Spirits
Bharti Airtel	GlaxoSmith C H L	Reliance Infra.	UPL
Bharti Infra.	Glenmark Pharma.	Reliance Power	Wockhardt
Biocon	GMR Infra.	Shree Cement	Zee Entertainment

Source: Company Annual Report, MOSL

Annexure 3: Companies capitalising forex fluctuations

Exhibit 106: Companies capitalising forex fluctuations

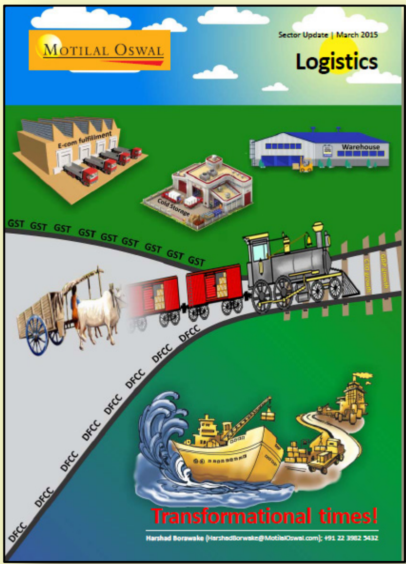
Adani Ports	Larsen & Toubro	DLF	Pidilite Inds.
Adani Power	Lupin	Emami	Rel. Comm.
Arvind Ltd	M & M	GMR Infra.	Reliance Infra.
Bharat Forge	Nestle India	H D I L	Reliance Power
Biocon	NHPC Ltd	Hero Motocorp	S A I L
Century Textiles	Oil India	Idea Cellular	SRF
CRISIL	P I Inds.	Indian Hotels	Suzlon Energy
Dish TV	Page Industries	IRB Infra. Devl.	Tata Chemicals
Jindal Steel	Tata Motors	JSW Energy	Torrent Power
JP Associates	Tata Steel	JSW Steel	United Breweries
Jubilant Life	Vedanta		

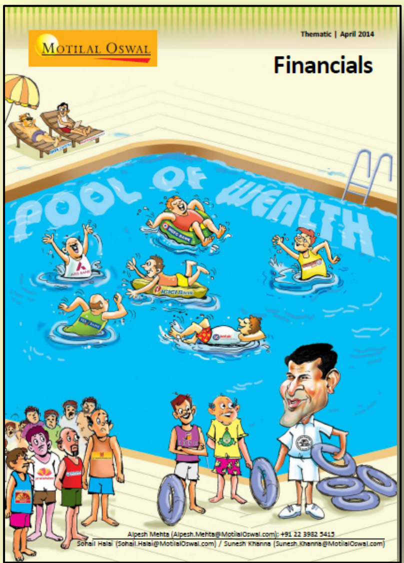
Source: Company Annual Report, MOSL

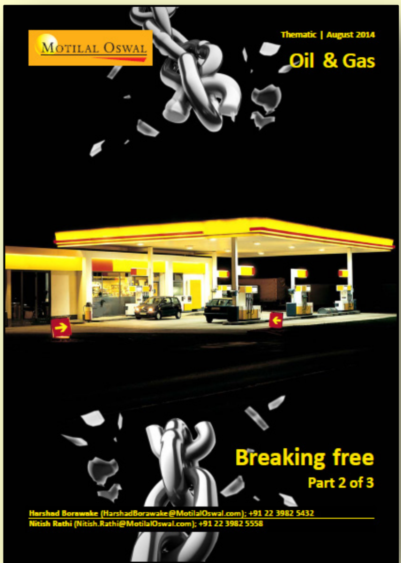
Annexure 4: Impact of Ind-AS on financials

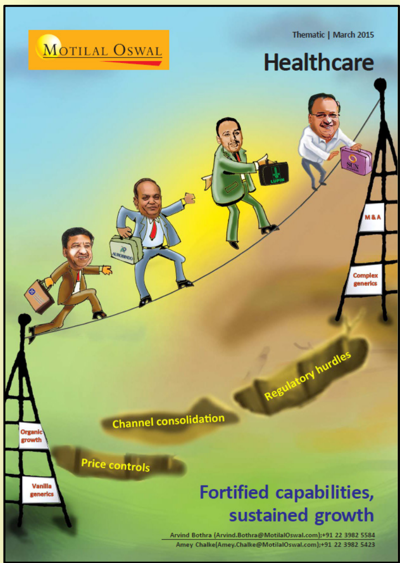
IMPACT OF IND AS		
On earnings	**On Balance sheet**	**On presentation of financial statements**
• Timing of revenue recognition • Revenues on multiples component contracts should be recognized separately and at the time of actual rendering of service • Service revenue to be recognized by percentage completion method • Joint Ventures will be consolidated by equity method only and hence impacting EBITDA • Timing of income recognition on financial instruments • Stock options to be accounted at fair value • Fund raising cost to be recognized through the income statements • Forex fluctuations to be charged through income statement only • Dividend on redeemable preference share to be recognized as interest cost • Actuarial gain/loss on valuation of future employee benefit expense should be recognized through OCI • Depreciation on revalued assets to be charged to income statement • Intangibles can have an indefinate useful life • Transaction cost on M&A to be charged to income statement	• Reclassification of financial instruments - Convertible bond as equity and redeemable pref. share as debt • Accounting for M&As using fair value approach • Long term provisions to be carried on present value • Deferred tax to be recognized using Balance sheet approach • Asset retirement obligation should factor for both constructive and contractual obligation on present value basis • Treasury shares to be presented as a reduction from equity. • Trust dealing with ESOPs needs to be consolidated • Investments to be recognized at fair value only • Mandatory use of G-sec yields to determine the actuarial liabilities	• Revenue to be reported on gross basis net of incenitves and discounts • Indirect taxes paid to form part of cost line items • Financial instruments to be carried at fair value/ amortised cost • No income / expenses can be classified as extraordinary • Financial statements to be restated retrospectively for prior period errors • Extensive disclosures on segments are required • Extensive disclosure on income tax and tax rate reconcilliation • Contingent assets to be disclosed if economic benefit is probable

THEMATIC GALLERY









N O T E S

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