Ind AS Impact on Telecom Sector

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The impact of Ind AS on telecom sector can be seen in the following areas:

- Business combinations
- Financial instruments
- Deferred tax
- Lease escalations
- Asset retirement obligations
- Property, pant and equipment (PPE)
- Revenue recognition
- Indefeasible Rights of Use (IRU)

Business combinations - *Reversal of amortisation of goodwill*

- Ind AS 103 prohibits amortization of goodwill arising on business combinations, and requires it to be tested for impairment annually.
- Indian GAAP required amortization of goodwill in the case of amalgamations.
- **Upon first-time adoption of Ind AS, application of Ind AS 103 to past business combinations prior to the date of transition to Ind AS is optional under Ind AS 101.**

Financial instruments

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

Deferred tax

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

Deferred tax on undistributed reserves of subsidiaries, joint venture or associates

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

Lease escalations

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

Asset retirement obligations

- A telecom company is required to recognize ARO when an asset is initially installed. This is mainly relevant due to the significantly high amount of leasing contracts entered into by companies for network infrastructure site.
- **Under Ind AS, an ARO provision is created at the present value of the best estimate of future cost of dismantling/ removing the asset and is generally measured as the best estimate of the expenditure to settle the obligation as of the balance sheet date.**
- Provisions for such constructive obligations are required even though they may not represent legal obligations.

Property, plant and equipment (PPE)

- On transition to Ind AS, instead of retrospectively recomputing the carrying value of PPE under Ind AS, a company has certain choices with respect to PPE balances on the transition date.
- In the event that a company elects such a choice, the amounts so substituted are referred to as the 'deemed cost' of the PPE.
- Specific choices include:
  - Remeasure some or all items of PPE to their fair value as at the transition date; or
  - In case assets have been previously revalued under Indian GAAP, then those revalued amounts can be considered as the deemed cost, provided that those revalued amounts are broadly comparable to the fair values as at the date of revaluation or cost or depreciated cost in accordance with Ind AS adjusted to reflect, for instance, the changes in the general or specific price index; or
  - Continue Indian GAAP carrying values of all items of PPE as at transition date without any modification, except for adjustments for decommissioning obligations to be included in the PPE.

Revenue recognition

- Consideration received by telecom companies from customers relating to content downloads and premium rate services generally can be recorded on a gross basis when the telecom company, in effect acts as a principal and retains the risks and rewards associated with the content rights before it sells them to users.
- If the telecom company merely passes the consideration received to the content owner after taking its share, then it may be appropriate that the consideration received by the telecom company be recorded on a net basis representing only the gross margin on the transaction.

Connection fees

- In determining the Ind AS treatment of connection fees it would be necessary to consider the type of contract entered into by the customer.
  - Pre-paid and post-paid customers are considered connected to the network upon activation of the handset or SIM card.

Indefeasible Rights of Use (IRU)

- Indefeasible Rights of Use are rights to use transmission cables, fibres or capacity thereon; such rights are typically contractual and may take the form of capacity or service agreements or leases.
- If the contract to sale IRU is identified to be a finance lease, revenue is recognized upfront.
- Revenue is deferred over a period of lease term and recognized on a straight-line method in case the contract is determined to be an operating lease or a service contract.

Impact of Ind AS on financial statements

- **Business combinations** - The Indian GAAP FY 2015-16 net profit of one telecom major increased by 61% on account of reinstatement of previously amortised goodwill and the effect of restatement of past business combinations in accordance with Ind AS.
- **Financial instruments -** Following table is based on the extracts of the financial results of one of the telecom operator, depicting the impact of the fair valuation adjustment in the quarterly results

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

Impact of Ind AS on financial statements

- **Lease escalations -** The net worth as at 31 March 2016 of one of the major telecom infrastructure companies reduced by Rs.2,086 crores, representing 13% of its previously reported equity, on account of adjustment of reversal of lease equalization balance.
- **Property, plant and equipment (PPE) -** One major telecom company opted for fair valuation option of its PPE. The consequential increase in depreciation charge reduced its net profits by 72%.