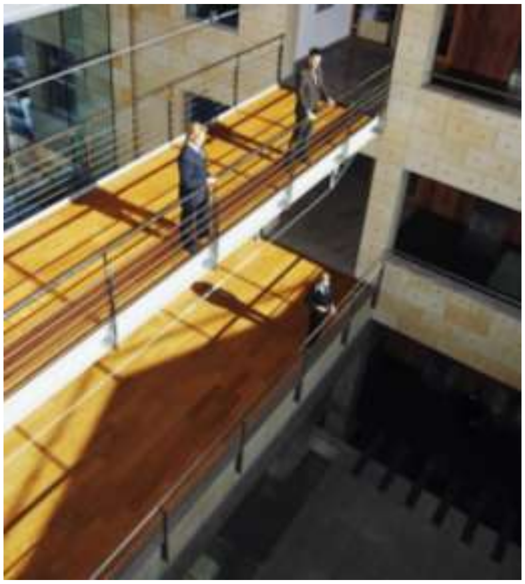
For Use of PKF Sridhar & Santhanam LLP Staff Only

Voice of Change

PKF Sridhar & Santhanam LLP
Issue 1, September 2018

In this Issue



Chief Editor Speaks

S Ramakrishnan, Managing Partner

The world is changing and developing at lightning speed. By 2020 it is expected that AI (Artificial intelligence) based accounting software will be available with amazing capabilities at low cost. In fact, one need not even wait that long! (Link reference: https://blog.oneup.com/what-is-accounting-automation/)

The "One up" software is voted as using 90% plus AAI (accounting automation index) i.e it uses Artificial intelligence for accounting, according to Forbes. This provides a peek into the future with over 700k clients already using the One up software in USA.

Imagine being able to take a photo of your expense bill in a restaurant and get it automatically accounted? Similarly, a bank statement can be auto downloaded and matched with your bills and accounted for. All the data collected will be encrypted. When in doubt, the software gives you a choice of choosing the account head. The software learns itself on a continual basis based on past experience. It maintains inventory on real time basis. I understand that 90% of all the transactions get accounted automatically. CPA's across USA are shivering, as their accounting business especially for small clients will go up in smoke.

Moreover, one can send quotes, bills etc. from their mobile phone. Everything will be real time and it's on cloud. All by a single click!! Welcome to the future of accounting.

So, what does it mean for us? We need to adapt to the change rapidly. If we still think that passing the CA course is the end, we are terribly mistaken. It is not even the beginning. Embrace technology like there is no tomorrow, be it CAAT, IT audit, cyber security, blockchain etc. else, be ready to be extinct.

I was telling the guys in Mettur recently that when I did 'Purchase Audit' in 1978 (yes, 4 decades back in the same Mettur), I started with a report from IBM 1401 machine which gave list of purchases where current month rate varied from previous month by over +/-10%. I had used statistical sampling!

Are you doing your audit like that today?

Partner Speaks - Ind AS 115

T V Balasubramanian, Partner

Ind AS 115 and Inco Terms

As you are all aware, Ind AS 115 *Revenue from Customer Contracts*, replaces Ind AS 18 and Ind AS 11 as a single standard for Revenue with effect from accounting periods beginning on or after 1st April 2018. In this context, this article deals with a key element of recognition of revenue under Ind AS 115 in the context of the general terms of the trade (Inco Terms).

The Inco terms or International Commercial Terms are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) and widely used in international commercial transactions or procurement processes and their use is encouraged by trade councils, courts and international lawyers.

Before we get on to the interpretation under the Ind AS 115, lets first understand the various Inco Terms used and their relevance.

In accordance with the Incoterms 2010 (International Chamber of Commerce), some of the terms are defined as given below:

- **FOB - Free on Board**

"Free on Board" means that the **seller delivers the goods on board the vessel** nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards.

- **CFR - Cost and Freight**

"Cost and Freight" means that the **seller delivers the goods on board the vessel** or procures the goods already so delivered.

DAP - Delivered at Place: Seller bears **cost, risk and responsibility for goods until made available to buyer at named place of destination**. Seller clears goods for export, not import.

The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.

- **CIF - Cost, Insurance and Freight**

"Cost, Insurance and Freight" means that the **seller delivers the goods on board the vessel** or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.

'The seller also contracts for insurance cover against the buyer's risk of loss of or damage to the goods during the carriage. The buyer should note that under CIF the seller is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the seller or to make its own extra insurance arrangements."

Thus, essentially, in all the three cases, the delivery and acceptance of delivery is happening when the goods are on board the vessel. In this context, when the Inco Terms of sales is DAT, DAP or DDP, the delivery to the customer happens later as explained below:

DAT - Delivered at Terminal: Seller bears **cost, risk and responsibility until goods are unloaded (delivered)** at named quay, warehouse, yard, or terminal at destination. Demurrage or detention charges may apply to seller. Seller clears goods for export, not import.

DDP - Delivered Duty Paid: Seller bears **cost, risk and responsibility for cleared goods at named place of destination at buyer's disposal**. Buyer is responsible for unloading. Seller is responsible for import clearance, duties and taxes so buyer is not "importer of record".

In all these three cases (namely DAT, DAP and DDP) revenue is recognized only when delivery is made at the destination location and accordingly revenue recognition is required to be deferred to such delivery stage.

Scenario under Ind AS 115

Para 31 of Ind AS 115 - *An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.*

Para 33 of Ind AS 115 - *Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services).* ***Control of an asset refers to the ability to direct the use of****, and obtain substantially all the remaining benefits from, the asset.* ***Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset****. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:*

(a) using the asset to produce goods or provide services (including public services);

(b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset.

Once the delivery is made and acceptance of delivery is considered to occur when the goods are on board the vessel, the primary obligation of delivery of goods is considered to have occurred and the control over the assets passes on to the buyer, in all the three cases of Inco terms, namely FOB, CIF and CFR. In CIF and CFR cases, the transport (and insurance), one will need to consider whether it may be necessary to allocate part of the transaction price to a distinct "shipping and insurance" service, with that element of revenue recognised potentially later when or as that service is provided.

However, this whole aspect needs to be evaluated for each industry / business model appropriately. Under the standard, an entity recognizes revenue only when it satisfies an identified performance obligation by transferring a promised good or service to a customer. While shipping terms may provide information about when legal title to a good transfer to the customer, they are not a determining factor when evaluating the point in time at which the customer obtains control of the promised asset. While an industrial customer may be considered to have taken control once the shipping has been effected, in the case of a retail consumer one must consider all relevant facts and circumstances to determine whether control has transferred.

In the case of DAT, DAP and DDP term supplies, the control over the goods rests with the seller until the delivery is effected at the destination point and accordingly, the performance obligation is satisfied only at that juncture. Accordingly, revenue recognition needs to be deferred to the time when the delivery is effected at the destination location.

And accordingly, the performance obligation is satisfied only at that juncture. Accordingly, revenue recognition needs to be deferred to the time when the delivery is effected at the destination location.

Data Analytics

T Padma, Audit Manager

Data analytics is the process for obtaining raw data and converting it into information useful for decision-making by users. There is convincing evidence that data-driven decision-making and big data technologies substantially improve business performance. Data is to be thought of as a business asset. A good system is useless with bad data (GIGO).

How would the process flow for data analysis be?

How should the data be prepared?
Step 1 – To create a data file

- Separate sheets must be created for each step in the data cleaning process. This has several benefits. First, the original data and all transformations are preserved, so it does not require much effort to back up a step.
- Second, the worksheet labels make clear the main differences between the worksheets.
- The data must be organized in the following work sheets - original data, interim data, final data.

Step 2 – To clean the data

- **Manage duplicate records**
  - *Concatenate*
  - *Sort*
  - *Conditional formatting*
  - *Remove duplicates function*
  - *Pivot table*
- **Strip out undesirable characters**
  - *Remove equal to symbol before text to decipher #NAME?*
  - *Use Find and Replace options*
  - *Remove relative references and circular references*
  - *Format the fields like Date format etc.*
- **Locate out of range variables**
  - *Use LEN function. Eg: - PAN, telephone no, CIN etc.*

Integrity Objectives	Questions	Command / Expression
Validity	• Are the fields correctly defined? • Is there any corrupt data?	• Verify
Control Totals	• Do the record counts reconcile with control totals? • Do the numeric values match control totals?	• Count • Total • Statistics
Bounds	• Identify date time and numeric bounds • Is numeric, character and Date time data within bounds?	• Statistics • BETWEEN Function
Quality & Completeness	• Are there blank character fields? • Do values adhere to specified formats? • Are sequential numbers missing?	• ISBLANK() Function • MAP() Function • Gaps
Uniqueness	• Are there any duplicate fields or records?	• Duplicates
Reasonableness	• Is the number of classes reasonable? • Is value distribution reasonable? • Are negative/zeros reasonable?	• Classify • Summarize • Stratify • Statistics
Association	• Are there correct associations between fields? Eg:- invoice due date is after invoice date	• Computed fields • Filters
Recalculation	• Are calculated numeric fields producing the correct values?	• Computed fields • Filters

What should the data preparation checklist have?

Best Practices

- **File Organization**
  - Use Folders and Sub folders
- **Naming Conventions**
  - Change file name on creating a new file. Don't retain "New Microsoft Office Excel Worksheet"
  - File contents to be traceable from file name.
  - Don't use generic names like "Data", "Workings", "Analysis" etc.
  - File name limit to be adhered to. Else there will be a problem wile copying and moving files.
- **File Size**
  - Check if the file size correlates with the data. Press Cntrl+End to check the data range in the worksheet
  - Paste special lookups since this will increase file size.

… To be continued

Celebration of First Birth Anniversary of Goods and Service Tax (GST)

S Keerthivel, Articled Assistant

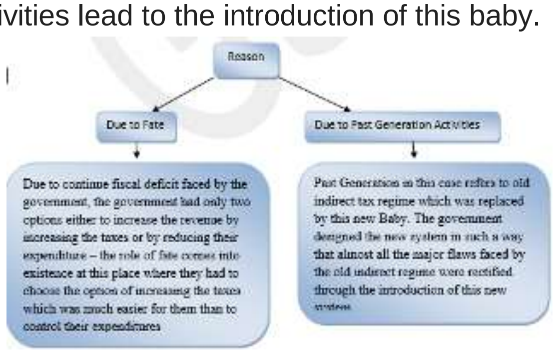
1st July 2018 was one of the memorable days in Indian History where India witnessed the first birth anniversary of GST. Despite being it a Sunday, people across the county were celebrating the joy by writing articles in various forums and by conducting meetings at various places. The best part of the celebration was the messages sent by those people who may not even have known about the importance and usefulness of GST. The day had even more significance, as it happened on the Chartered Accountants Day. This gave an additional flavour to the joy and happiness.

Reason for the great celebration:

Similar to the pain faced by a to-be mother during the gestation period, many issues were faced by the Central government for bringing this Baby into a county like India where changes are not so very easily accepted. There was a lot of expectations and anxiety created since the announcement of this new baby. Moreover, the new baby was brought into the county after so many struggles and compromises made by everyone which lead to the great celebration.

Why was the Baby brought into this country?

Birth and death of human beings are purely determined by fate and past generation activities. Like human beings, the same fate and past generation activities lead to the introduction of this baby.



Achievements done by the baby in the first year:

Even though only one year has been over since the new baby was brought into the country, there are many drastic changes brought by it to the Indian Government:

Was it a premature Baby?

Many people felt that it was not the right time to introduce the new system into our economy as they felt that the people weren't ready enough for adapting to this new system. Several attempts were made to defer the introduction of this system. However, we always need to remember the quote, "Better start early than regret later". Hence it was better that they have introduced this system at an earlier stage where it can take some time to stabilize. Till now, it has shown a consistent growth and has proved that it is on the right track.

Skills to be developed by the baby:

In spite of the baby already being well equipped as compared to its past generation, it needs to develop some more qualities to survive in this economic system and to serve the requirements of the Government and the public, better. Some of the important qualities that need to be developed are as follows:

1. **Strong IT System:** As the new baby is purely based on IT system, the same needs to be more effective and equipped to serve the taxpayers in a better way. This is seen as one of the major weakness which needs to be immediately rectified.

2. **Awareness to people:** Even though one full year has been passed since the introduction of GST, most of the small traders are finding it difficult to comply with the provisions of GST. Hence more awareness needs to be created among the small traders which will lead to better acceptance even among the smaller sector of business people.
3. **GST Registration Process to be simplified:** The complex registration process at present discourages many small traders from getting registered under GST and thereby they lose the benefit of taking Input credit from their inward supplies. Hence the GST council needs to simplify this process in order to bring much people under the coverage of GST and thereby help the small traders to take Input credit.
4. **GST Returns to be simplified:** Even though only few returns have been notified by the Government till now, they however need to simplify the existing returns by keeping in mind the difficulties faced by wide range of taxpayers and come out with solutions as soon as possible for their grievances faced by them while filing their returns.
5. **Tax rates variety:** At present there are various tax slabs against which the GST is being charged on the various goods and services. This once again leads to more compliance issues for those industries which come out with products that fall under different GST rates. Hence the several rates need to be reduced to the maximum extent by retaining only two or three.

Other qualities apart from those mentioned above, also need to be developed by this baby. However we also need to remember that these improvements shall be shown gradually and not drastically as it is only in its beginning phase.

Support for the new Baby:

Bringing a change into a country like India is almost a mission impossible. Hence first we need to appreciate and give due credits to the government for introduction of this new indirect tax system into our Indian Economic System. Hence, we as Finance professionals can join hands with the Government in effective implementation of this new Indirect system so that it gets a better reach across the entire nation. Besides all these, we always need to remember that there is no use complaining about what has happened and why it had happened, hence let us all welcome this change by hoping that it will do good to us.

Quality - An Audit Story

Sharada Ravi, Articled Assistant

In today's fast paced world, the importance of quality is being overstressed but given lesser attention to - in the personal spheres and at our workplace. The profession is always taking initiative in quality control, through Quality Peer Review, conducting audit in accordance with the standards, mandatory CPE, etc. However, how much do we really adhere to?

I have highlighted some of the repercussions that lapses in quality could have, at various levels.

Let's take the case of a statutory audit, where, by overlooking quality, we may overlook significant issues which on their day might lead to extreme scenarios, concluding in a qualified opinion, or perhaps even a disclaimer of opinion instead of a standard unqualified opinion which one may have issued. Specifically, if indicators of insolvency were overlooked, maybe even the going concern concept might be vitiated!

Take the similar question of quality when it comes to internal audits, which might help us eliminate superfluous, meaningless processes that do not add any value whatsoever to the Company as a whole, and quite on the contrary might burden the people in charge of the controls resulting in a rather unproductive work environment. This is a typical scenario where going through the rigmarole of the chain of decision-making produces little benefit at a huge cost of time and money, and opportunity cost of losing first mover advantage.

Taking this same question of quality away from assignments in general to something specific, let us see a example, say the relatively recent PNB fraud, in which conclusions were drawn stating that the audit was not really performed. If the audit procedures are not performed correctly, key audit matters with huge financial implications may have been overlooked.

Because SWIFT was not linked with the CBS, sample testing should have been done to ensure that approvals for Letter of Undertaking were obtained through proper channels. Checks and balances which might seem as trivial go miles in ensuring that suspicious transactions are kept under control. How far does the cover of 'true and fair' view go, though one might argue stating that in bank audits where the volume of transactions is so huge, the audit couldn't have been performed better.

Quality should be a drive to have us do something right, and at the *very first time* in all aspects. Studies recently show how the ongoing floods in Kerala are partially man-made; excessive mining, deforestation, construction in low-lying areas, etc. led the floods to have a more devastating impact than they should have had. The Kerala floods are not the first time a disaster of this magnitude has occurred. The precedents – our Chennai floods of 2016, the Uttarakhand floods of 2013 also had similar causes. Assessing the risks, developing a control mechanism to mitigate it, is very much a part of quality. Even if one was not able to attain quality at the very first time, to turn away from it completely, is little short of a travesty.

Conclusion

Since the absence of quality is costlier than the cost of ensuring quality, like when the cost of replacement after a flood is more than the cost of insuring, we must not undermine the importance of quality.

In my opinion, if we begin at the personal level, by taking even the most routine tasks seriously (and not do it just for the sake of doing it), it may make a difference at a much larger level than we had originally anticipated. As the quote goes, "Do what you love and love what you to." Putting in one's best efforts with the thirst to learn something new will automatically imbibe quality into the work.

Be a yardstick of quality. Some people aren't used to an environment where excellence is expected.
– Steve Jobs

Demystifying the accounting for biological Assets

Narayanan B, Articled Assistant

"Our assets walk out of the door each evening. We have to make sure that they come back the next morning. - Mr Narayana Murthy (Ex CEO – Infosys) The assets that he mentioned was human resource of his organization. Are only human beings the asset for an organization amongst the living beings?

The answer is No. Even animals and plants forming part of living beings are treated as assets and they can be valued. This article is about basics of how to account for living beings (animals and plants)

What is the fair value of a living animal or a plant? This question is of high relevance to a country like India but it may seem strange that in a country where agricultural sector contributes more than 17% of GDP and provides job to around 53% of population, there was no specific accounting literature (previous GAAP) that required recognition of biological assets in the past and hence no accounting for such items was made in the financial statements.

The Standard – Past, Present and future

In the year 1980, agriculture was the only sector, which contributed major source of income. Research committee of Institute of Chartered Accountants of India (ICAI) issued a monograph on accounting for livestock. However, the same became obsolete in the present scenario, with the revision of AS 10 in 2016 which brought biological asset into the picture. However, the scope was restricted to bearer plant. An accounting Standard on agriculture is still under formulation, which will, inter alia, cover accounting for livestock, hence there, was no comprehensive standard in previous GAAP, which dealt about the accounting treatment of agriculture.

After the introduction of the Companies (Indian Accounting Standards) Rules, 2015, there has been a paradigm shift with respect to accounting for livestock. Indian Accounting Standard 41 – Agriculture [Ind AS 41] set outs the accounting treatment and disclosures relating to agricultural activity

Key Definitions from Ind AS 41

- **Biological Asset**
  - A living animal or plant.
- **Bearer Plant**
  - A living plant that:
    - is used in the production or supply of agricultural produce;
    - is expected to bear produce for more than one period; and
    - has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales
- **Agricultural produce**
  - Is the harvested product of the entity's biological assets
- **Biological transformation**
  - Comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset

- **Agricultural activity**
  - Is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets

Application of standard:

Consider an animal say a horse. How will the same be accounted it in books? Obvious answer for the question will be to treat the horse as biological asset as it is a living animal, but the answer to the question is not that simple. Let us consider two scenarios.

Horse is used as a carthorse: - This should be accounted in accordance with Ind AS 16 and not Ind AS 41 as horse used for transportation does not constitute an agriculture activity.

Horse is used to produce, raise and sell the horse: - In this case the Ind AS 41 should be applied as breeding of horse, satisfy the definition of agricultural activity.

Hence its clear from the example that in order to apply this standard, the important aspect which needs to be taken into consideration is whether an activity done by an entity, constitutes an agricultural activity or not.

Some other interesting examples of agricultural activities are-

- Pharmaceutical companies growing plants to produce drugs.
- Development of living organisms such as cultures, cells, bacteria and viruses represent agricultural activity if the same is not for research purpose.

Biological Asset Vs Agricultural Produce.

When accounting for assets of an agricultural nature, a clear distinction needs to be made between when asset is a “biological asset” and when the asset constitutes “inventory”

Agricultural produce is the harvested product of the entity’s biological assets

It should thus be clear that “the point of harvest” is the determining factor. As soon as the biological asset is harvested, the harvested agricultural product is defined as “agricultural produce” and accounted for as inventory under Ind AS 2

Example: - Picked fruits, Harvest cotton, Milk Etc.

Is the produce or harvest from a biological asset another biological asset?

No. The produce or harvest from a biological asset (for example, milk, tea leaves and cotton) is inventory. However, while the produce is still growing or still attached to the biological asset, its value forms part of the value of the biological asset.

Recognition

According to standard, the biological assets should be recognized in the balance sheet when the following criteria are fulfilled:

- The business controls the biological assets because of a past event
- It is probable that the business will get future economic benefits from them
- Fair value or cost of the biological asset can be measured reliably

Measurement

A biological asset shall be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell.

Ind AS 113 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Biological asset is a non-financial asset and hence the fair value measurement considers a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. The market approach is the most relevant type of approach to determine the fair value of biological asset.

Are biological assets always measured at fair value less costs to sell?

No, they are not; it is true that the general rule in standard is to measure all biological assets at fair value less costs to sell. However, there are few exceptions:

1) When the biological asset is a bearer plant.

Consumable biological assets are those that are to be harvested as agriculture produce or sold as biological assets.

Bearer biological assets are those other than consumable biological assets. Bearer biological assets are not agricultural produce but, rather, are held to bear produce.

Bearer plants are measured in accordance with Ind AS 16, 'Property, plant and equipment'.

2) When the fair value is not reliably measurable.

When the fair value cannot be measurable, asset can be measured at its cost less accumulated depreciation.

Conclusion

The above-mentioned details are the essence of the standard. The standard gives rise to other interesting and practical issues as well. Thus, we can conclude that every living object in the world has some value attached to it and there is no object in the world without a value.

"Price is what you pay, value is what you get." – Warren Buffett

Chennai Leaders' Meeting held on 8th July 2018 @ Hyatt Regency, Chennai:







Partners' Meet on 23rd and 24th June 2018 @ Taj Fisherman's Cove, Chennai



PKF Sridhar & Santhanam LLP

KRD GEE GEE Crystal, 7th Floor,
91-92, Dr. Radhakrishnan Salai,
Mylapore, Chennai 600 004.

Phone: (+91) 44 28112985/86/87/88,
Fax : (+91) 44 28112989
Email : admin@pkfindia.in

Bangalore

T8 & T9, Third Floor,'
GEM PLAZA,
No 66, Infantry Road
Bangalore 560 001
Tele Fax : (+91) 080 25590553
Email : bangalore@pkfindia.in

Delhi

No. 512, 5th Floor,
Chiranjiv Towers,
Nehru Place,
New Delhi 110 019
Phone: +91 11 40543689
Email: delhi@pkfindia.in

Mumbai

No. 406,Madhava Building,
4 th Floor, Bandra Kurla Complex,
Bandra (E), Mumbai 400 051
Phone: (+91) 22 26591730/26590040
Email : mumbai@pkfindia.in

201, 2nd Floor, Center Point Building,
Dr. Ambedkar Road,
Opp. Bharatmata Cinema,
Phone : (+91) 22 24170163

Hyderabad

Flat No.105, First Floor,
Door No:6-3-639/640,
Golden Edifice,
Khairatabad Circle,

Hyderabad 500 004
Phone: (+91) 040-23319743
Mobile No:+91-9176662077
Email : prasana@pkfindia.in

Chief Editor

S. Ramakrishnan

The Team

Janani Vijayakumar

Harini Vijayakumar