DECODING THE NEW ‘IFRS’

India Inc.’s journey towards global accounting standards is close to the finish line. Finance heads plan for the transition ahead to Ind-AS—accounting standards which align with IFRS and make India-specific exceptions.

BY CLIFFORD ALVARES & VARTIKA RAWAT
The old accounting standards are going to be history once the clock ticks April 1, 2017. Scores of Indian companies listed on the bourses with a net worth of at least Rs 500 crore will have to make a switch to the new the accounting norms based on the International Financial Reporting Standards (IFRS). It’s a mammoth task that requires a complete overhaul of current accounting and management information systems. At stake is billions of dollars worth of market-capitalisation.

As per the road map, the first full year of IFRS reporting will kick-in with FY16-17 for large companies with network over Rs 500 crore. By FY17-18, all the remaining listed companies and unlisted companies in the bracket networth of Rs 250 crore to Rs 500 crore will have to switch to the new Indian accounting standards (Ind-AS) giving way to the old accounting rules.

Another group which will have a separate transition will be the companies in the banking, insurance and financial services space.

In many cases, this transition will change the way earnings are reported. Numerous checks and balances will be instituted, which can also entail investments. However, the IFRS, which is what Indian standards are aligning with, are appreciated and respected in the international community, and as India integrates itself more closely to global trade and networks, such globally-accepted accounting and reporting will be key especially for international investors.

Says Suresh Senapaty, executive director and CFO, Wipro: “The new accounting standards are mandatory so one better start designing the systems now. The new standards change many things and it’s important to account everything into our MIS. The way we look at revenue, operating margins, reserves, cash flows can change. And this recognition in details can go well if we design our system in the right manner. It has to capture all the necessary data.”

**THE LONG WINDING PATH TO IFRS**

So far, the road map that many Indian companies have adopted is on the slower lane. The Finance Minister, Arun Jaitley’s in his maiden budget speech said that Indian companies could opt for the Indian Accounting Standards (Ind-AS) which will converge with IFRS. He has encouraged companies to take up the new accounting standards early, yet, it is unlikely that Indian companies will be able to take advantage of the voluntary deadline of April 1, 2015. In a pan-India survey by an advisory firm, Grant Thornton, voluntarily adoption was not considered feasible by majority of the respondents and only 36 per cent expressed intent to do so.

Besides, the new accounting standards were notified only in mid-February. “Considering the delayed notification of Ind-AS, it is unlikely that many companies would be able to benefit from the voluntarily early adoption,” says Sai Venkateshwaran, Partner-Advisory and India Head, KPMG.

On the other hand, to be able to adopt IFRS in FY2016-17, companies will need to report comparative information for FY15-16 as well. This essentially means that a lot of companies will have to begin preparing their IFRS accounts as early as next quarter, although they are not obliged to disclose the same.
The new standards have been on cards for some time now. They were to be implemented three years ago, but the issue went off the table for various reasons. The delay, however, has been good for the Indian companies.

One, the IFRS standards themselves are far more robust now and the Indian standards are following most of the changes. Second, the Ministry of Corporate Affairs (MCA) and Institute of Chartered Accountants of India (ICAI) have made some carve outs or exceptions to the original IFRS to account for the ecosystem in a developing country like India. Third, Indian companies got additional time to make the transition.

**IND-AS NOT REALLY IFRS**
The Indian accounting standards or Ind-AS have a few exceptions from the international IFRS as carve-outs were made on thirty five standards. These were prepared by National Advisory Committee on Accounting Standards (NACAS) to make it applicable in the Indian context.

The exceptions deal with accounting for financial derivatives that a large number of corporate are using these days, and also accounting for lease rentals, among others.

Girish Bhat, independent finance professional and former CFO of Gammon India believes that the Indian version of IFRS has started making sense in the last few months. “Schedule VI has undergone major change in the last two years. The balance sheet two years back is different from how it is presented now," he explains.

Charanjit Attra, Executive Director, 3i Infotech says that “the carve-outs are made 99 per cent compliant to IFRS.” Attra is currently incubating an IFRS solutions company within his group’s fold and was also involved with the drafting of the Indian standards. However, the International Accounting Standards Board (IASB)’s Hans Hoogervorst reckons that the IFRS will not be the same even if they have very minor differences (See: interview on page 28).

To be a part of the global league, Hoogervorst reckons that India Inc. has to be completely IFRS-compliant though Attra assures a smooth business with Ind-AS also.

Ashish Gupta, partner, Walker Chandiok & Co. also agrees with Attra that Ind-AS fills the gap between the existing GAAP and IFRS. This will enhance the credibility of the financial statements produced by Indian companies and enables Foreign Institutional Investors (FII) faster investment decisions.

Harak Banthia, CFO, HPCL-Mittal Energy has worked in different countries that were IFRS-compliant and believes that some accounting standards in India were outdated and by adopting the new standards those glitches will disappear.

**HITTING THE ROAD**
In preparation for the transition, Institute of Chartered Accountants of India (ICAI) in the past five years has conducted more than 500 presentation programmes for IFRS across the country and over 20,000 people have already undergone through a related training programme.

Sanjeev Kumar, Group CFO, Inter-globe Enterprises says, “one needs to work on building capability of your people as everyone has to comply with the standards eventually.”

Companies such as Tata Chemicals and HPCL-Mittal Energy are brushing up their systems as they are almost in compliance with IFRS and ready to switch over. P.K Ghose, Executive Director & CFO, Tata Chemicals who is also the co-chair in the National Committee on Taxation, CII feels that the Indian GAAP is not updated and it will be easier to follow new Ind-AS and report under it. “We have identified the differences and now are working on changes in internal processes and IT systems,” he says.

Though a good move, the transition...
BENEFITS OF IFRS
Global standards help raise the game

Updated and new reporting standards: Help in efficient formulation of domestic accounting standards, build international image, enhance global rankings and international competitiveness

Greater compatibility: Provide better comparability between the financial statements of local and foreign companies

Simplified platform: There are lower costs of accounting services due to standardisation. For example a financial services entity in a particular IFRS-compliant jurisdiction can meet the needs of all subsidiaries of a multinational in other countries

Substantial savings and efficiencies: Use of single set of accounting standards by the local companies with investments overseas, will reduce the cost of account conversions and improve corporate efficiency

Source: CFO Research

“The way we look at revenue, operating margins, reserves, and cash flows can change with the new standards.”
SURESH SENAPATI
Executive Director & CFO, Wipro

“We have identified the differences and are right now working on the changes in internal processes and IT systems.”
PK GHOSE
Executive Director & CFO, Tata Chemicals

to IFRS will have challenges. “The move from traditional accounting to the contemporary one is great, but how will the international standards cope with Indian tax laws,” asks Ajay Sahani, AGM- Indirect Tax, Maruti Suzuki India. Sahani also feels that in the short run, “transfer pricing and income tax perspectives will affect profits as reported under Ind-AS.” Maruti Suzuki is running trials with the new standard as a proactive measure. The government, though, had come out with the draft Income Computation and Disclosure Standards (ICDS) (taxation) which were to be notified separately.

While big companies may be all prepared what about smaller firms. As Gupta of Walker Chandiook & Co claims, “there are more than 500 companies in Phase One and more then 5,000 companies in Phase Two that are moving to the new converged standards.” KPMG’s Venkateshwaran points out that “companies that want to be seen as progressive and comparable with their peers in their sector will adopt the new standards irrespective. It will be important for them to align their reports with the IFRS-compliant firms.”

COST OF TRANSITION
According to a recent Grant Thornton survey, mostly, the respondents have not factored any cost of transition. Only 22 per cent respondents have an operational plan for transition. The study notes: It is clear that the intent to prepare for the change is there, though the blueprint to adopt this change is still in the works.

The two major costs of transition include the convergence advisory services and technology. The cost depends on the readiness of the company and the choice of resource (internal or external).

This coming year, Indian companies take the first major steps towards convergence with international reporting norms. And that can only be a cause for celebration.
Until now, the Indian accounting standards were specific to Indian investors. Now, a new standard that is a close version of the international standards is also set to be adopted by the Indian regulators. But what are these new standards and how to they impact the Indian corporate? To talk about this and much more, CFO India spoke with Hans Hoogervorst, chairman, International Accounting Standards Board (IASB), Sai Venkateshwaran, partner and head accounting advisory services, KPMG and Jamil Khatri, deputy head of audit, KPMG.

What is the state of IFRS development across the world? Which are the countries that are at the forefront of adopting the IFRS?

Hans: Ten years ago nobody used it, now 114 countries all over the world use IFRS. Many countries in Asia and Latin America have adopted IFRS, including many Chinese companies. In Japan, the use of IFRS is increasing very rapidly. Within a year or so, we expect 25 percent of Japanese market capitalisation to move to IFRS.

IFRS has become the de facto system around the world and investors around the world recognise it. It will help lower the discounts that foreign investors apply when they cannot fully appreciate the local accounting standards. So, now India is adopting new Indian Accounting Standards, which are very close to the IFRS. They unfortunately have some exceptions.

Indian companies do have the option of choosing IFRS fully, so if they find it beneficial, they will adopt IFRS.

Hans: My message is that India should choose its own way, what it wants to do with its accounting standards. India is not the only country that is adopting a more gradual path, China too has done the same. Countries like Korea have decided to switch to IFRS in one go. But there’s an option for Indian companies to take the full IFRS, and it’s a wise option which does not make use of the carve-outs. It will save costs and it will also increase their appeal to foreign investors. In India, the carve-outs and exceptions will make it impossible for Indians to say we use IFRS. It’s because it’s simply not the same accounting standard. The problem is that foreign investors don’t have the time to study the differences between IFRS and local accounting. When they see a national standard is not IFRS, it will be unknown territory for them. So if you want to lower the discounts for Indian firms internationally, it’s better to go the whole way.

What are the IFRS adoption levels in the country?

Sai: A few Indian companies are fully IFRS compliant such as Tata Motors and Tata Steel. Foreign investors understand IFRS. Indian companies also have the option of going for a full IFRS. Foreign investors won’t really look at whether you are an 80 per cent IFRS or 90 per cent IFRS compliant, either you are an IFRS complaint company or not. Adopting most of it and leaving out a few exceptions, it always gets lost in translation and adds to the confusion.

India was set to adopt the IFRS sometime back. What’s changed from the earlier draft up until now?

Sai: As compared to the 2011 draft standards, we are getting closer to the international IFRS standards, and I think those carve-outs or exceptions today are bare minimum. It will be a good thing if we can eliminate those or at least put a time table to eliminate them in the future. One exception is on foreign currency convertibles, where we are simply treating it as an equity element rather than a
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derivative element. Another one is around how do you treat the gain when making a profitable purchase during an M&A activity. Does it go through the P&L or does it go through the balance sheet. Those are a couple of differences with the current IFRS. Even how you take your opening balance sheet, whether it’s at historical valuations or the way you treat lease rentals.

These differences or carveouts are not very huge, but the question is whether there is any merit in going down the path of all those deviations.

We are making a significant step forward though. In fact, there’s practically no Indian standard that deals with its valuations of financial instruments. Many companies make use of forward contracts. On the other hand, we don’t have guidance on a vast majority of M&A activity that happens today. In a lot of these areas there is a vacuum in terms of accounting practice. So IFRS is actually filling up that vacuum.

Is India too far behind on the IFRS scene internationally?

Hans After this adoption, it will be not far behind. US has not yet adopted the IFRS. But it allows IFRS companies to list on their exchanges. So if an Indian company wants to access the American capital market, it can use IFRS. If the Indian companies adopt IFRS fully, then it’s firmly in the vanguard of accounting in the world. One of the main reasons that Japanese companies that have subsidiaries all over the world have adopted IFRS is because it ensures only one reporting system for all their subsidiaries. So it’s a huge advantage.

How will the new standards affect profitability?

Hans There will be a material impact for many companies. We have been having a lot of discussion with companies and why they should reach out to the analyst and investor community to sensitise them that earnings will be different going forward. The impact of future earnings should be understood. Profits could change quite significantly. For example, if a company has taken a foreign currency borrowing and there’s an exchange loss on that borrowing, that difference never shows up in the earnings. Going forward, that will be a part of EPS. According to the IFRS framework there is no difference between a company taking a rupee borrowing at 10 per cent or a foreign currency borrowing at three per cent.

Will this make a material difference on investors?

Khatri IFRS helps in creating a transparency and how foreign investors look at financial statements. It’s like a brand. Today a financial investor may have some apprehension about Indian companies because they don’t understand the local accounts or the brand. IFRS will increase the transparency and increase the credibility of companies.

How will it impact taxation for instance?

Hans On the taxation front, things will remain the same. A concern has emerged that the companies’ tax liability will change substantially. The government has come out with a computation standard, which now states that irrespective of what you do for accounting, tax will be driven by another set of principles.

What are the benefits some of the Indian companies have seen with IFRS? Will it bring down the cost of capital in a significant way?

Hans Currently, SEBI has given permission to Indian companies to use IFRS instead of Indian standards. And there are seven big companies together that use the IFRS reporting framework. Most of them also prepare their accounts as per Indian GAAP. One prepares its accounts only in the IFRS format. A lot of these companies have seen the benefits of IFRS in the overseas markets. That is where the cost of capital also tends to come down, and they tend to see the benefit of it. There’s far more confidence that a foreign investor sees when he sees an IFRS-compliant statement.

Even in Europe, which had about 18 different accounting languages, there was a study that said that the adoption of IFRS led to considerable lower cost of capital.

Unfortunately, we don’t charge for the intellectual property of our standards, but the value is immense. We are an independent standard setting body and we are financed by public money around the world. We are an international organization, and not for profit.