India Inc grapples with Ind-AS

Transition to new accounting standard triggers concern over fair valuation, wider definition of control

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Inter-globe Aviation, the owner of IndiGo. In its draft red-herring prospectus for its proposed share sale offering, lists among risk factors: "We may be required to prepare financial statements under new Indian accounting standards that are different from Indian GAAP beginning in fiscal 2016. A failure by us to successfully transition to the new Indian accounting standards (Ind-AS) could have a material adverse effect on our stock price."

Likewise, there are about 1,000-odd companies, with net worth of Rs 500 crore or more, that are required to adopt the international financial reporting standards (IFRS)-compliant Ind-AS in FY17. They could roll over to the new standard in FY16 on a voluntary basis, but many are not game for it.

As corporate India prepares to put its house in order, the transition raises concerns: impact on financial statements and revenue recognition, shape and size of consolidated group structures, accounting for intangibles while going for business acquisitions and mergers, and the volatility and subjectivity in income statements brought about by the mandatory use of fair-value method. "The impact of the new accounting standard will vary by industry, and for each company, touching practically every area comprising revenues, expenses, assets, liabilities and equity," says Sumit Seth, partner and IFRS leader, Price Waterhouse.

Accountants and audit experts point out that as quantum of disclosures increases under Ind-AS, it would result in making more estimates and judgments that are new to them. The extensive use of fair value accounting in Ind-AS - rather than book values followed under current Indian GAAP - could have an impact on capitalisation profiles of many companies. "Items such as redeemable preference shares will get recorded as liabilities, and hybrid instruments split into liability and equity components. This will in turn impact net worth, financial ratios, and debt covenants," adds Seth.

Group structures of Indian companies are likely to include more entities, given the wider definition of control under Ind-AS, making the evaluation of holding-subsidiary relationships more judgmental. Terms of loans, guarantees given for financing business, existence of potential voting rights, control through agents, contractual arrangements will determine whether a business will get consolidated. Ind-AS mandates recognition of assets acquired and liabilities assumed at fair values on acquisition date. "The evaluation of the post acquisition impact of M&A deals, especially on EPS and net worth will become more complicated with the recognition of all liabilities and assets at fair values, including intangibles," notes Iain Venkateshwaran, partner - advisory India head - accounting advisory services, KPMG in India.

Under Ind-AS, revenue recognition is based on the concept of transfer of control of goods and services to the customer. "Revenue contracts need to be carefully drafted to avoid unintended negative impacts on the income statements," says an advisory note by Grant Thornton to its clients.

Tax and accounting experts point out that the new accounting standard would have an impact on the timing and amount of tax outflows of a company - direct, indirect and minimum alternate tax (MAT). The government has recently appointed a committee to look into Incidence of MAT on companies that are Ind-AS-compliant.

What has added to the uncertainty is the raging debate over the need to defer the revenue recognition standards, Ind-AS 115. Globally, the application of the new standards on revenue has been deferred until January 2018, largely due to issues around IT implementation. Following this, various industry bodies in their representation to NACAS, a statutory body involved in the rollout of the new accounting standard, advocated pushing the adoption of the new revenue standards by two-three years.

"Ind-AS 115 should be deferred to enable Indian companies to apply the standard in its final shape, rather than one which is still undergoing changes," says Sanjeev Singhal, chairperson, CII sub-group on accounting & auditing standards. The advisory body is expected to give its view to the government in September.

Clearly, over the next three-five years, Indian businesses have to get used to the multiple reporting framework. Banking, insurance and financial services companies are likely to migrate to Ind-AS around 2018 or 2019, while other companies will switch to the new accounting standard in phases. "There will be a large population of companies that will continue to follow the current Indian GAAP," notes Vichesh Chandkik, national managing partner, Grant Thornton India.

With just seven months to go, there is now a compliance risk if a business does not get it right, points out Pankaj Chadha, partner in Indian member firm of EY Global.