Opportunities and Challenges for Chartered Accountants from IFRS Convergence

Convergence brings a golden opportunity to comprehensively re-assess financial reporting and take 'a clean sheet of paper' approach to financial policies and processes. Understanding IFRS or Ind AS and its implications is a business imperative for Indian companies. The changeover to the International Financial Reporting Standards (IFRS) is a major challenge, but it is also an opportunity for chartered accountants. Its success depends on the availability of adequate tools and resources, development of expertise by the professionals as well as a considerable investment of time and money on the part of management. This article gives sneak peak into the background of the IFRS and a lucid analysis and insight into the opportunities and challenges arising out of IFRS convergence for chartered accountants and the roadmap to success.

CA. (Dr.) Sanjeev Singhal

(The author is a member of the Institute. He can be reached at sanjeevsinghalca1997@gmail.com)

The Council of the ICAI, on 20th-22nd March, 2014, has accepted the roadmap for convergence with the IFRS. The revised roadmap recommends Ind AS to be implemented for the preparation of Consolidated Financial Statements of listed companies and unlisted companies having net worth in excess of ₹500 crore from the accounting year beginning on or after 1st April, 2016, with the previous year comparatives in Ind AS for the year 2015-16. The stand-alone financial statements will continue to be prepared as per the existing notified Accounting Standards which would be upgraded over a period of time.

What are International Financial Reporting Standards (IFRS)

The statements of IAS issued by the Board of the IASC (1973-2001) are designated as IAS. However, the IASB announced in April, 2001 that its Accounting Standards would be designated as 'International Financial Reporting Standards' (IFRS). The IASB publishes its Standards in a series of pronouncements called The International Financial Reporting Standards (IFRS). It also adopted the body of Standards issued by the Board of the International Accounting Standards Committee. Those pronouncements continue to be designated as the "International Accounting Standards" (IAS). Presently, there are 41 IAS and 13 IFRS. Some of the Standards issued by IASC have since been withdrawn and replaced or superseded.

Benefits of Adopting or Convergence to IFRS

In the present era of globalisation and liberalisation, the World has become an economic village. The globalisation of the business world and the attendant structures and the regulations, which support it, as well as the development of e-commerce makes it imperative to have a single globally accepted financial reporting system. A number of multinational companies are establishing their businesses in various countries with the emerging economies and *vice versa*. The entities in emerging economies are increasingly accessing the global markets to fulfill their capital needs by getting their securities listed on the stock exchanges outside their country. The Capital markets are, thus, becoming integrated, consistent with this world-wide trend. Sound financial reporting structure is, thus, imperative for economic well-being and effective functioning of capital markets.

The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in the capital markets across the world. Therefore, increasing complexity of business transactions and globalisation of capital markets call for a single set of high quality accounting standards. The high standards of financial reporting underpin the trust investors place in the financial and non-financial information. Hence, the case for a single set of globally accepted accounting standards.

Adoption of IFRS helps the economy at large, investors, industry as well as the accounting professionals. It benefits the economy by increasing growth of its international business. It facilitates maintenance of orderly and efficient capital markets and also helps to increase the capital formation and thereby economic growth. It encourages international investing and thereby leads to more foreign capital flows to the country.

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So far as investors are concerned, they want the information that is more relevant, reliable, timely and comparable across the jurisdictions. The financial statements prepared, using a common set of accounting standards, help investors to better understand the investment opportunities as opposed to the financial statements prepared using a different set of national accounting standards.

The industry is able to raise capital from the foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. With the diversity in accounting standards from country to country, enterprises, which operate in different countries, face a multitude of accounting requirements prevailing in the countries. The burden of financial reporting is lessened with the convergence of accounting standards because it simplifies the process of preparing the individual and group financial statements and thereby reduces the costs of preparing the financial statements using different sets of accounting standards.

India's Roadmap to the IFRS Convergence

The Ministry of Corporate Affairs (MCA) had earlier issued the convergence roadmap from 2011 but the same was not implemented primarily due to tax implications. Since then, the Parliament has passed the new Companies Act, 2013. The new Act has introduced various new provisions, including

requirement to prepare the Consolidated Financial Statements, which would facilitate implementation of Ind AS converged with the IFRS.

Having regard to this and the ever growing need to implement the IFRS, the convergence roadmap has been issued by the ICAI in the press release dated 24th March, 2014. The revised roadmap recommends Ind AS to be implemented for the preparation of the Consolidated Financial Statements of listed companies and unlisted companies having net worth in excess of ₹500 crore from the accounting year beginning on or after 1st April, 2016, with previous year comparatives in Ind AS for the year 2015-16. The stand-alone financial statements will continue to be prepared as per the existing notified Accounting Standards which would be upgraded over a period of time.

The roadmap also proposes that the previous year comparatives for the year 2015-16 shall be prepared in accordance with Ind AS as against the previous roadmap which required the same to be prepared in accordance with the existing notified Accounting Standards, which was done at that time because the time for implementation of Ind AS was very short. This proposal would also be another step to make Ind AS convergent with the IFRS, as without this, Ind AS would not be considered to be IFRS-converged. It is felt that for preparation of the previous year comparatives also, the time presently proposed is sufficient.

Opportunities for CAs from Convergence with the IFRS

The adoption or convergence with the IFRSs benefits the accounting professionals in a way that they are able to render their services as experts in different parts of the world. It offers them more opportunities in any part of the world if uniform accounting practices prevail throughout the world. For accounting professionals in the industry as well as in practice, their ability to work in different parts of the world also increases.

Some of the specific opportunities that the convergence to the IFRS brings in are given below:

International Gateway for Indian Accountants

The world of the IFRS offers a distinctly Indian opportunity. There are several areas which promise growth on the world stage. A working knowledge and experience in IFRS offers an international gateway for Indian accountants to take their professional abilities anywhere around the world.

Growing Demand of Valuation Experts

The IFRS requires recognition of certain assets and liabilities hitherto unrecognised under the Indian GAAP. It also derecognises certain assets and liabilities hitherto recognised under the Indian GAAP. A significant proportion of the total items in the balance sheet will be measured on fair valuation. The fair valuation will require valuation experts which is another opportunity for chartered accountants.

Hiring of the IFRS Specialists by Companies

Companies would consider hiring or teaming up with the recognised IFRS specialists. So, there would be more demand for IFRS experts both in-house and as outside consultants. Presently, there are around 50,000 listed companies in India. Thus, there could be requirement of 50,000 teams consisting of IFRS experts for 3-6 months for the first-time convergence itself. Also, for a continuous review, IFRS professionals would be required.

Continuing Education and Core Resources

The conversion process should start with intensive and ongoing IFRS training for key audit and review personnel. It is a major task to impart knowledge and training, both to the preparers of these financial statements and to the auditing profession. This responsibility has been assigned to the ICAI, which has already embarked on the task. There would be extensive education initiatives to train around two lakh chartered accountants for this purpose.

Challenges for CAs

The changeover to Ind AS is a major challenge. A critical factor in the convergence to IFRS is the application of IFRS 1 on 'First-time Reporting of International Financial Reporting Standards' for which a corresponding Indian accounting standard (Ind-AS) 101 has been issued. This Standard requires the preparation of an opening balance sheet which requires:

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(a) recognition of all assets and liabilities which are required to be recognised under Ind AS.
(b) derecognition of all assets and liabilities which cannot be recognised under Ind AS.
(c) reclassification of items required under Ind AS
(d) application of Ind AS to the measurement of assets and liabilities. Some of the challenges in the IFRS convergence are highlighted below:

Challenges in First Time Adoption

First-time adoption has its own challenges. One has to undergo the exercise. There is no escape. And that is the easier part of the entire exercise. The difficult part is that in first time adoption, the Ind AS grants limited exemptions in certain areas where the cost of compliance may exceed the benefits. These exemptions are optional and not mandatory. You may choose not to avail the exemption.

An entity thus has to evaluate all these exemptions and understand the impact these will have on its financials in the short run as well as in the long run. Moreover, quite a few new accounting policies may need to be adopted. The previous policies may need modifications. The basis of judgements and estimates will need detailed working and understanding. The decision will not be easy and will require expert assistance provided after considering the financial and regulatory environment.

Regrouping/Reclassification

Presently, items are regrouped or reclassified to conform to the current year classification without any justification being provided in the financial statements. Under the Ind AS, in case any regrouping or reclassification is done, the same needs to be disclosed along with reasons thereof.

Industry Comparatives

Now with the Ind AS, not only the basis of quantitative data will change, the compiling and collation itself will become a major challenge. The comparison of present performance on the Ind AS basis with the historical data prepared on the Indian GAAP would be challenging.

Changes in Concepts Requiring Consideration

a) ***Introduction of 'fair value' concept***
A number of the Ind AS, mainly (a) Ind AS 102- Sharebased Payments (b) Ind AS 103- Business Combinations (c) Ind AS 20- Government Grants (d) Ind AS 39- Financial Instruments, *etc.* require that certain assets and liabilities have to be measured at their initial recognition and also at their subsequent measurement at their fair value and not at their cost. There are also a number of Standards where an option is given to use the fair value method or the cost method.

b) ***Introduction of 'time value of money' concept***
This concept requires that where the expected date of recovery of an asset or payment of a liability is deferred, it is recorded at its discounted value using an effective rate of interest and not at its face value. Some of the assets and liabilities where this concept is used are deep discount bonds, deferred receivables and payables and long term provisions

c) ***'Substance over form' concept***
There are also a number of Standards which use the concept of substance over form, *e.g.*, redeemable preference shares are considered to be debt and not share capital; employee loans at concessional rates are deemed to include an employee cost equivalent to the interest forgone; convertible instruments are bifurcated into debt and equity, *etc.*

Awareness at the Board Level

Unless and until the Board of directors themselves understand the Ind AS, the buy-in for the Ind

AS implementation will be difficult. Thus, the board needs to be aware about the impact the Ind AS implementation will have on the entity's financial results, ratios, the remuneration packages, distributable surplus *etc.*

External communications

It is, nowadays, necessary for any public interest entity, to regularly communicate in a transparent manner with its various stakeholders. To ensure a continuous growth momentum, strong investor relations are a prerequisite. The challenge would be to educate the stakeholders including the analysts, shareholders and lenders to correctly understand and analyse the Ind AS statements.

Internal Changes

The Ind AS will cast its shadow not only on the accounts department but will influence the other departments also. There will be new terms, new definitions for old terms, different ways of things done hitherto. Ind AS will entail changes in various internal processes and systems. There would also be a need to reconfigure accounting software. The way the budgets are drawn, the way performance is measured, the way performance is rewarded will require substantial changes. The MIS also has to follow Ind AS and cannot be based on old systems.

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Lack of core financial background amongst users of financial statements, such as research analysts, shareholders etc.

The annual reports are becoming bulkier. Instead of results, more and more information is being provided in the name of transparency. The onus of understanding the results has shifted considerably from the management to the person analysing the results. It is advisable that the results should be crisper so that an average user can make an intelligent use of it.

Most of the financial and research analysts do not have a core financial background and rather hails from the management profession such as MBA where the advance financial knowledge is usually not imparted. It may be advisable that in the financial courses more emphasis is given in the core curriculum so that the educated trained work force is available for the industry.

Availability of Valuers

A significant proportion of the balance sheet items will be measured on fair valuation. The fair valuation will require valuation experts, thereby increasing the requirement of trained valuers and adequate numbers of subject matter experts. In the absence of the requisite number of valuation experts, the quality will be hampered.

Accounting Policy Changes

The Ind AS entails major accounting policy changes in the areas such as:

(i) Revenue Recognition
(ii) Inventory Valuation: Service Sectors
(iii) Accounting for taxes on income
(iv) Useful life of Intangible asset
(v) Prior period items
(vi) Extraordinary items
(vii) Financial Instruments
(viii) Business Combinations

The Roadmap to Success

The Ind AS implementation requires a project approach with a commitment from the highest level. If done properly, it provides a huge opportunity. From my practical experience, the following approach to the Ind AS implementation is suggested.

Phase I : Plan Conversion
Phase II : Impact Analysis & Quantification
Phase III : Redefine/Redesign

Phase IV : Opening balance sheet as per the Ind AS
Phase V : Reporting date – the Ind AS financial statements

Phase I: Plan conversion

The Steering Committee:

- The steering committee has to consist of members of the audit committee including the CFO, CEO & COOs of the Company.
- The role of the steering committee may include:
  a) Create and allocate resources
  b) Develop major milestones
  c) Oversee the project
  d) Develop a communication plan for all stakeholders e) Interact with the Board of Directors
  f) Assessing the impact on the internal control systems.
  g) Evaluating the various exemptions available under the Ind AS 101
  h) Evaluating the alternative accounting policy choices available
  i) Organising training for the staff at various levels
  j) Assessing impact on normal business and financial contracts
  k) Developing communication plans to various stakeholders

The Project Team:

- The project team should be headed by the CFO. The SBU heads should be invited on need base. The senior and middle level corporate, finance and accounts professionals should be other members of the team. Each of them should be assigned specific rolls.
- The role of the project team may include:
  a) Mapping each line item of the financial statements-whether quantitative or narrative to the applicable Ind AS
  b) Conducting a gap analysis between requirements under the Ind AS and the current practices under the Indian GAAP
  c) Redesigning the chart of accounts
  d) Evaluating the IT related requirements
  e) Evaluating the impact on the processes for gathering information f)Assessing the need for multiple GAAP reporting.
  g) Evaluating the impact on regulatory information submissions

- A champion should be identified who will act as an interface with the external world and the internal world.

Train the team

- Once the steering committee and the project team is in place, they have to be trained.
- The interaction and training of the steering committee will involve basic understanding of the Ind AS. They need to appreciate the strategic implications of the Ind AS implementation.
- The training and workshop sessions of the project team has to be an extensive and focussed exercise and will require a phased approach. After the training sessions, the team members should be able to comprehend and appreciate the operational aspects of the Ind AS.

Develop milestones

- The Ind AS implementation needs a determination of milestones. The milestones have to be categorised under various groups to be developed by the project team.
- The milestones will include determination, fixation of dates for completion and evaluation of various activities such as:
  a) Training Program
  b) Impact Analysis
  c) Choice of accounting policies
  d) Valuations
  e) Opening the Ind AS balance sheet
  f) Interim financial statements
  g) Annual financial statements
  h) Changes in the ERP
  i) Modifications of the accounting tree
- One should use extensively the Gantt Charts, CPM & PERT techniques to develop these milestones.

Phase II: Impact Analysis & Quantification:

- The project team will study the existing policies, practices, processes and records.
- Assess and evaluate implication of Ind AS on
  a) financial statements and reporting
  b) Long term contracts
  c) Supporting business processes
  d) Systems and controls
  e) Tax compliances
  f) MIS
- Identify the differences/gaps between existing policies, practices, processes and records with Ind AS requirements.
- Thereafter, analyse the above and quantify each of the items.

Phase III – Redefine/Redesign policies, practices, processes and records

- Once the team and the committee has evaluated the impact, they should carry out an ABC analysis for gaps/differences and identify items and areas that:
  1. requires minimal changes
  2. requires medium level changes
  3. requires significant IT and system changes
- Alternatives should be developed and options identified by the team. On the recommendation of the team, the committee should develop a suitable criteria for approval of the most appropriate alternative.
- The knowledge for the selected alternative will need documentation for smooth implementation and subsequent references.

Phase IV: Opening balance sheet as per Ind AS

- After evaluating the accounting policy alternatives and selecting the Ind AS accounting policies most appropriate to the entity, the initial conversion to create Ind AS opening balance sheet will be undertaken.

Note: In the Indian context, opening the Ind AS balance sheet will mean the balance sheet as on 01-04-2015, *i.e.*, the Ind AS balance sheet on the earliest date for which the comparatives will be presented.

- At this stage, a decision will need to be taken whether one would like to prepare two sets of books of accounts - one for the Indian GAAP reporting and the other for the Ind AS reporting or one would like to continue maintaining accounts under the Indian GAAP with a suitable spreadsheet being prepared for the changes required for converting the Indian GAAP accounts to the Ind AS accounts.
- Further, one must exercise a caution that one will not only need the annual financial statements for 2016-17 but also the quarterly financial statements since all the listed companies will need to give comparative Ind AS quarterly numbers in 2015-16.
- The accounting staff will be trained as per the Ind AS requirements. ERP or any other accounting software will be reconfigured. The Internal MIS budgets and other parameters will need to have equivalent Ind AS numbers for understanding and transition.

Phase V: Reporting date Ind AS financial statements

- The opening trial balance as on 01-04-2015 has to be as per the Ind AS.
- The Ind AS methodology will be integrated into day to day operations
- The auditors will vet the quarterly financial statements as per the Ind AS requirements
- The project team and the steering committee will have to ensure self-sustenance.

Conclusion

The decision to converge with the IFRS will go a long way in the history of the profession. While it has its challenges, it is a golden opportunity for the profession to rise to the occasion and make a mark for themselves. ■