

Convergence with IFRS – Challenges and Strategies

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AGENDA

IFRS LANDSCAPE

INDIAN GAAP AND CONVERGENCE

IFRS IMPLEMENTATION ISSUES

CRITICAL SUCCESS FACTORS

THOUGHT LEADERSHIP

IFRS LANDSCAPE: OUR VIEW POINT

IFRS: Today and tomorrow

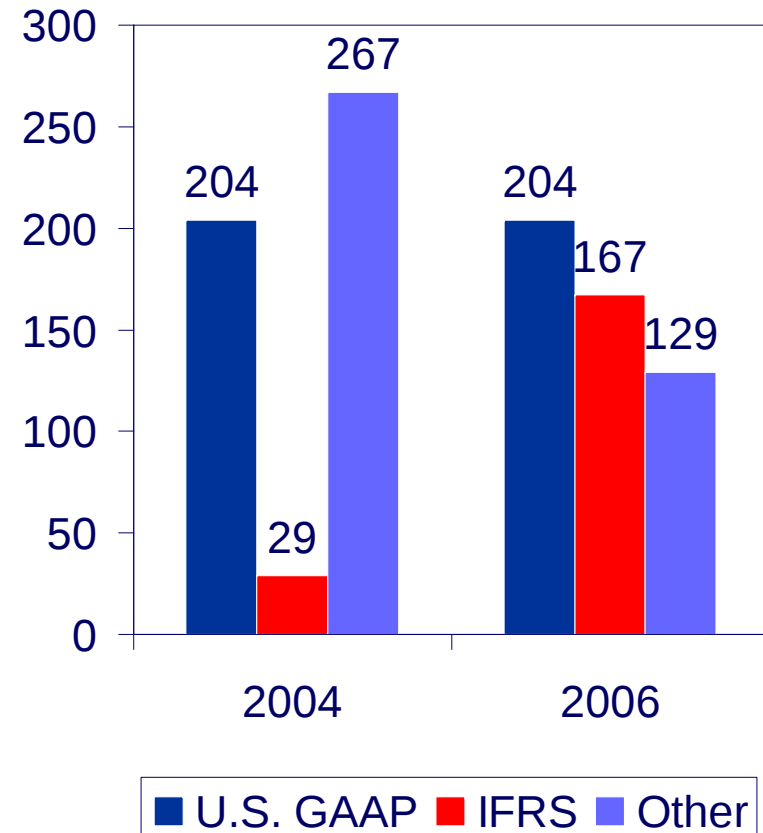
Today

- Used in over 100 countries and by approximately 40% of the Global Fortune 500
- Required for listing companies across all EU countries and majority of countries in Asia Pacific including China
- Adoption date announced by large countries like Brazil, Canada, and India
- SEC has allowed FPIs to report under IFRS without reconciling to USGAAP.

Tomorrow

- Expected that all major countries will have adopted IFRS to some extent by 2011
- Substantial majority of Global Fortune 500 will report under IFRS
- U.S. public companies will likely have the option of using either IFRS or US GAAP by 2011

Global Fortune 500



Challenges of a principles-based approach



“Are these just guidelines or actual new policies?”

IFRS – how much of a change ?

- Telecom company – loss increased by 40%
- Property and construction company – profit increased by 8%
- Financial services company – profit reduced by 35%
- Property investment company – profit increase huge, net assets reduced by 11%
- Safety and Security service Co. – profit reduced to zero, net assets tripled
- Software provider – profits doubled, net assets up 22%
- Utility company - profit decreased by 9%, net debt up 55%

INDIAN GAAP AND CONVERGENCE

Indian Experience

- New Standards significantly in line with IFRS
- Concept paper on Convergence of IFRS in India
- Expected convergence by 2011

Major differences between IFRS and AS

- **IAS 1/AS 1**

- Based on pre-revised IAS 1
- No format specified in AS 1
- Revised AS 1 under finalisation

- **IAS 2/AS 2**

- IAS 2 also includes within its scope the cost of inventories of service enterprises
- IAS 2 permits fair value measurement for inventories held by commodity broker-traders
- IAS 2 excludes only 'selling costs' and not "distribution costs"
- IAS 2 requires same cost formula to be used for all inventories having a similar nature and use to the entity
- Exposure draft of AS 2 being issued to converge with IAS 2.

Major differences between IFRS and IAS

- **IAS 6 / AS 6**

- AS 6 being withdrawn upon issuance of the revised AS10
- IAS 6 has already been withdrawn

- **IAS 7 / AS 3**

- AS 3 does not provide any option regarding classification of interest received, interest paid, dividends received and dividends paid
- AS 3 is presently under revision to converge with IAS 7

Major differences between IFRS and AS

- **IAS 8/AS 5**

- AS 5 is based on the earlier IAS 8
- Under AS 5 prior period items are recognised in the period in which the error is identified. Under IAS 8, errors are retrospectively adjusted.
- Exposure draft of revised AS 5 being prepared

- **IAS 10/AS 4**

- Proposed dividend treatment
- Disclosures relating to material non-adjusting events to be given the financial statements
- AS 4 is presently under revision to bring it in line with corresponding IAS 10 Events After the Reporting Period

Major differences between IFRS and AS

- **IAS 11/AS 7**

- No difference

- **IAS 12/AS 22**

- AS 22 based on Income Statement approach where IAS 12 is based on Balance Sheet approach
- Under IAS 12, a deferred tax liability has to be created for the undistributed earnings of subsidiaries, joint ventures and associates if certain conditions are met
- Virtual certainty versus reasonable certainty for creation of deferred tax assets
- AS 22 proposed to be brought in line with IAS 12

Major differences between IFRS and AS

- **IAS 14/AS 17**

- IASB has recently issued IFRS 8 which will be applicable from January 2009

- **IAS 16/AS 10**

- Cost of major inspections and overhauls can be considered, in case it meets recognition criteria as per IAS 16. These expenses are charged off in accordance with AS 10
- Revised AS 10 approved by Council of ICAI and the NACAS

- **IAS 17/AS 19**

- Lease agreements to use lands specifically excluded from the scope of AS 19
- Arrangements in the nature of a lease covered by IFRIC 4
- AS 19 specifically prohibits upward revision in estimate of unguaranteed residual value during lease term
- Accounting for initial direct cost incurred by a lessor other than a manufacturer or dealer lessor

Major differences between IFRS and AS

- **IAS 18/AS 9**

- AS 9 is based on the earlier IAS 18
- AS 9 is presently under revision to converge with current IAS 18.

- **IAS 19/AS 15**

- AS 15 does not permit 'corridor' approach in respect of actuarial gains and losses
- AS 15 does not permit recognition of termination benefits as a liability merely on the basis of a detailed formal plan

Major differences between IFRS and AS

- **IAS 20/AS 12**

- AS 12 revised corresponding to IAS 20 has been approved by the Council and the NACAS. There is no difference between the revised AS 12 and IAS 20

- **IAS 21/AS 11**

- AS 11 is based on the integral and non-integral foreign operations approach
- IAS 21 is based on 'Functional Currency' approach

Major differences between IFRS and AS

- **IAS 23/AS 16**

- No major difference

- **IAS 24/AS 18**

- IAS 24 provides for including non-executive director in key management personnel
- AS 18 the term 'relative' is defined whereas IAS 24 deals with "close members of the family of an individual"

Major differences between IFRS and AS

- **IAS 27/AS 21**

- Difference in definition of control
- Non-controlling interests are presented in consolidated statements within equity, separately from equity of the owners of the parent whereas under AS 21 they are presented separately from liabilities and equity of the parent's shareholders
- IAS 27 specifies different accounting treatment for disposal that leads to loss of control and for disposals that do not result in loss of control.
- Fair value approach is followed for computing goodwill / capital reserve in IAS 27

Major differences between IFRS and AS

- **IAS 33 / AS 20**

- IAS 33 requires disclosure of basic and diluted EPS for continuing operations, discontinued operations and total operations
- IAS 33 requires disclosure of anti-dilutive instruments also

- **IAS 36 / AS 28**

- No major differences

Major differences between IFRS and AS

- **IAS 37 / AS 29**

- Under IAS 37 provisions are made for constructive obligations also.
- Discounting of provision not allowed as per AS 29 which is proposed to be revised
- As a measure of prudence AS 29 does not require contingent assets to be disclosed but acknowledges that the same are usually disclosed in the report of the approving authority

- **IAS 38 / AS 26**

- AS 26 is based on IAS 38 (issued 1998). IASB as a part of its project on Business Combinations has revised IAS 38
- AS 26 is based on the assumption that the useful of the intangible asset is always definite – rebuttable presumption of 10 years
- AS 26 is presently under revision to converge with IAS 38
- Evidence to support renewal in IAS 38 versus Virtual Certainty in AS 26 to determine tenure of renewable legal rights

Major differences between IFRS and AS

- **AS 13**

- Will be withdrawn (except provisions relating to Investment Property) when AS 30, AS 31 and AS 32 become operative

- **IAS 32, 39 and IFRS 7**

- AS 30, 31 and AS 32 issued by the ICAI. However these are not yet notified.
- Most complicated of all standards
- Significant new concepts

- **IAS 40**

- Presently dealt with by AS 13
- Proposed AS is under preparation

Major differences between IFRS and AS

- **IFRS 3**

- Corresponding standard is AS 14
- AS 14 significantly divergent from IFRS 3
- Major divergences of principles between AS 14 and IFRS 3

- **IFRS 5 / AS 24**

- An Indian Standard corresponding to IFRS 5 is under preparation

New AS under preparation

- IAS 10 – Events after the balance sheet date
- IAS 26 Accounting and Reporting by Retirement Benefit Plans
- IAS 40 – Investment Property
- IAS 41 – Agriculture
- IFRS 2 – Share based payment: Guidance Note on Accounting for Employee Share-based Payment and SEBI's accounting guidelines are available
- IFRS 4 – Insurance contracts
- IFRS 6 – Exploration for and Evaluation of Mineral Resources : Guidance Note available on Accounting for Oil and Gas Producing Activities
- IAS 29 – Financial Reporting in Hyper-inflationary Economies

Projects undertaken for convergence with IFRS

- Preparing the work plan of ASB and liaising with the IASB
- Liaising with Government and Regulatory authorities
- Identifying issues relating to adoption of IFRS for Banks and other Financial Institutions
- Revising the formats of financial statements of banks
- Identifying issues relating to Companies Act
- Identifying issues relating to adoption of IFRSs for Insurance sector
- Identifying issues relating to adoption of IFRSs for SEBI rules and regulations
- Identifying issues relating to NBFC
- Liaising with Industry Associations
- Education and training on IFRSs

IFRS IMPLEMENTATION ISSUES

IFRS impact beyond financial statements

Most aspects of the business can be affected:

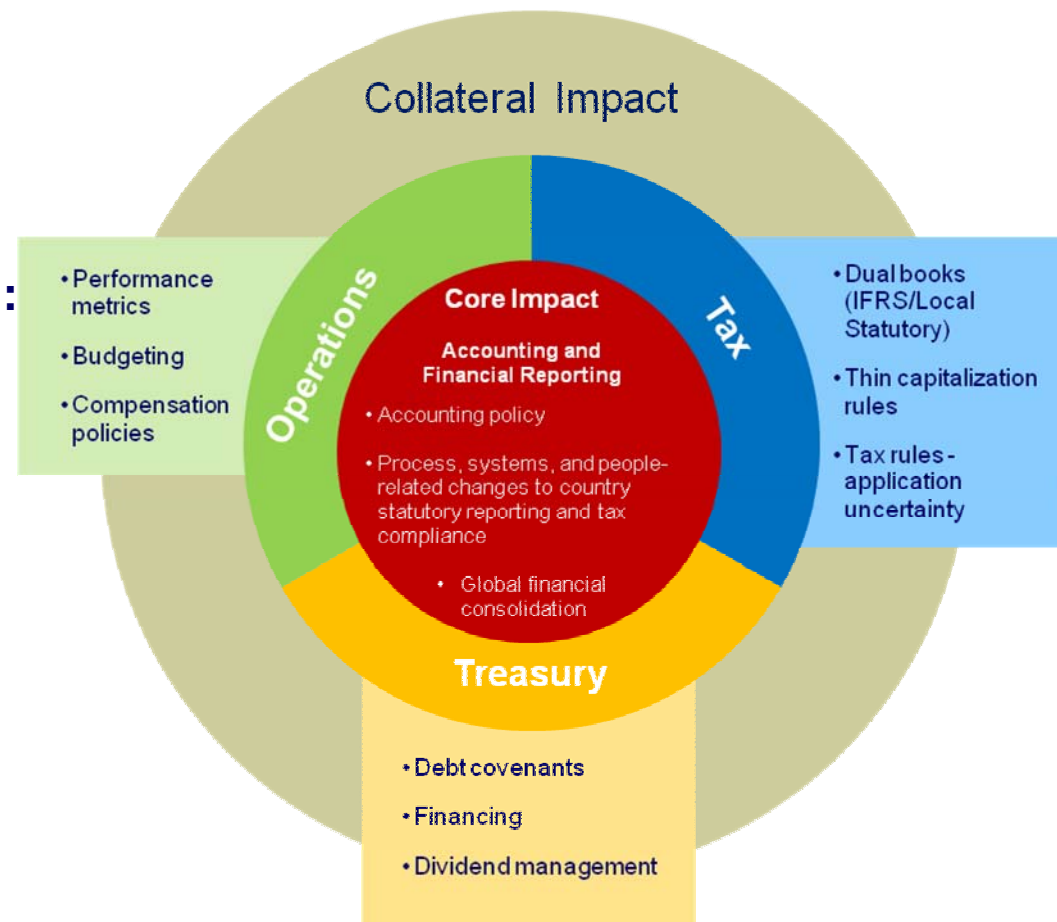
- Processes and systems
- Operations
- Tax
- Treasury

The adoption of IFRS affects more than a company's accounting policies, processes, and people.

Ultimately, most aspects of a company's business and operations are affected potentially.

Examples include impact on:

- Debt covenants
- Compensation plans
- Revenue contracts
- Tax returns
- Joint ventures and alliances
- Investor communication



Likely key challenges of implementing IFRS

Accounting

General

- Joint ventures: Consolidation proportionate or otherwise may become an issue
- Contracting: Different rules may result in changes in revenue recognition
- Debt / equity: Possible reclassification of preference shares as liabilities
- Subsidiaries and associates: Different rules may impact the current treatment

Financial instruments

- Valuation: Greater use of fair value
- Hedge accounting: Strict rules around qualifying hedge relationships, effectiveness and documentation
- Restrictions on common risk management techniques: Internal hedges and portfolio hedging through Group Treasury
- Embedded derivatives: Possible requirement to fair value components of other instruments, including long-term contracts

Other statements of IFRS

- Pensions, segmental reporting and others

Wider business issues

Business development

- Contracting: Different rules will present different opportunities, challenges, management and accounting issues
- Joint ventures: Consolidation method may impact structure of new arrangements

Financing

- Covenants: Changes to balance sheet and key ratios may impact covenants

Motivation

- Remuneration structures and performance measurement – especially executives

Systems and processes

- Data requirements
- Calculation methodologies
- Integration

Tax planning and capital management

- Uncertainty about IT Department response

Project management

Complexity

- Most significant accounting step change ever
- Identification of appropriate resources
- Data, systems and integration issues can be extremely complex
- Requires multi-disciplinary participation

Group interaction

- Systems and policy development
- Fair valuation models
- Hedging models and documentation

Aiming at a moving target

- Uncertain timetable for implementation
- Uncertainty about final form of IFRS

Potential business issues

- **Some of the key business issues that will need to be addressed for successful implementation:**
 - Treasury management
 - Distributions
 - Debt covenants & financing
 - Mergers & acquisitions
 - Management compensation
 - Uncertainty in tax implications
 - Management information
 - Human resources & training
 - IT systems
 - Investor relations

Potential business issues

- **Treasury management**

- Certain financing and hedging policies which are beneficial from a business and economic perspective, may not be displayed as such in the reported financial results, and may instead create volatility in reported results

- **Distributions**

- Equity may change – current dividend policy may no longer be sustainable
- Altered dividend patterns may directly impact the share price

Potential business issues

- **Debt covenants & financing**

- Where debt covenants do not provide for changes in accounting standards, changes to financial position may cause these covenants to be breached
- Impact company's ability to ensure continuity of financing arrangements
- When seeking to raise finance, comparative figures may need to apply IFRS as well

- **Mergers & acquisitions**

- Accounting for potential acquisitions will be altered by the adoption of IFRS
- Goodwill => become non-amortised
- Past mergers/acquisitions may contain clauses including price revisions based on accounting data

Potential business issues

- **Management compensation**
 - Fair value of share options and other incentive plans shall be recognised
 - Incentive compensation may be impacted
 - Any adjustment to a directors' remuneration scheme is a sensitive issue
 - Careful management of investor relations is essential

Potential business issues

- **Potential tax implications**
 - Definition of “taxable profits”, follow accounting rules?
 - Major accounting principles adopted:
 - Mark-to-market basis for valuation
 - Flow through Profit or Loss account for most items
 - Both unrealised gains and losses may appear in profit or loss account
 - Items may cause material impact:
 - Financial instruments
 - Share-based payments
 - Investment properties
 - Income taxes
 - Revenue recognition

Potential business issues

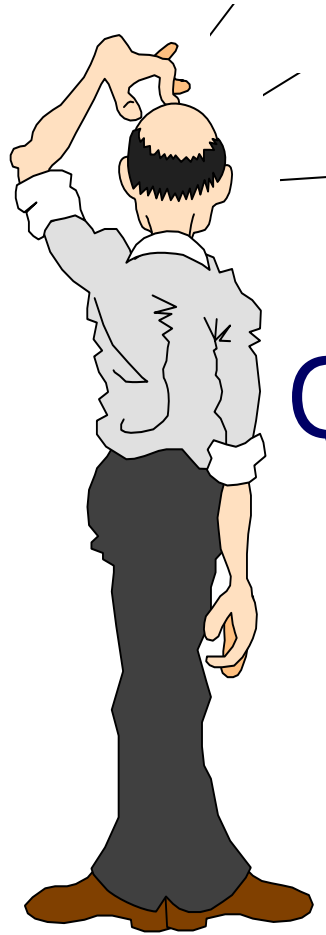
- **Management information**
 - Forecasts and internal performance measurements may no longer be comparable with results reported in FS (eg. fair value change)
 - Making forecast more difficult
- **Human resources and training**
 - Training will be required throughout the organization, not just for finance department
 - Existing skills may not be adequate to tackle IFRS related issues → need to be supplemented externally, by recruitment or by training internal resources

Potential business issues

- **IT systems**
 - Systems that will be affected:
 - internal and external reporting systems, accounting systems and operating systems
 - E.g. new accounting treatments for financial instruments may require treasury systems to be integrated with financial reporting system

Potential business issues

- **Investor relations**
 - May challenge the changes in profits and EPS
 - Investors will form their own expectation on new accounting policies and expect certain accounting outcomes
 - Nobody likes surprises



Questions