Changing the 'I' in IGAAP:

Perspectives on India's transition to IFRS

Executive Summary

ABOUT ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our 131,500 members and 362,000 students throughout their careers, providing services through a network of 80 offices and centres. Our global infrastructure means that exams and support are delivered – and reputation and influence developed – at a local level, directly benefiting stakeholders wherever they are based, or plan to move to, in pursuit of new career opportunities. Our focus is on professional values, ethics, and governance, and we deliver value-added services through our global accountancy partnerships, working closely with multinational and small entities to promote global standards and support.

We use our expertise and experience to work with governments, donor agencies and professional bodies to develop the global accountancy profession and to advance the public interest.

Our reputation is grounded in over 100 years of providing world-class accounting and finance qualifications. We champion opportunity, diversity and integrity, and our long traditions are complemented by modern thinking, backed by a diverse, global membership. By promoting our global standards, and supporting our members wherever they work, we aim to meet the current and future needs of international business.

Changing the 'I' in IGAAP: Perspectives on India's transition to IFRS, is available in PDF. The full report can be downloaded free of charge from the ACCA website.

www.accaglobal.com/general/activities/library/financial_reporting/

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Background

In July 2007, the Council of the Institute of Chartered Accountants of India set a target of adopting International Financial Reporting Standards (IFRS) for all listed, public interest and large-sized entities from accounting periods beginning on or after 1 April 2011. IFRS already forms the basis of accepted accounting principles for companies based in over 100 countries around the world. With other major economies such as Brazil, Canada and Japan set to require their major companies to report under IFRS (or equivalent standards), along with the US paving a road map for convergence, IFRS has cemented itself as the global accounting language of choice.

As businesses increasingly operate and seek to access finance around the globe, international businesses need to be able to communicate their performance through globally comparable and harmonised financial reporting. Indeed, in a 2008 survey conducted by CFO Research Services in collaboration with ACCA,[1] 41% of the 94 Indian CFOs surveyed felt that the 'timetable [for adopting IFRS] should be accelerated because China and other competitors are already reporting using global financial standards'.

With 2011 rapidly approaching, Indian companies and finance professionals are faced with a major change to financial reporting. Experience from other jurisdictions has shown that not only can the financial statements themselves be impacted significantly, but the transition costs related to adopting IFRS can be substantial. In order to ensure as smooth a transition as possible, businesses need to develop detailed strategies and programmes for implementation.

In July 2009, ACCA chaired a series of discussion groups in Delhi, Mumbai and Pune, where a number of leading finance professionals from various sectors of Indian business discussed India's pending transition to IFRS. This paper summarises participants' views on a number of related issues including:

- how companies, and the Indian economy as a whole, will benefit from IFRS
- what progress is being made, by companies and their clients, to prepare for IFRS, and
- the challenges that are being faced to ensure 'India Inc.' is well placed to meet the adoption date and continuing use of IFRS thereafter.

1. CFO Publishing Corporation, *A Climate of Convergence: India's Road to Global Reporting Standards*, 2008.

What are the expected benefits to India of adopting IFRS?

Indian companies have already embraced globalisation, as evident in the prominent role they play in the international outsourcing and information technology sectors. Similarly, participants unanimously believed that Indian organisations will not only embrace IFRS, but will flourish through increased global trade and the creation of new knowledge-based business opportunities leveraged from an understanding of IFRS.

From the national economic view, there is a general perception that the increased comparability and transparency in financial reporting of Indian companies will:

- facilitate global investment opportunities, both inbound and outbound
- reduce barriers to entry to global capital markets
- potentially lower cost of capital, and other costs and risks associated with dual filings.

By helping Indian companies themselves to expand, there will also be knock-on effects such as additional revenues for the government, allowing further investment in the infrastructure of the economy as a whole.

For individual businesses and industries, there will be increased opportunities:

- to provide new and enhanced services, especially in the Business Process Outsourcing (BPO) sector and for professional services firms
- for cost savings in education and training, as professionals will only need to maintain understanding of a single accounting regime
- to conduct a comprehensive, once-only review of financial reporting and information systems processes and controls within an organisation.

There is also a resounding perception that reporting under IFRS will benefit management decision-making. The expected transparency in reported figures under IFRS will be more suitable for making strategic decisions.

What progress is being made to prepare for IFRS?

Participants had a clear idea of what their organisations need to achieve by 2011. The discussion groups outlined the most important areas of activity for Indian companies.

While the key elements of a transition programme were readily agreed upon. Participants' views about how much most Indian companies have progressed with such programme varied considerably.

HUMAN RESOURCES

The right number and level of expert staff **is** important both for the professional services firms and corporates. The professional services firms need to be in a position to fulfil their assurance role, as well as being able to offer appropriate technical advice. Corporates need to be in a position to understand the impact of IFRS on the operations of their business as well as financials, and be able to communicate this to internal and external stakeholders.

SYSTEMS

In order to achieve the benefits of producing information under IFRS, appropriate IT and information systems will need to be in place to capture and analyse data relevant to IFRS.

COMMUNICATION

Although there is a need to ensure early consultation with auditors and professional consultants, it is essential for channels to be in place to ensure that investors, analysts and financiers are updated in a timely manner so as to understand the impact of moving from Indian GAAP (IGAAP) to IFRS. Such a major adjustment to corporate reporting requires well thought out change management.

RAISING AWARENESS

As IFRS is seen to have a wide impact beyond the finance function, it is important for managers to be made aware of how IFRS may affect their decision-making. Also, it will help ensure that there is high level buy-in to the IFRS strategy.

There is a belief in many companies that management remained ambivalent to IFRS, and this is often reflected in the lack of forward planning in those companies. Where companies have already started implementing a conversion programme, it is because their management had been informed about the implications of IFRS early.

STRATEGY AND ASSESSMENT

Typically companies (including clients of the professional services firms) that were listed or multi-nationals tended to be more advanced in terms of having strategies in place. Of those, some had set up steering groups to manage the process. These groups had already conducted diagnostics of how IFRS will impact the financial statements and following early buy-in from management, their organisations had heavily invested in IFRS implementation programmes. However, the majority of companies are simply aware of IFRS, but little concrete preparation work has been done.

UP-SKILLING

Education and training of staff is seen to be the overriding factor in successful implementation. Nonetheless, while management in some companies has evaluated the skills of the internal workforce, and were beginning to train relevant staff through IFRS courses and qualifications, this is not the case in the majority of businesses. There is also a fear that many companies were over relying on external consultants to ultimately manage their conversion process as well as updating staff on key issues relating to IFRS. This is felt to be unsustainable and inefficient in the long-run.

What are the main challenges of IFRS adoption?

Although participants indicated that some companies were well advanced when examining most of the key elements fundamental to conversion to IFRS, there was believed to be a general lack of focus in the Indian business community.

This relatively casual attitude appears to reflect a lack of clarity about the transition from regulators. It also hides the fact that there are significant challenges for India in achieving a successful and worthwhile conversion.

Participants noted a number of challenges.

DIFFERENCES BETWEEN IFRS AND INDIAN GAAP

While IGAAP has been converging with IFRS as much as possible in recent years, differences still remain, and some of these were viewed as significant challenge to overcome. Participants noted concerns in the following areas.

a) IFRS is more principles based, and therefore more ‘liberal’ than Indian GAAP. More choice under IFRS will mean the increased need to use professional judgement, and this will require a fundamental change in mindset for Indian accountants.

b) Initial transition will be a challenge given differing recognition and measurement criteria for assets and liabilities. These will not only impact earnings, but it is important to be able to capture those differences through appropriate information systems.

c) Specific accounting areas that will be more complex included business combinations and financial instruments. Many of the problems associated with them arise from the greater use of fair value accounting under IFRS.

INTERACTION BETWEEN LEGISLATION AND ACCOUNTING

There are concerns about the compatibility of Indian laws with IFRS in certain matters pertaining to accounting, such as formats and presentation requirements.

Similarly, there is uncertainty over tax treatments of items arising from convergence such as unrealised gains and losses and the move from a tax basis for depreciation (IGAAP) to one of useful economic life (IFRS).

EDUCATION AND TRAINING

A key challenge is to ensure companies, auditors, regulators and the investment community are appropriately skilled to apply and interpret IFRS.

EFFICIENT FINANCIAL REPORTING PROCESSES

Although many Indian companies have still not thought about the impact on their information systems. These will require a fundamental review and initial costs could be significant.

At the same time, it is important to have in place sound systems in order to ensure that subsequent generation of reporting information is efficient.

Recommendations

It was evident in the discussion groups that there is considerable level of ambivalence in the business and professional community around IFRS. This largely stems from the perceived uncertainty over the 2011 transition date.

Some participants believed that this is because the government, regulators and standard-setters are frantically looking into many of the issues associated with IFRS adoption in India. It was, however, unanimously agreed that more dialogue with industry and greater transparency about government and regulator thinking on adoption is needed.

Although adoption at the earliest opportunity is preferred, most companies will be happy to delay as long as the reasons are communicated openly.

GOVERNMENT, REGULATORS AND STANDARD SETTERS – A UNIFIED APPROACH

Corporate reporting in India is directed by a number of bodies, including the accounting standard-setter (ICAI), regulators (IRDA, RBI and SEBI) as well as through legislation (Companies Act). Together with potential tax implications, this means that IFRS adoption is not simply a matter of companies implementing IFRS instead of Indian Accounting Standards.

In order to assist stakeholders throughout the financial reporting supply chain, and ultimately to bring momentum to the implementation process, participants recommended:

- a stronger lead from key government departments such as the Ministry of Corporate Affairs
- a more coordinated approach from the varying groups of standard setters
- clear and transparent signals from regulators and standard setters as to the transition approach and date, with a detailed and complete roadmap for conversion as soon as possible.

OUTLOOK: MOVING IN THE RIGHT DIRECTION

Positive steps are being taken, as revisions to the Companies Act, the new Income Tax Code, and Valuations Act are now in progress. In August 2009, the Indian Ministry of Corporate Affairs also established a group of prominent experts to address implementation challenges related to convergence.

BUSINESSES – MANAGING THE PROCESS

With the requirement to prepare opening balance sheet numbers for comparative figures using IFRS – effectively 1 April 2010 – the need for assessment and planning is increasingly urgent. In order to ensure that the process runs smoothly, businesses need to:

- assess the impact IFRS will have on their financial results, their information systems and their operations, and then instigate appropriate processes to enable conversion to take place
- communicate, internally and externally, to ensure that there is buy-in from internal stakeholders throughout the organisation and to manage investor relations and expectations as soon as possible.

OUTLOOK: BENEFITTING FROM EXPERIENCE

Participants strongly urged businesses and professional services firms to review transition models in jurisdictions that had already implemented IFRS. There is much knowledge available on how European organisations successfully planned, implemented and communicated their conversion strategies, and these were of considerable value here in India.

PROFESSIONALS – HARNESSING KNOWLEDGE

In order to successfully manage the process, it is vital to have the expertise to assess what the impact of IFRS will have, when compared to IGAAP.

Whether it be preparing, auditing, or analysing financial statements under IFRS, the current level of expertise needs to be nurtured and grown significantly. Participants recommended:

- embedding IFRS into the syllabus of professional qualifications and the curriculum of graduate accounting courses
- raising IFRS expertise in qualified and practicing accountants, through focused training sessions and recognised qualifications in IFRS
- focused training and recruitment of specialists for complex areas in IFRS, such as valuation experts to deal with aspects of fair value measurement
- formation of industry-based forums and discussion groups to help raise awareness of key issues, facilitate best practice and to strengthen accounting practices and policies adopted by companies.

Enabling effective transition to IFRS in India: 8 key action points

1. **Leadership**: the government needs to clearly emphasise the benefits of IFRS, and together with regulators provide a stronger lead in declaring a complete roadmap to convergence to bring momentum to IFRS implementation.

2. **Coordination**: the government and regulators need to work closely and take urgent steps to align regulatory and legislative requirements with those of IFRS.

3. **Preparation**: businesses need to ensure that transition programmes are in place as soon as possible, as the 2011 transition date means comparative figures need to be restated under IFRS. Businesses need to start assessing the impact of IFRS on their organisation in earnest and instigate processes to enable that conversion.

4. **Training**: businesses need to commit resources for IFRS training and development of staff. The training programme has to be led by internal management, with experienced consultants providing expert support.

5. **Communication**: businesses need to communicate their IFRS conversion strategies at an early stage. Internal stakeholders need to understand the impact of IFRS on their business and their buy-in is crucial to forming a workable transition plan. Expectations of external stakeholders need to be managed, as IFRS could have a significant impact on performance measures.

6. **Expertise**: professionals need to develop their skills to meet the specific requirements of IFRS. With the increased use of fair value accounting, there is an acute need for valuation specialists, and clear systems need to be in place to accredit such professionals.

7. **Education**: professional bodies and universities need to be embed IFRS into the syllabus of their professional and university courses, in order to meet the demand for IFRS qualified, professional accountants.

8. **Influence**: professionals from industry and practice need to form working groups to highlight and respond to key issues. These should set objectives of lobbying for national regulatory changes as well as influencing the IFRS standard-setting process.

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