

Implementation of IFRS Steps in Convergence

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1. Applicability

The Ministry of Corporate Affairs has announced on 22.01.2010 a roadmap for convergence with IFRS. The road map for Corporates has been specified and there will be two separate sets of Accounting Standards u/s 211(3C) of the Companies Act. The first set would comprise of Indian Accounting Standards which are converged with IFRS and shall be applied by a specified class of companies. The second set would comprise of the existing Indian Accounting Standards and would be applicable to other companies including SMCs.

1.1. The First set of Accounting Standards (i.e. converged accounting standards) will be applied to the specified class of companies in 3 phases converting their opening balances as at 1.4.2011, 1.4.2013 and 1.4.2014.

1.2. The first phase of companies which need to convert their opening balance sheets as at 1st April 2011 in compliance with the notified accounting standards which are convergent with IFRS are-

- Companies which are part of NSE-Nifty 50
- Companies which are part of BSE –Sensex 30
- Companies whose shares or other securities are listed on stock exchanges outside India
- Companies whether listed or not, which have net worth exceeding Rs 1000 crores

The second phase of companies will comprise of companies, whether listed or not, having a net worth exceeding Rs 500 crores but not exceeding Rs 1000 crores and will convert their opening balances as at 1st April 2013.

The third phase of companies consist of listed companies which have net worth of Rs 500 crores or less and will convert their opening balances as at 1st April 2014.

Companies which fall under the following categories will not be required to follow the notified accounting standards which are converged with the IFRS (though they may voluntarily opt to do so) but need to follow only the notified accounting standards which are not converged with the IFRS. These companies are –

- Non listed companies which have a net worth of RS500 crores or less and whose shares or other securities are not listed on Stock Exchanges outside India
- Small and Medium companies (SMCs) which is defined as –

An SMC is a Corporate

- Whose equity or debt securities are not listed or are not in a process of listing on any stock exchange, whether in India or outside India.
- Which is not a bank, financial institution or an insurance company.
- Whose turnover (excluding other income) does not exceed Rs. 50 crores in the immediately preceding accounting year.
- Which does not have borrowing (including public deposit) in excess of Rs. 10 crores at any time during the immediately preceding accounting year.
- Which is not a holding or subsidiary company of a company, which is not a small and medium sized company.

1.3. Revised Schedule VI to the Companies Act 1956 according to the converged Accounting Standards is likely to be notified along with suitable change in Schedule XIV (Depreciation rates).

1.4. MCA has announced that ICAI will finalise the IFRS convergence Accounting Standards within 31.3.2010 and NACAS will submit their recommendation within 30.4.2010. The necessary notification under the Companies Act is expected to be issued thereafter.

2. **Stages in implementation**

The steps involved in the implementation of IFRS for convergence from IGAAP to IFRS by a corporate would be as follows.

2.1. **Impact Study**

2.1.1 At first it is necessary to carry out an impact study of introduction of IFRS on the entity. This will involve a review of the existing accounting practices of the entity relating to the Accounting policies being followed and identifying the areas of differences between existing practices and IFRS requirement. The areas of differences are likely to be areas relating to

- Accounting treatment as per IGAAP and that as per IFRS
- Measurement differences of the carrying values
- Assets and liabilities not recognised in IGAAP but required to be recognised in IFRS
- Reclassification of assets and liabilities as required under IFRS
- De-recognition of assets and liabilities under IGAAP which need not be recognised under IFRS

2.1.2 As per IFRS 1 certain treatments are mandatory for the first time adoption of IFRS in the transition period accounts in setting up the opening balances. Thus the differences that need to be analysed will also be those that are required for the first time adoption of IFRS and those which are for adoption in subsequent IFRS Financial statements. In the First time adoption of IFRS for transition to IFRS, the transitional rules in the individual standards are ignored and the provisions of IFRS 1 apply.

2.1.3. Further, the differences in accounting treatment would need the identification of the differences in relation to:

- Accounting of
 - Assets and liabilities
 - Revenue and expenses
 - Acquisitions and consolidations
- Presentation and disclosures

The first step in IFRS implementation is to carry out the impact study as outlined in 2.1.1, 2.1.2 and 2.1.3 above.

2.2. **Treatment of Fixed Assets**

The major issues that need to be addressed relating to fixed assets will normally be the following.

2.2.1. Property, Plant and Equipment (PPE)

Property, Plant and Equipments are accounted for as per IAS 16. Assets are initially recognised at costs and subsequent recognitions are at fair values on the dates of their measurement except in the cases where the cost model is permitted under IAS 16. The carrying amounts under the Cost or Revaluation model are equal to the fair value less subsequent accumulated depreciation and impairment loss. Assets are therefore regularly required to be revalued so that the carrying amounts do not differ materially from the fair value.

Further IAS 16 mandates the component approach in accounting of fixed assets. This means that there is requirement of -

- In-depth analysis to identify significant components that make up a plant
- Each significant component to be depreciated over its own useful life
- Technical knowledge for the purpose of application of component accounting
- Identifying major repairs and overhaul expenditure which are capitalised as if it were a separate component in IAS 16

Major spares and standby equipments which are expected to be used for a period more than one accounting period, will be recognised as PPE and depreciated over their useful life. Spare parts and servicing equipments which can be used only in connection with a particular item of PPE are depreciated over a period not exceeding the useful life of the related asset. Thus critical parts identification is an important exercise required for PPE accounting. In IFRS, replacements are

capitalised and replacement costs are also capitalised while in present IGAAP this is done only if future benefits are beyond the original standards of performance.

Further, for the purpose of IFRS accounting -

- Depreciation is to be accounted on the basis of useful life as against the rates provided in Schedule XIV. Depreciation change in method and residual value is a prospective effect in IFRS.
- Exchange differences on imports cannot be capitalised.

2.2.2. All assets of the entity will have to be reviewed by Registered valuers appointed for this purpose and this exercise would also help in setting up a Fixed assets register based on the fair value concept and componentialisation of the assets. The Registered valuers would have to interact with technical persons of the entity and physically verify all assets at the plant to identify various components, assess the useful life of the plant, equipments etc. The object is to segregate the components from the plants, ascribe fair values to them on the basis of remaining life, residual values a depreciation. The opening values will have to be setup based on Cost or Revaluation model and ascertainment of depreciation on residual useful life and residual value. The Fixed assets register under IFRS will have to be set up based on this exercise. .

Thus the second step in IFRS implementation will be to make a detailed study of fixed assets keeping in mind 2.2.1 and 2.2.2.

2.3 **Opening Balances**

The third step in implementation of IFRS is the ascertainment of opening balances. All assets and liabilities on the opening balance sheet date must be measured in accordance with IFRS as per detailed review to be done of all items covered under 2.3.1 to 2.3.11 below. Items measured at cost will be converted at revaluation cost models where IFRS so mandates. In this stage the changes that are required in year-end procedures to compile the data relevant to IFRS will have to be determined and finalized. Such procedures should take care of procedures

required for periodical ascertainment of the fair valuation as on the balance sheet dates

2.3.1 Investment Property

Investment property is property that is held by the owner or the lessee under finance lease to earn rentals or for capital appreciation or for both. However, under certain cases an Investment property may include property interest held by a lessee under an operating lease.

Further -

- Investment property may be accounted at fair value under IAS 40 while IGAAP allows only depreciated cost model
- Disclosure requirements are different from IGAAP
- Revaluation is allowed for some non financial assets

2.3.2. Intangible assets

- Revaluation/ discounting allowed
- Rebuttal assumption
- No amortisation required under IAS 38 and only impairment testing
- Amortisation of intangibles having indefinite life
- Intangible asset “held for sale” amortisation to be stopped

2.3.3 Provisions, Contingent Liabilities and Contingent Assets

- Restructuring provisions based on constructive obligations as against legal obligation
- Identification and disclosure of contingent assets
- Whereas discounting method is allowed in measurement of some of the provisions in IFRS this is not presently allowed under IGAAP
- Provision has to be based on legal obligation and not on constructive obligation
- IAS 37 provides certain basis and statistical methods to be followed for arriving at the best estimate of expenditure for which provision is required.
- Disclosure of contingent assets required under IFRS

2.3.4 Non current assets held for sale and discontinued operations

- Classification, measurement and presentation as per IFRS 5
- Measurement principle- lower of carrying value or fair value less costs to sell
- Presentation requirements of discontinued operations

2.3.5 Arrangements in the nature of lease

- Arrangements in the nature of leases are to be determined based on –
 - Substance of the arrangement
 - Whether fulfillment is dependent on use of specific assets and whether it conveys a right to use the asset
 - And whether it conveys a right to use the asset

2.3.6. Financial Instruments

- Fair valuation requirements
- Interest expense and income –based on effective interest rate
- Embedded derivatives
- Sales tax deferral –imputed interest rate
- Commodity hedging implications
- Classification and measurement of investments as per IAS 39
- Preference shares
- Disclosures as per IFRS 7.

2.3.7 Revenue and expenses:

These will have to be on the basis of IAS 18 (Revenue recognition), IAS 12 (Income Taxes), IAS 19 (Employee benefits) and IAS 21 (Effects of changes in foreign exchange rates). Employee benefits are accounted for on corridor approach for actuarial gains and losses and terminal benefits are accounted on constructive obligation. The effects of changes in foreign exchanges are based on the effect on the functional currency.

2.3.8 Revenue Recognition:

- Measurement – fair value /charges to customer, discounting
- Service income only on percentage of completion method
- Multiple element contracts

2.3.9 Deferred Tax Assets/Liabilities

- Accounted for on timing difference on balance sheet approach

2.3.10 When applying the accounting policies required under IFRS, adjustments may arise for a number of reasons and may involve-

- Recognition/ derecognition
- Re-measurement
- Reclassification

The items that need to be recognised under IFRS but not so required under IGAAP will have to be identified under recognition rules. Some such items are liabilities under finance leases, provisions where there are constructive obligations, derivative financial instruments and acquired intangible assets. Similarly some items may need to be derecognised like internally generated intangible assets, deferred tax assets where recovery is not possible.

Items measured at cost may require re-measurement if the amount recognised as cost does not meet IFRS definition of cost or if the adopted IFRS policy requires measurement under fair value

Items will also have to be reclassified as per IFRS in respect of items in the Balance Sheet, Income statement and statement of equity.

2.3.11 There are some important exceptions to the general restatement and measurement principles and in the following cases there are options available:

- Business combinations
- Fair value or revaluation as deemed cost

- Employee benefits
- Cumulative translation differences
- Compound financial instruments
- Assets and liabilities of subsidiaries, associates and joint ventures
- Designation of previously recognised financial instruments
- Share based payment transactions
- Insurance contracts
- Decommissioning liabilities included in the cost of property, plant and equipment
- Leases
- Fair value measurement of financial assets or financial liabilities at initial recognition
- Borrowing costs

Hence the options need to be reviewed to determine the alternative acceptable for the company so that accounting policies are developed accordingly.

It is to be noted that in preparing IFRS estimates, the entity must use the inputs and assumptions that had been used to determine the previous IGAAP estimates in periods before the date of transition to IFRS so long as these inputs are consistent with accounting policies under IFRS.

2.3.12 Thus, in this stage the opening balances will be set on the basis of above reviews and data collection following the measurement guidelines in IFRS 1 and the other relevant IASs. These will include setting up of the balance sheet items based on IFRS classification and then measuring the items based on guidelines discussed above and generally considering, fair valuation model, best estimate measurement, revaluation discounting, impairment testing, and provisioning on legal obligation.

2.4 **Financial statements formats**

2.4.1 IAS prescribes minimum structure on financial statements and contains guidances on disclosures. There is no “Extra-ordinary item” classification in IFRS. IFRS provides a “Statement of Changes in Equity”. The Financial statements consist of-

- Statement of financial position as at the end of the period
- Statement of comprehensive income for the period
- Statement of changes in equity for the period
- Statement of cash flows for the period
- Schedules as will be disclosed in the Notes to accounts

Modified Schedule VI format after convergence to IFRS may have to be adopted with whatever options available in this regard.

The balance sheet is prepared on a current and non-current distinction or a liquidity approach in presentation of the financial statements and subsequent events are not considered for classification of liability.

2.4.2 The schedules are contained in a statement on Notes on accounts which contains all disclosures as well as the schedules

The Notes on accounts will have to consider separately the following for disclosures and adequate information is required to be collected on -

- Related party transactions disclosures
- Changes in accounting policies, estimates and prior period errors
- Events occurring after balance sheet date

2.4.3 The disclosures relate to –

- Critical judgements made in applying accounting policies
- Key sources of estimation uncertainty causing risk of material adjustment to carrying amounts of assets and liabilities within the next financial year

- Information to evaluate the entity's objectives, policies and processes for managing capital
- Reclassifications are also disclosed separately

2.4.4. In changes in accounting policies, retrospective effect is to be given by adjusting retained earnings. Prior period figures are restated retrospectively by restating opening balances, liabilities and equity for the earliest period practicable. There is no concept of accounting of proposed dividend.

2.4.5 The 4th stage in IFRS implementation is therefore to finalise the various formats of financial statements and disclosures that will form part of IFRS accounts and also the presentation of financial data compiled as per IFRS, in the format presented.

2.5 **Training**

The staff involved in preparation of accounts in the new IFRS format needs to be acquainted with the changes that have been identified for the purpose of IFRS implementation. Therefore they need to be trained on the various aspects of IFRS Accounting applicable to the entity.

Thus a suitable IFRS training programme should be part of the IFRS implementation plan of an entity and such training should be of the following durations depending upon the size of the corporate.

- Large Company - two training sessions of 5 full days each at a gap of at least 3-4 months during the stages of implementation.
- Medium Company – two trainings sessions of 3 full days each at a gap of at least 1-2 months during the stages of implementation.
- Small Company - one training session of 3 full days

3. **Estimated time for different stages:**

The detailed stage wise implementation will vary from company to company and will depend upon the size of company, numbers of locations and number of separate business carried out by the corporate. A range of likely time frame, depending upon the nature and size of company, would be as follows-

- (1) The first stage in IFRS implementation consist of completion of impact study highlighting the existing practices and the changes required and is likely to take about 15- 60 working days.
- (2) The second stage in IFRS implementation involve making fair value estimates of fixed assets which are classified as property, plant & equipment (PPE) and is likely to take between 90 – 180 working days.
- (3) The third stage in IFRS implementation involving setting up of opening balance of other accounts (other than property, plant & equipment) is likely to take between 60 – 150 working days.

Stages 2 and 3 can be done simultaneously

- (4) The fourth stage in IFRS implementation involving finalization of format of presenting the financial statement & IFRS data required to be compiled in the above stages and is likely to take between 30 – 90 working days.

4. **Other Issues:**

Apart from the steps mentioned above, major changes in I.T. systems and software will be required to make the same in line with major new IFRS compliant accounting policies.

Based on the changes adopted under IFRS the management will require to make suitable amendment in the various MIS generated for the company.