Is corporate India ready for Ind AS?

A PwC Ind- AS Outlook Survey indicates more than half of corporate India is yet to plan or commence implementing changes at an organisational level.

Strikingly, one- third is yet to start or plan for the impact assessment of IndAS adoption.

Impact on net worth, net income Ind- AS is a principles- based standard purporting to reflect the underlying economic substance of business transactions. Also, there is increased emphasis of fair- value accounting. Its adoption will have a significant impact on both, net worth and net income.

In certain cases the 'net' impact would be small due to offsetting adjustments. However, the changes to specific line items within the financial statements can be quite large. For example, in the case of retail or pharma sectors certain customer incentive schemes, rebates may have previously been recognised as an expense. These will now get reported as reduction of revenue. Though this not impact the net income, it could have a material impact reducing the revenue line item – an important metrics. Another example could be preference share capital and related dividend, which under Ind- AS will be debt and interest expense thereby reducing net worth and net income. However, non- amortisation of goodwill might increase reported income. Also, contrary to the apprehensions there could also be a positive impact. For example, the use of fair-value accounting for financial assets, including derivatives, can result in recognition of unrealised gains that were not possible under the Indian GAAP. Similarly, the threshold for recognition of Deferred Tax Assets (DTA) is now lower under Ind- AS.

Top three expected changes Revenue recognition, taxes and financial instruments are likely to be the most impacted. Revenue recognition, including due to accounting for matters such as multiple element arrangement and linked transactions, gross versus net presentation, financing benefits, service concession arrangements for infra projects and extended warranties. The impact of taxes can be substantial not only due to changes in the recognition rules for deferred taxes, but more importantly due to implications on MAT, which are based on accounting profits, and can be quite different under Ind- AS. Recognition of unrealised gains on financial instruments, non-amortisation of goodwill, recognition of actuarial losses on defined benefit obligations in other comprehensive income are some examples that might potentially increase the Ind- AS reported accounting profits, and thereby the MAT liabilities. According to the PwC survey, taxes are viewed as the No. 1 area to have a significant impact.

Segment reporting continues to be an important area of discussion. This is because Ind- AS 108 requires segmental information to be disclosed, based on how the chief operating decision-maker evaluates the financial information for the purposes of allocating resources, and assessing performance. This could require certain companies to change their segment disclosures, in line with their internal reporting.

'Half of corporate India is yet to plan' The switch to reporting under Ind- AS is largely seen as an accounting change. It is expected to significantly impact the way companies negotiate terms and enter into contractual arrangements with almost all stakeholders — customers, vendors,

strategic partners, lenders, investors. This framework seeks to present the substance of arrangements, rather than their legal form. The reality is that many companies are yet to fully comprehend the implications such business arrangements have on key metrics, including their debt- equity ratio, earnings per share (EPS) and revenue. Some of the key issues that need special consideration are as:

Strategic partnerships and joint venture arrangements: Under Ind- AS, rather than majority ownership, it is the contractual arrangements that define which party has control over the most relevant activities, that will determine who gets to consolidate this venture. This will impact the universe of entities that are consolidated in a group.

Fund raising from private equity and financial investors: Under Ind- AS, most investments that were generally structured as preference capital with terms guaranteeing return, redemption will get treated as debt, with the assured return being treated as a finance cost. This has a significant impact on the debt- equity ratio as well as the net profit and EPS.

Fund raising from banks: Re- cast of financial information under Ind- AS could potentially lead to violation of several covenants. These include the debt- equity ratio, and asset and debt service coverage ratios. Companies will, therefore, need to quickly renegotiate key covenants that are likely to be breached on this transition.

Customer and vendor arrangements: Contracts with customers also require reevaluation, especially where these include (i) extended credit terms, where the financing element is stripped out; (ii) dedicated supply arrangements, where it might contain an embedded lease (finance or operating) together with a service/ supply arrangements; customer funded assets, wherein some cases the asset may need to be de-recognised, or in other cases, the upfront fees deferred over the supply term, etc; Similarly, collaboration or out- licensing arrangements involving upfront fees, may no longer qualify for upfront recognition of such income. Acquisitions: According to Ind- AS, all acquisitions will hitherto be accounted by the purchase method using fair- values, thereby taking away the flexibility that existed under current standards. This would result in an increase in value of assets, including intangible assets, and a corresponding reduction in goodwill. This also has a knock- on effect on EPS, as these assets are amortised/ depreciated. Further, deferred payouts, including contingent consideration, might get routed through the profit and loss account rather than as additional investment, if it is linked to continuing employment of selling shareholders, etc.

There is a lot at stake and companies need to act quickly and evaluate business arrangements carefully.

‘Evaluate impact on business arrangements’ While some forward- looking corporate houses have started to analyse the impact of Ind- AS on their accounting, impact analysis from the tax perspective is lagging. From financial year 201617, there will be three different standards – (i) existing Generally Accepted Accounting Practices (GAAP), (ii) Ind- AS, and (iii) ICDS (Income Computation and Disclosure Standards). On top of this, there will be new presentation and reporting requirements under the Companies Act.

The three standards have divergent approaches.

GAAP predominantly follows a historical cost accounting, whereas Ind- AS lays more emphasis on fair- valuation at reporting date. ICDS, being tax accounting standards, seeks to prepone taxable income to current years - by recognising incomes early and delaying the recognition of expenses. These divergent approaches bring up certain important tax issues, having significant impact. Let us consider a couple of examples. Ind- AS lays emphasis on fair- value accounting, thus resulting in large differences in book profits under Ind- AS versus those under GAAP. This can result in increased Minimum Alternate Tax (MAT) liability of companies, as MAT is a tax on book profits. It also creates different classes of tax payers - the Ind- AS adopters over non-adopters. This is certainly not desirable or equitable- as the rules for all tax payers should be identical.

Further, Ind- AS requires component accounting of fixed assets, where each major item of property, plant and equipment is depreciated separately. This depreciation is allocated on a systematic basis over the useful life of the asset, reflecting the pattern in which entity consumes the benefits from the assets. However, for income tax purposes, the assets have historically been clubbed and formed a part of block of assets under the head Plant & Machinery.

Variation in classification under Ind- AS could throw up challenges for the existing income tax classification, which has different depreciation rates. The issue arises as to how to segregate the existing block of assets and to classify the block of assets for future acquisition — in two different contexts or under two or more regulations. Considering such issues would arise, the 10member Income Tax Simplification Committee, headed by RV Easwar, had also maintain status quo in respect of tax impact of Ind- AS till a deeper study is concluded.

It is now imperative for the regulators to sit together and bring in a unified approach in accounting and tax accounting to save business from unnecessary compliance burden. A unified regime will help in better understanding and robust implementation of such standards

(Anshul Kumar, senior manager at Deloitte, also contributed to this article) To weather the storm in corporate reporting, companies have been undertaking a variety of actions for readiness when the first reporting deadline comes into effect. These include: Training: Companies have invested in training, which is not only for the finance department but also for key users of financial information Impact assessment: Many companies undertook impact assessment early while many are still assessing. Users would remain curious of changes in corporate reporting over the medium to long- term, considering the significant impact it could have on them Use of external advisers: For the one- time transition project, some companies worked with external advisers to ensure the accounting positions at the time of transition are evaluated carefully and thoughtfully Timely engagement with auditors: Companies continue to engage with external auditors to avoid last minute surprises.

For all the listed companies, the Ind- AS financial results for June 30 would be out latest by August 15. These are compelling times for the finance department unless companies see these changes favourably and work to align its actions with these Effective use of technology: Given the enormous size of underlying information and the use of fair- value under Ind- AS, effective

use of technology is an imperative. Use of innovative tools, enablers and data analytics would aid smoothening of information gathering and resultant quality of corporate reporting Talent: A well- laid technology- enabled interactive accounting manual and a well- structured annual training calendar must be a part of a finance department's expenditure budget. Talent acquisition would also require some tactical focus on other low- cost IFRS reporting countries. For example, India headquartered businesses as well as large multinational companies are working innovatively to get talent from their various markets to work together Trust of audit committees and board members: Audit committees and board members have many responsibilities in the recent Companies Act.

Coupled with the significant learning curve in areas of new financial reporting standards under Ind- AS, there needs to be a continuous engagement with them. Trust would only improve if the finance leadership proactively engages with board/ audit committees Educate investors and other stakeholders: To maintain healthy investor relations, increased focus is necessary towards educating them for changes over a period of time. Other users like lenders, employees, suppliers and customers would also expect higher engagement to understand the changes better.

(Business Standard)