

# **Demystifying IFRS**

**December, 2008**

# Contents

- Basics of IFRS
- Key Differences
- Latest Developments
- Challenges and Issues
- Case Study

# What is IFRS ?

- International Financial Reporting Standards
- Standards for Reporting Financial Results
- IFRS requirement includes IASs
- Issued by International Accounting Standard Board ('IASB')

## Why IFRS ?

- Globally Accepted
- Simplified
- Cost Effectiveness
- Principles Based Environment
- Scope for Professional Judgment

## HOW..?

- Guiding Principles for IFRS Adoption:-
  - IFRS- 8 Standards
  - IAS- 41 Standards
  - IFRIC- 17 Interpretations
  - SIC- 33 Interpretations
  - Framework- Presentation of Financial Statements
  - Concepts- Other GAAPs

## Position in the World..

- Nearly 100 countries (require or permit)
- All Listed European Companies – 2005
- Pakistan – Already Reporting as per IFRS
- Canada – to Converge in 2011
- US – Sooner or Later – To be Complete by 2014
- India – 2011

# Key Differences

## IFRS Vs US GAAP

- Principle Based
- Complexity
- Globally Accepted

# IFRS vs. INDIAN GAAP

- First Time Adoption
- Presentation
- Substance – Rules
- Law vs. Standards

# IFRS vs. INDIAN GAAP

- Cost – Fair Value
- Functional / Reporting Currency
- Valuation of Taken over Assets
- Current vs. Non Current Assets / Liabilities
- Intangible Assets

# How to Convert

- Study (understand)
- Discussions and Checklist
- Applicability
- Disclosures

# Latest Developments..

- Company Law Bill 2008 (Proposed)
  - Direction towards IFRS
  - One Director / One Shareholder Companies
  - Financial Year Synchronized
  - Financial Statements to include Cash Flow Statements
  - Special Provisions for Merger and Acquisitions
  - Revised Schedule VI (Proposed)

# Latest Developments....

- Changed Accounting Standards (Drafts)
  - AS – 3 Cash Flow Statements (IAS 7)
  - AS – 2 Inventory Valuation (IAS2 )
  - AS – 12 Government Grants (IAS 20)
  - Guidance Note on Service Concession Arrangements (IFRIC – 12)

## Issues - Impact

- Increased Depreciation May Hit Bottom Line
- Adjustments May Hit “Net Worth”
- Understanding of Concept - A Must for USER

# Issues - Challenges

- WHO'Z THE BOSS ?
- Local Laws
- Training
- Awareness
- Action Plan

ARE YOU READY....

# Case Study..

## Covers - Main Topics

- Steps to be Taken- Common Steps/ Individual Steps
- Common Step (start point) – Functional Currency Testing
- IFRS 1- First Time Adoption
- Revenue Recognition- IAS 18, SAB 104 (US GAAP guidance)
- Current/Non Current Bifurcation
- Fair Value – Requirement/ Impact/ Issues
- PP&E- Miscellaneous Expenditure- Treatment

# Step by Step Approach

- Common Steps – To Start Up
  - Functional Currency Testing – CTA Impact
  - First Time Adoption- IFRS-1 Adoption
  - Revenue Recognition
  - Expense – Accrual/ Liability
  - Bifurcation of Assets/Liabilities in Current/ Non-Current
  - Presentation- SOCE (New Concept)

# Step by Step Approach

- Individual Steps- Based on Each Company
  - Impairment Testing/w/off's
  - De-recognition of Financial Assets & Liabilities
  - Standards Application- Immediate/ Retrospective/ Prospective
  - Change in Policy Statement
  - Fair Valuation
  - PP&E - Depreciation

## Reference Table (Main Standards)

- First Time Adoption- IFRS-1
- Presentation of Financial Statements- IAS-1
- Depreciation Accounting- IAS-4
- Cash Flows- IAS-7
- Segment Reporting- IAS-14
- PP&E (Fixed Assets)- IAS-16

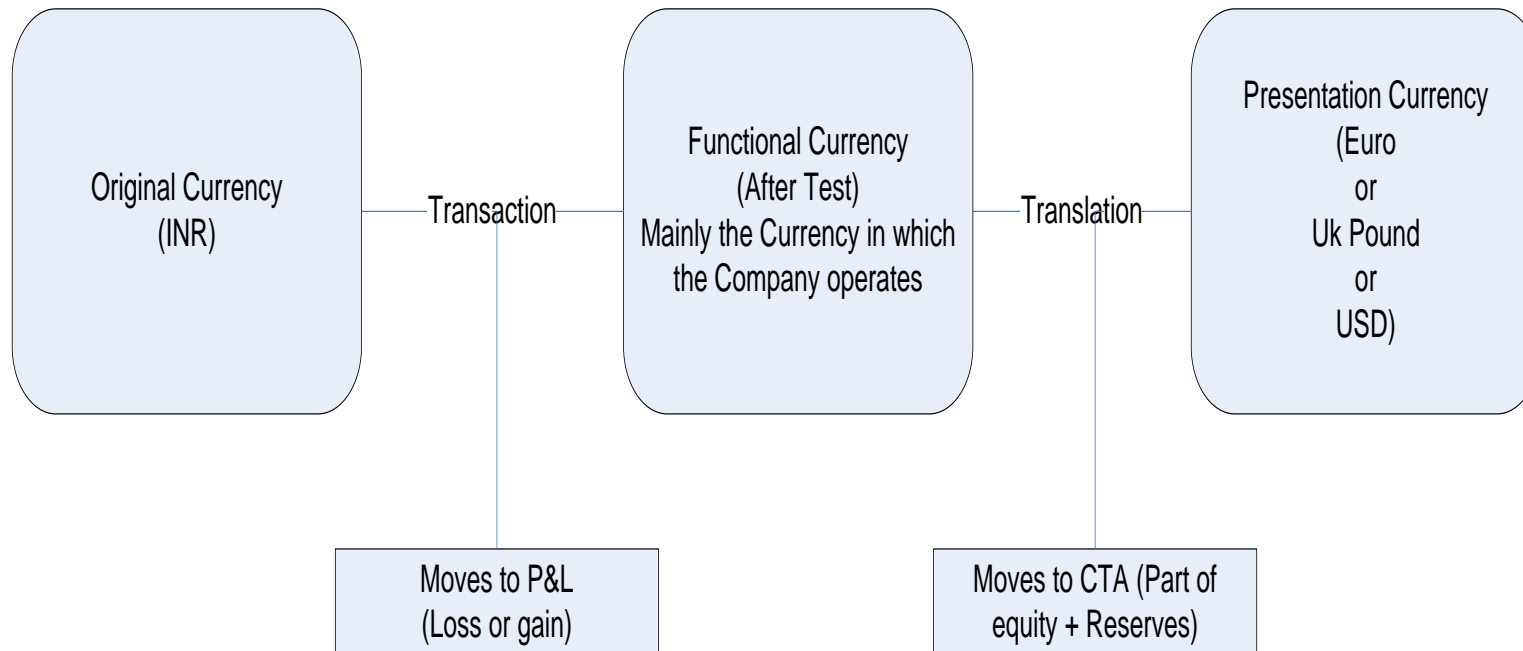
Cont....

## Reference Table (Main Standards)

- Revenue – IAS 18
- Leases- IAS 17
- Related Party Disclosures- IAS 24
- Earnings Per Share- IAS 33
- Impairment of Assets- IAS 36
- Interim Financial Reporting- IAS 34 + IFRIC 10

# Functional Currency

## How to determine?



# Functional Currency

## 6 Step Approach

- Expenses Incurred
- Revenue Booked/Billed
- Equity – Funded
- Inter Company Transactions- Settlements
- Billing Rate/Currency Determined
- Cash

(Refer page 11 – Validate the impact of CTA)

# Functional Currency Example

|                     | Original Currency<br>(Amount in INR) |      | Functional Currency<br>(Amount in USD) |        | Reporting Currency<br>(Amount in EUR) |        |
|---------------------|--------------------------------------|------|--|--------|---------------------------------------|--------|
| Sales               |                                      | 5000 |  | 99.40  |                                       | 78.53  |
| Expense             | 3000                                 |      | 59.64                                  |        | 47.12                                 |        |
| Equity              |                                      | 2000 |  | 39.60  |                                       | 31.68  |
| Fixed Assets (PP&E) | 3000                                 |      | 59.41                                  |        | 47.52                                 |        |
| Current Assets      | 1000                                 |      | 19.80                                  |        | 15.84                                 |        |
|                     | 7000                                 | 7000 | 138.85                                 | 139.01 | 111.08                                | 110.21 |
| Difference          |                                      | 0    |  | (0.16) |                                       | 0.87   |

P&L rate 1 USD = Rs. 50.3      P&L rate 1 USD = EUR .79  
 B/sheet rate 1USD=Rs.50.5      B/sheet rate 1USD=EUR 0.80

Transaction

↓

Moves to P&L

Translation

↓

Moves to B/sheet

# First Time Adoption- IFRS 1

- a) Who is a First Time Adopter:
  - i) In preceding year, prepared IFRS for internal purpose
  - ii) In preceding year, compliance with some IFRS
  
- b) Adjustments required to move from previous GAAP to IFRS:
  - i) Recognition/Derecognition of Assets/Liabilities
  - ii) Previous year comparative- Not required on IFRS
  - iii) Adjustments – Required to move from previous GAAP to IFRS – Recognize directly in retained earnings

# Revenue Recognition- IAS 18

## US GAAP Condition- SAB 101 & 104

(i) Revenue is recognized when following criteria is met:

- a) Persuasive evidence of an arrangement exists
- b) Delivery has occurred or services have been rendered
- c) The seller's price to the buyer is fixed or determinable and
- d) Collectability is reasonably assured.

Cont.....

# Revenue Recognition- IAS 18

## (ii) IFRS & US GAAP on Revenue Recognition:

- a) Principally on same concepts
- b) US GAAP is much more detailed, no such guiding principles in IFRS
- c) In case of defer receipt of Receivables, discounted on Imputed rate of interest
- d) The completed Contract method is not permitted in Construction accounting, only permitted is percentage-of-completion method.

# Property Plant and Equipments

## Treatment of Pre-Operative and Trial Run Expenses?

- As per Indian GAAP, pre-operative or trial run expenses to be capitalized in the year of commencement of operations.
- Under IFRS, capitalization not permitted. Therefore,
  - Need to treat such expenses as revenue expenses
  - Separate these expenses from assets value while convergence.
  - Depreciation amount would be adjusted accordingly.

## Depreciation – What Rates?

| Nature of Assets     | Rates as per Indian laws* | Rates as per IFRS                  |
|----------------------|---------------------------|------------------------------------|
| Building             | 4.75%                     | Over the useful life of the assets |
| Plant and Machinery  | 18.91%                    |                                    |
| Tooling & Dies       | 18.91%                    |                                    |
| Computer             | 40%                       |                                    |
| Vehicles             | 25.89%                    |                                    |
| Furniture & Fixtures | 13.91%                    |                                    |
| Office Equipment     | 18.91%                    |                                    |

**(Refer page 11 – Validate the impact of PP&E + Depreciation)**

**\* Schedule XIV of the Companies Act, 1956 (WDV)**

# Presentation - Notes to Accounts

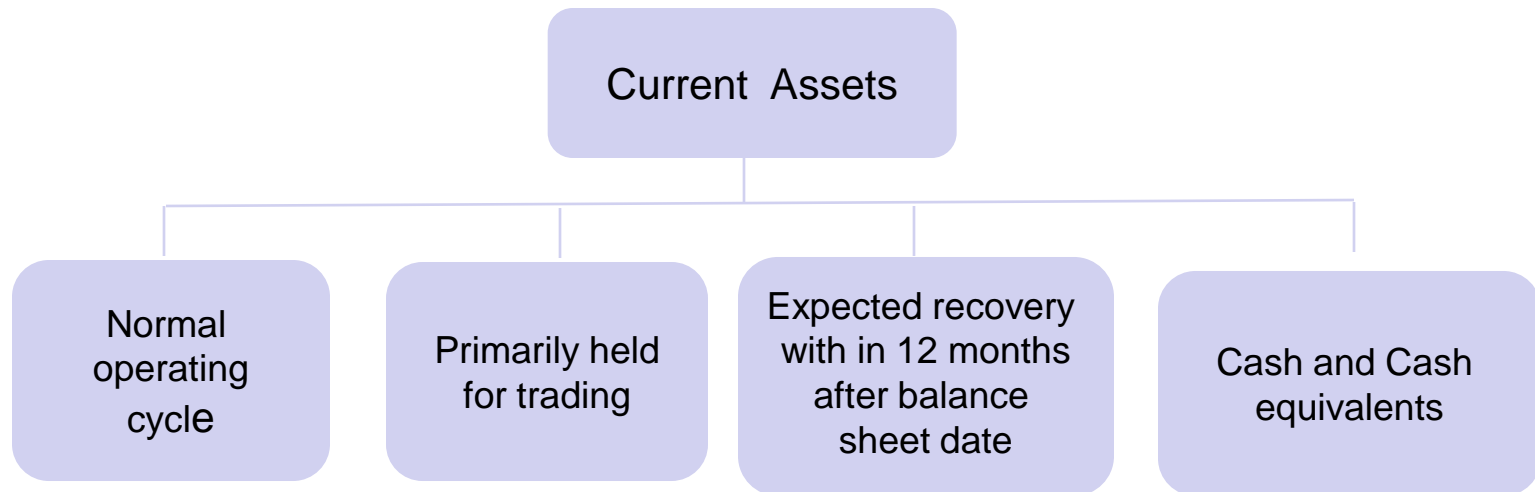
- Basis of Transition to IFRS  
- *Page 5*
- Retrospective Application–Applied/Exempted/Not Applied  
- *Page 6*
- Current Application- Applied/Exempt/Not Applied  
- *Page 7*
- Future Application- Applied/Exempt/Not Applied  
- *Page 8,9*
- Covered- IFRS – IAS – IFRIC - SIC etc.

# Assets/Liabilities - Current & Non Current

- Issues
  - How to Differentiate ?
  - How to Classify the Assets/Liabilities into Current and Non Current ?

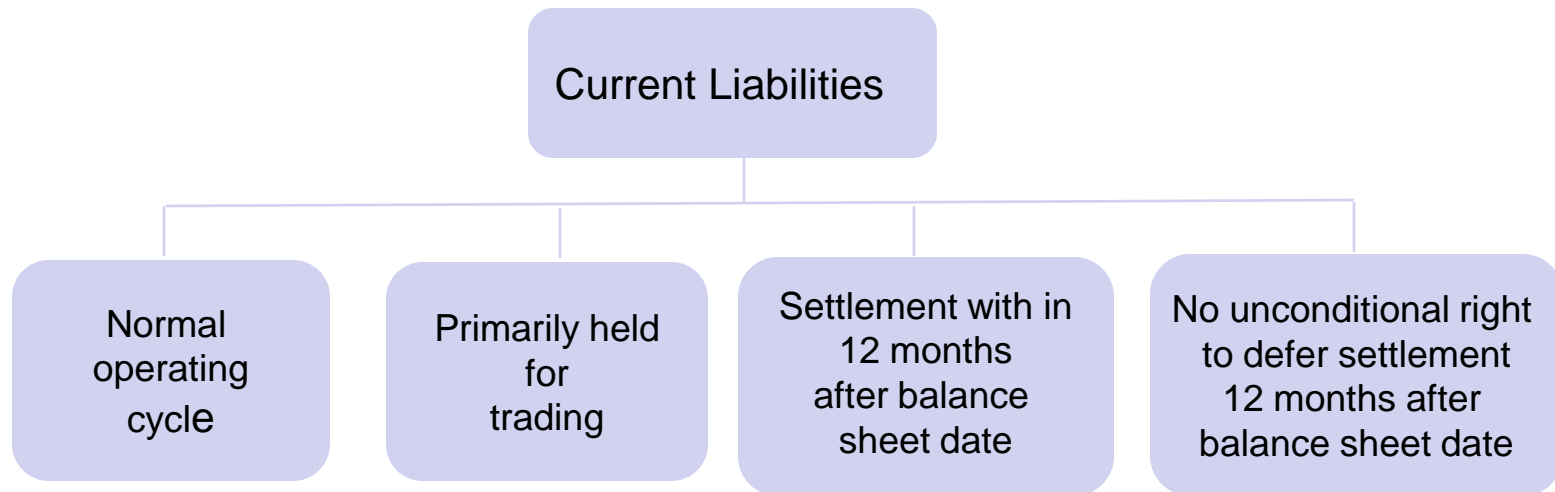
# Current Assets

- Cash or cash equivalent assets - held for trading (within next 12 months)



# Current Liabilities

- To be settled within next 12 months.



# Fair Valuation

*Logic*

*Fair Value- Revenue to be Recognized*

*Net Book Value- No Revenue, Book in Balance Sheet*

- How to Valuate ?
- Some IFRSs require Fair Value Approach-Examples :
  - IFRS-3, Business Combinations
  - IAS 39, Financial Instruments: Recognition and Measurement
  - IAS 41, Agriculture

## Fair Valuation ? ..How

- Fair value - for which the assets could be exchanged by willing parties in arm's length transaction.
- US GAAP provides a hierarchy of 3 levels of input data -
  - *Level 1* - *Quoted prices for identical items.*
  - *Level 2* - *Observable information for similar items.*
  - *Level 3* - *Unobservable inputs to be used.*

## Fair Valuation - Tax Implications?

- During Fair Valuation – effect flow through profit and loss account.
- Both unrealized gains and losses may appear in profit and loss account.
- As per Indian Income Tax Act, 1961 – this gain would be chargeable.
- Therefore, Income Tax Act needs to be changed accordingly so that unrealized gain may not be taxed.

# Change in Policies / Estimates

As per IAS 8

| S. No | Changes                       | Effect        |
|-------|-------------------------------|---------------|
| 1     | Change in Accounting Policies | Retrospective |
| 2     | Change in Estimates           | Prospective   |
| 3     | Prior Period Items            | Retrospective |

# Change in Policies / Estimates

## How to Judge ?

- Accounting Policies - Due to change in standard or interpretation or Voluntary change
  - ✓ *Retrospective application*
  - ✓ *Comparative Information is restated - to the extent it is practicable.*
  - ✓ *Example - Initial application of a policy to revalue assets, FIFO method for inventory*
  
- Prior Period Items –Error, omission or misstatements in prior period financial statements
  - ✓ *Retrospective application*
  - ✓ *Comparative Information is restated - to the extent it is practicable.*

# Change in Policies / Estimates

## How to Judge ?

- Estimates- Due to Uncertainty in Business Activities
  - ✓ *Prospective application*
  - ✓ *Comparative information is not required to be restated*
- Examples:
  - Bad Debts
  - Inventory Obsolescence
  - Useful Life of Depreciable Assets

# Net Outcome !!!

- IFRS – Unavoidable
- Earlier the Better
- 2009 is The Action Point

Questions....