Gaining perspective
Ind AS considerations for Indian real estate companies
August 2016
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Introduction
Indian Accounting Standards (Ind AS) are accounting standards converged with International Financial Reporting Standards (IFRS) and notified by the Ministry of Corporate Affairs (MCA) under the Companies (Indian Accounting Standards) Rules, 2015. Ind AS conversion is expected to be the largest change in financial reporting policies and procedures ever undertaken by companies in India. For many companies, the change will extend beyond technical accounting to direct and indirect taxation, IT systems, product pricing, performance measurement, employee compensation, mergers and acquisitions, and other business areas. Therefore, the implementation of an appropriate Ind AS conversion strategy should be a priority for all companies covered under Ind AS conversion.

According to the Ind AS implementation roadmap that the MCA has issued, companies covered in Phase 1 of the roadmap will start applying Ind AS from 1 April 2016. By 1 April 2017, all listed companies and companies with net worth in excess of INR2.5 billion (INR250 crores) will be covered under Ind AS reporting. Ind AS will apply to both standalone financial statements (SFS) and consolidated financial statements (CFS) of companies covered under the roadmap. Holding companies, subsidiaries, joint ventures and associate companies of companies covered under the roadmap are also required to implement Ind AS.

In an attempt to provide Indian real estate companies with a head start on Ind AS implementation, this publication highlights the key peculiar issues associated with it and their implications. This publication also covers first-time adoption issues and other key implementation aspects that Indian real estate companies should consider, including the impacts of the Guidance Note issued by the Institute of Chartered Accountants of India (ICAI) on Accounting for Real Estate Transactions for entities to whom Ind AS is applicable (issued in May 2016).
Understand key issues
The application of Ind AS to Indian real estate companies is expected to give rise to the most significant accounting changes in the areas of real estate sales, barter transactions, sale of flats with buyback obligations, multiple element arrangements, joint development agreements, investment property, consolidation of land owning companies, convertible debt and interest-free borrowings from promoters.

A. Revenue

Companies involved in the construction of real estate often enter into sale agreements with one or more buyers before construction is complete. Such agreements may take diverse forms and involve certain unique terms and conditions. Our experience indicates that the recognition of revenue from such agreements poses significant challenges.

Under IFRS, IFRIC 15 on Agreement for Construction of Real Estate prescribes that construction of real estate should be treated as sale of goods. Revenue from such contracts should be recognized when the entity has transferred significant risks and rewards of ownership and retained neither continuing managerial involvement nor effective control. IFRIC 15 has not been included in Ind AS. Instead, the ICAI has recently issued a Guidance Note on Accounting for Real Estate Transactions for entities to whom Ind AS is applicable (Ind AS GN), which is along the lines of the Guidance Note by the same name issued in 2012 for entities applying Indian GAAP (2012 GN).

The following are the key considerations in accounting for the revenue of real estate companies:

A.1 Real estate sales

Real estate activities and transactions take diverse forms. While some are for the sale of land (developed or undeveloped), others are for the construction, development or sale of units that are not complete at the time of entering into agreements for construction, development or sale. Our experience indicates that recognition of revenue from such transactions poses significant challenges.

Under Ind AS, there is a footnote under Ind AS 18 Revenue specifying that for real estate entities, revenue shall be accounted for in accordance with the Ind AS GN. According to the Ind AS GN, in case of real estate sales, the seller usually enters into an agreement for sale with the buyer at initial stages of construction. This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer provided that the agreement is legally enforceable and subject to the satisfaction of conditions that signify transferring of significant risks and rewards even though the legal title is not transferred or the possession of the real estate is not given to the buyer. Accordingly, revenue is recognized by applying the percentage of completion method on the basis of the methodology explained in Ind AS 11 Construction Contracts. The treatment is similar to that given in the 2012 GN applicable to entities applying Indian GAAP.
Considerations

Completed contract method vs. percentage of completion method

Under Indian GAAP, some real estate companies accounted for real estate sales transactions using the completed contract method according to AS 9 Revenue Recognition instead of the 2012 GN. It was generally interpreted that the guidance notes are recommendatory in nature and also that the standards would override the guidance notes. However, under Ind AS, the standard Ind AS 18 itself requires real estate companies to follow the Ind AS GN. Hence, companies applying Ind AS will find it difficult to continue with the completed contract method for accounting for revenues.

A.2 Barter transactions

Many real estate companies in India entered into agreements with residential flat owners/societies for the redevelopment of existing buildings and structures where the development rights are acquired by way of construction of built-up area.

Under the Indian GAAP, according to the 2012 GN, the cost of acquisition of development rights would be the amount spent on the construction of built-up area. However, the Ind AS GN requires the development rights to be measured in accordance with the principles of exchange of assets enunciated in Ind AS 38 Intangible Assets. Ind AS 38 requires intangible assets acquired in an exchange transaction to be measured at the fair value of the asset given up.

Considerations

Change in revenue and purchase cost

The application of Ind AS 38 will require entities to fair value the development rights and include it in purchases. The constructed built-up area provided to original residential flat owners will be accounted for as revenue in accordance with the Ind AS GN. A similar principle would apply to any barter transaction where an asset has been acquired.

A.3 Sale of flat with buyback obligation

Real estate companies have certain schemes allowing a buyer to return the flat to the company at a pre-decided buyback price.

A general practice of companies under Indian GAAP is to account for a returns when it happens. However, under Ind AS, whether the revenue recognition criteria is fulfilled will have to be evaluated. Ind AS 18 requires both the transactions – the sale of goods and the agreement to repurchase at a later date – to be dealt with together. Hence, the recognition of revenue could get deferred till the expiry of the right to return. It could also get classified as a financing arrangement instead of a sale.

Considerations

Timing of revenue recognition

Globally, the accounting for arrangements such as those involving a “right to return” is subject to close scrutiny. Once Indian real estate companies start applying Ind AS, their accounting in these areas is expected to be benchmarked to their global peers. As a result, they will have to evaluate whether the revenue recognition criterion is met in such peculiar cases.

If the criterion is not met and depending on specific facts and circumstances, the company may have to defer the entire revenue on these arrangements or recognize lower revenue.

The accounting for such transactions as financing arrangements may have legal implications.

A.4 Sale of flat with guaranteed returns

Many real estate transactions are structured in a manner that allows real estate entities to manage and lease out constructed properties to third parties on behalf of investors. In such transactions, the real estate entities offer guaranteed rentals/returns to investors. In case the entities are not able to generate the guaranteed returns on the property, they have to make good the losses to the investors. Accounting for such schemes under Ind AS will be different from that under AS. Under Ind AS, the sale of property and managing/leasing out the property would become multiple elements of a contract. The entities will have to evaluate whether the sale consideration of the property contains some element of compensation for probable losses on the leasing obligation. In that case, the probable losses on the leasing element will have to be estimated and considered at the time of revenue recognition from the sale of property. Also, entities will have to analyze whether it is a financing arrangement or a sale of property.

Considerations

Measurement of revenue

Accounting of such transactions under Ind AS will result in reduction in revenue from sale of property and increase in revenue from leasing arrangements. This will not only have an impact on the profits for the year, but will also have tax implications. If it is accounted for as a financing arrangement, it will also have legal implications.
A.5 Penal interest on delay in construction

Real estate contracts generally include a penalty clause for delay in construction, requiring real estate entities to compensate the investor in the form of interest for the period of delay. Under AS, such transactions are accounted for as cost of construction. However, under Ind AS, the penal interest will be used in determining the fair value of revenue to be recognized from the sale of property.

Considerations
Measurement of revenue

Delays in real estate construction are common in the Indian scenario. With companies now required to estimate the charge due to delays and include it in the calculation of fair value of revenue, their financial statements will be adversely impacted. Companies will also have to consider tax and legal implications of such a treatment.

A.6 Multiple element arrangements

Real estate companies enter into contracts with buyers to deliver goods or services in addition to the construction/development of real estate—such as property management services, sale of decorative fittings (excluding fittings that are an integral part of the unit to be delivered) and rental in lieu of unoccupied premises.

The current practice is to club all the amenities along with revenue from flats, while applying the percentage completion method.

However, according to the Ind AS GN, these amenities will need to be evaluated for a multiple-element arrangement. Though the previous Guidance Note (2012 GN) had the same requirement, it was not strictly followed with respect to transactions with multiple elements. Further, Ind AS 18 Revenue has more detailed guidance on accounting for multiple-element arrangements.

Considerations
Revenue recognition

The contract consideration should be split into separately identifiable components that have stand-alone value to the customer. The recognition criteria will be applied to the separately identifiable components in order to reflect the substance of the transaction. The consideration received or receivable for the contract should be allocated to each identifiable component on the basis of the fair value of each component.

B. Group accounts/consolidation

B.1 Joint development agreements

Real estate companies in India generally enter into joint development agreements (JDAs) with land owners for permission to construct buildings in return for ownership of a part of the building. Also, property investors commonly enter into JDAs to facilitate investment in real estate sales. Often, such arrangements are in the form of an interest in another entity and are therefore generally classified as joint arrangements.

Considerations
Determining the substance of a transaction

In practice, JDAs may be structured in different ways and may involve significantly different terms and conditions. Real estate companies engaged in such arrangements will need to closely examine their terms and conditions to determine their true substance. An analysis of the terms and conditions may indicate whether the contract involves exchange of goods according to Ind AS 18 Revenue or it is in the nature of a joint venture or joint operations according to Ind AS 111 Joint Arrangements. Appropriate accounting will depend upon this determination. Consequently, it will have to be examined whether the real estate entity can apply the percentage completion method for projects under JDAs.

Under Indian GAAP, AS 27 Financial Reporting of interests in Joint Venture requires interest in jointly controlled entities to be proportionately consolidated in the consolidated financial statements of a venture. Under Ind AS, Ind AS 28 Investments in Associates and Joint Ventures requires interests in joint venture to be accounted for using the equity method.

As a result, companies with a significant number of their real estate investments through jointly controlled entities will not be able to include their share of real estate investment assets and the related income statement items in their financial statements.

B.2 Business combination/consolidation of land-owning companies

Real estate companies in India are regulated under the Land Ceiling Act, which fixes a maximum limit on the area of land that may be owned by one company. To overcome this restriction, real estate companies float various special purpose entities (SPEs) that purchase land from the market. Real estate companies may have differing
arrangements with SPEs – for example, holding directly or indirectly the majority share capital of SPEs, holding exclusive rights to develop land, guaranteed minimum returns to the shareholders or contracts that may restrict the decision making powers of the SPE.

Considerations

Business combinations

When real estate entities acquire a land-owning company, they need to analyze whether they have acquired an asset – i.e., land – or business in accordance with Ind AS 103 Business Combination. If they have acquired an asset and not a business, the entire consideration paid to acquire the company should be allocated to the asset acquired. Hence, there will not be any goodwill calculation. As a consequence, the acquisition cost of land will change in the consolidated financial statements. Under Indian GAAP, goodwill is calculated on such transactions and hence the land cost would be different from that recorded under Ind AS. This will depress the consolidated profits of the entity when the sale of such land, as part of inventories, happens. Also, entities will have to consider its impact on revenue recognition according to the percentage completion method in the consolidated financial statements. It may also impact the deferred tax calculation.

Consolidation of SPE

Under Indian GAAP, real estate companies preparing CFS normally consolidate SPEs where they directly or indirectly hold the majority share capital or have a majority on the board of directors or other governing bodies. However, the concept of “control” under Ind AS 110 Consolidated Financial Statements is wider in scope. Under Ind AS, the following circumstances, for example, may also indicate a relationship in which an entity controls an SPE and consequently should consolidate the SPE:

a) In substance, the activities of the SPE are being conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the SPE’s operations
b) In substance, the entity has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an “autopilot” mechanism, the entity has delegated these decision-making powers
c) In substance, the entity has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE
d) In substance, the entity retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain the benefits from its activities

Upon transition to Ind AS, real estate entities will need to evaluate their relationship with SPEs based on the criteria laid down in Ind AS 110. Consolidation of SPEs may significantly affect key ratios and performance indicators of the group. Real estate companies will also need to examine whether such consolidation may have any legal or other implications.

B.3 Real Estate Investment Trust/Infrastructure Investment Trust

A Real Estate Investment Trust (REIT) is an entity that offers common shares/units of an operating real estate business to the public. A REIT has two unique features: its primary function is managing income-producing properties and it must distribute most of its profits as dividends. Similarly, an Infrastructure Investment Trust (INVIT) is an entity that offers common shares/units of an operating infrastructure project to the public. In India, REITs and INVITs may be required to prepare their financial statements according to Ind AS.

Many real estate entities in India are in the process of creating a REIT/INVIT structure, wherein they would transfer some of their real estate/infrastructure business to the REIT/INVIT in return for units of the REIT/INVIT in order to monetize their assets.

Considerations

REITs/INVITs bring along with them a multitude of accounting issues – both for real estate entities (sponsors) and trusts. The entities will have to analyze whether they have retained control of the business or have relinquished it in favor of the trust/investment manager in accordance with the definition of “control” under Ind AS 110 Consolidated Financial Statements. As a consequence, real estate entities will have to decide whether Ind AS 103 Business Combination should be applied to the transaction or not.

C. Financial instruments

C.1 Convertible debt

Many Indian real estate companies use structured products – for example, convertible debentures, convertible preference shares or foreign currency convertible bonds (FCCBs) – to raise
funds for their operations. Sometimes, the return on these complex instruments is linked to the project cash flows. Our experience indicates that these instruments may contain complex terms with regard to conversion or redemption. In the absence of any specific guidance on the treatment of FCCBs under current Indian GAAP, most companies adjust the redemption premium to the securities premium account. Consequently, there is no or little charge to the income statement.

Considerations
Debt vs. equity classification
The application of Ind AS 32 Financial Instruments: Presentation will require companies to evaluate whether convertible instruments are equity in their entirety. Considering the redemption option or other terms of arrangement, which guarantee fixed or determinable payments to the holder, it is less likely that the instrument will be treated as equity in entirety. However, it is possible that companies may identify certain instruments as “compound financial instruments,” containing both debt and equity (an option to the holder to convert to shares) elements. In such cases, the host contract will be accounted for as debt at its fair value on initial recognition, and interest thereon will be accrued at the market rate of interest. In a few cases, convertible debts can even be classified as liabilities in their entirety if the number of shares is not fixed or if the contract mandates the issuance of a variable number of bonus shares to match the expected returns.

Embedded derivative accounting
If the conversion option does not satisfy certain criteria in Ind AS 32 to be identified as an “equity feature,” companies will evaluate it for derivative accounting under Ind AS 109 Financial Instruments. If the conversion option is identified as an embedded derivative, it will need to be separated from the host contract and accounted separately at its fair value at each reporting date. In the meantime, interest on the host instrument will be recognized at the market rate of interest. This is expected to bring significant volatility in the profit or loss of companies.

Fair value accounting
If there are multiple embedded derivatives in the contract, making the debt a complex instrument, the measurement of the instrument at fair value through profit or loss may be permitted. In that case, the entire instrument will have to be accounted for at its fair value at each reporting date.

Interest expense/dividend
Interest expense under Ind AS will be calculated based on the effective interest rate, deferring the costs incurred in issuing the instrument/processing fees over the expected life of the debt. If such an instrument is classified as equity, the interest payments are classified as dividends and reduced from equity instead of a charge to profits. Dividends on preference shares that have been classified as debt will be charged to profits. Hence, the finance cost will change according to the classification of the instrument.

Accounting from holders’ perspective
Holders of such an instrument will also have to analyze whether the investment is in a debt instrument or an equity instrument. If it is a debt instrument, the holder will have to further analyze the cash flow characteristic and its business model. It may be possible that such an instrument is fair-valued at each reporting date.

C.2 Interest-free borrowings from promoters
It is common for real estate companies to receive interest-free/subsidized loans from promoters. Under Indian GAAP, due to lack of accounting guidance, there is no accounting for notional interest on the borrowings. However, Ind AS requires borrowings to be fair-valued and notional interest to be accounted for as finance expense. The difference between the borrowing amount and the fair value of the loan is treated as investments by the promoters in the company.

Considerations
Increase in expense and equity
Accounting for the notional interest under Ind AS will result in an increase in expense – i.e., a decrease in profits – and an increase in the net worth of the company seriously affecting the return on capital employed ratio. It might also result in taxation issues for the company.

C.3 Financial guarantees
Real estate entities commonly give/receive financial guarantees from its related parties in respect of borrowings from banks/financial institutions. Under Indian GAAP, such borrowings were presented as contingent liabilities in the financial statements of the issuer of guarantee and were presented in the notes below the borrowings in the financial statements of the beneficiary of the guarantee. Under Ind AS, financial guarantee contracts will be measured at fair value.
Gaining perspective

Considerations
Increase in finance cost/income
Accounting for notional finance guarantee costs will result in an increase in increase in expense – i.e., a decrease in profits – and an increase in the net worth of the company. Similarly, for the issuer of the guarantee, it will increase the finance income and investment in subsidiary.

D. Investment property
Many real estate entities construct properties to give on rent rather than for sale. Under Indian GAAP, entities accounted for such properties as fixed assets under AS 10 Accounting for Fixed Assets. However, under Ind AS, they will be classified and accounted for as investment property.

Ind AS 40 Investment Property defines the term “investment property” as property (including land or building or both) held to earn rentals or capital appreciation or both, rather than for (a) use in the production or supply of goods or services or for administrative purposes, or (b) sale in the ordinary course of business. Though Ind AS 40 requires entities to apply the cost model to their investment properties, it requires all entities to measure the fair value of an investment property for the purpose of disclosure.

Entities are encouraged, but not required, to appoint an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued to measure the fair value of the investment property.

Considerations
Valuation requirements become more onerous
The need for companies to be able to disclose fair values requires the development of robust internal valuation processes, as well as regular external appraisal schedules. This may lead to additional administrative and advisory costs.

E. Presentation and disclosure
Ind AS will require companies to make significant new disclosures, such as segment reporting based on management information systems, additional related parties to be identified and reported upon, financial risk management disclosures and critical estimates/judgments. Compliance with some of these may be extremely onerous. A review of the 2005 financial statements of European companies indicates that financial disclosures under IFRS increased significantly, as compared to their previous disclosures. In fact, compliance with disclosure requirements was one of the most challenging areas for European companies. To ensure compliance with the presentation and disclosure requirements of Ind AS, managements should identify “data gaps” early so that necessary information can be captured and recorded for all periods required to be converted.

Considerations
Disclosures in the first year of adoption

a) In the first Ind AS annual financial statements
The first Ind AS financial statements will be presented in accordance with the presentation and disclosure requirements in Ind AS 1 Presentation of Financial Statements and other accounting standards. Ind AS 101 First Time Adoption of Indian Accounting Standards does not provide exemptions from the presentation and disclosure requirements in other Ind AS.

Ind AS 101 requires companies to explain how the transition from Indian GAAP to Ind AS affected their reported balance sheet, financial performance and cash flows. To comply with this requirement, first-time adopters will have to give the following reconciliations in their first Ind AS annual financial statements:

► Reconciliation of Ind AS and Indian GAAP equity at the date of transition
► Reconciliation of Ind AS and Indian GAAP equity at the end of the comparative period
► Reconciliation of total comprehensive income in accordance with Ind AS to Indian GAAP comprehensive income for the comparative period

b) In the interim financial reports of the first Ind AS financial statements
According to the Securities and Exchange Board of India (SEBI) circular dated 30 November 2015, similar disclosures as in the annual financial statements are required to be presented in each
interim financial report for the part of the period covered by a company’s first Ind AS financial statements. However, SEBI’s circular dated 05 July 2016 gives significant relaxations from the presentation of the results of comparative periods in the interim financial statements. According to this circular, the following reconciliation is required in the interim Ind AS financial statements of the first year of adoption:

- Reconciliation of net profit/loss for the corresponding quarter of the previous year

**G. Tax considerations**

Currently, tax computation is based on the profits calculated in accordance with the Companies (Accounting Standards) Rules, 2006 (Indian GAAP) and is adjusted for allowances/disallowances according to the Income Tax Act. According to a recent press release dated 06 July 2016, Income Computation and Disclosure Standards (ICDS) will have to be implemented for the computation of tax from 01 April 2016. The ICDS add a separate set of complications to the scenario. It is not clear whether the ICDS are applicable to real estate developers. Further, given the differences between Ind AS and the ICDS, entities will have to evaluate whether they need to maintain a separate set of accounts to comply with the ICDS.

Minimum alternate tax (MAT) is based on the book profits, which will now be calculated according to Ind AS. Many of the previously mentioned Ind AS impacts will adversely affect MAT calculations. As a result, the Central Board of Direct Taxes (CBDT) constituted a committee to suggest the framework for the computation of book profits for the levy of MAT for Ind AS-compliant companies. Though the committee has already submitted its report, the CBDT has not yet notified the final provisions. Hence, companies will have to await the final provisions to evaluate the MAT implications on the Ind AS adjustments.

Accounting for deferred taxes under Ind AS will be based on the balance sheet approach, which requires identifying temporary differences between the carrying values of assets and liabilities according to Ind AS and the tax base according to the ICDS. This will result in accounting for deferred taxes on various items such as revaluation of assets, fair valuation of financial instruments, and business combinations and consolidation. Entities will have to carefully analyze each line item of the financial statements to identify the deferred tax impact.

**F. Others**

In addition to these adjustments, which are more peculiar to real estate companies, Ind AS will require various other adjustments relating to, for example, ESOP accounting; property, plant and equipment; employee benefits; foreign exchange and derivatives. The extent and relevance of these differences will depend on company-specific transactions and events.
First-time adoption of Ind AS
The first-time adoption of Ind AS poses a distinct set of problems. To assist users in overcoming these practical difficulties, the ICAI published Ind AS 101, based on IFRS 1 First-time Adoption of IFRS. As with IFRS 1, Ind AS 101 provides the basis on which companies will convert their financial statements to Ind AS. It lays down the ground rules and prescribes the accounting policies to be followed in a company's first set of Ind AS financial statements, and to prepare for its opening Ind AS balance sheet.

Although Ind AS 101 somewhat eases the pressures of first-time adoption, it does not turn the transition process into a problem-free job. Even after applying Ind AS 101, the transition process may remain complex and time-consuming for many companies. It is essential for everyone involved in the conversion process to understand the issues and how to resolve them.

**Basic transition rules**

First-time adopters use the same accounting policies as those used in all periods presented in its first Ind AS financial statements. The fundamental principle of Ind AS 101 is to require full retrospective application of the standards in force at a company's reporting date, with limited exemption and exceptions.

**Optional exemptions/mandatory exceptions from full restatement**

Ind AS 101 grants 22 limited optional exemptions from the general requirement of full retrospective application of Ind AS. The application of these exemptions is entirely optional, and first-time adopters can select the exemptions they want to apply. However, they are specifically prohibited from applying these exemptions by analogy to other items. Ind AS 101 prohibits the retrospective application of Ind AS in seven areas, where retrospective application will require management judgments with regard to past conditions after the outcome of a particular transaction is already known.

It is important that companies familiarize themselves with all exemptions and exceptions. Specifically, the appropriate selection of exemptions is key, and it may significantly impact conversion efforts and numbers disclosed in Ind AS opening and future financial statements.
IV

Approach to transition to Ind AS
In companies’ conversion plans to Ind AS, they need to consider the significant business process and stakeholder communication issues along with the technical challenges. Our experience indicates that if the conversion is not planned properly, these issues can be potentially more problematic than the associated technical challenges. In an attempt to help companies develop a robust conversion plan, we will discuss certain aspects that they will need to address.

**Tax**

The tax implications of Ind AS conversion could affect every aspect of a company’s tax life cycle, particularly in the areas of tax return positions, tax planning and financial reporting. The various differences between Indian GAAP/ICDS and Ind AS mean that the profit or loss numbers for companies will change significantly, leading to a significant impact on tax outflow and tax strategies.

A strategic and proactive tax function should be involved through the entire conversion process. As each new accounting standard is considered, the potential tax effect should also be assessed.

Further, companies will need to modify the management information system (MIS) that supports direct and indirect tax chains so that the tax function can receive all the information it requires. Ind AS conversion is an opportunity to align tax provisioning and reporting processes.

**IT modifications**

As a result of changes to accounting policies related to the recognition, measurement and disclosure requirements of Ind AS, companies will need a clear strategy to address the effects of these changes on IT applications. However, instead of implementing IT changes as part of their Ind AS conversion plan, certain companies may use quick-fix solutions to capture data. Such an approach has the following major implications vis-à-vis an approach to implement IT changes.

<table>
<thead>
<tr>
<th>Fully embedded approach</th>
<th>Quick-fix solutions</th>
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<tbody>
<tr>
<td>IT systems fully support the preparation of Ind-AS compliant financial information</td>
<td>Little, if any, changes are made to existing financial reporting infrastructure and processes</td>
</tr>
<tr>
<td>Ind-AS embedded in baseline accounting ledgers</td>
<td>Ind-AS adjustments are quantified and tracked “offline” (outside the normal control environment) and adjusted as topside entries</td>
</tr>
<tr>
<td>Ind-AS viewed as a change-management program that goes beyond the finance and accounting finance</td>
<td>No changes are made to baseline accounting ledgers</td>
</tr>
<tr>
<td>Conversion risk is relatively low</td>
<td>Conversion risk is relatively high</td>
</tr>
<tr>
<td>Transition cost and efforts are relatively high</td>
<td>Transition costs and efforts are relatively low</td>
</tr>
</tbody>
</table>

There is no doubt that quick-fix solutions can work only in the short run. However, some companies may find them desirable, given that tax legislations will undergo changes and certain standards such as Ind AS 115 Revenue from Contracts with Customers and Ind AS 116 Leases are not yet effective. Nevertheless, in the long run, IT systems will need to be modified so that the financial data produced accurately supports new Ind AS accounting and financial reporting requirements. Obviously, these changes will affect not only IT application modules related to the general ledger.
but also asset management, treasury, financial instrument and payroll systems. Depending on the needs of a particular company, the IT systems may also need to be modified to capture data to support internal valuation calculations where active market data is not available.

To achieve such IT objectives, companies must set up a multidisciplinary IT project team. This group should include representatives from accounting, finance, tax, treasury, technology and training so as to understand the broader implications of redesigned IT processes for each of the company’s applications.

**Involvement of boards of directors and audit committees**

Depending on the accounting and disclosure differences that a company ultimately identifies, conversion to Ind AS may significantly affect its financial results. The board of directors needs to be involved right from the outset and throughout the Ind AS conversion process in order to monitor the quality and integrity of the process. Audit committees must understand the rationale behind the management’s decisions to select a particular Ind AS accounting policy and, when necessary, communicate with the board of directors to create the requisite external communications.

**Developing a robust communications plan**

The management will have to educate many internal and external constituencies on the efficacy of new performance metrics, and be prepared to address questions on the differences in these metrics. Companies will need to determine how and when to communicate the effect that the Ind AS conversion will have on financial statements. In Europe, the Committee of European Securities Regulators (CESR) had recommended that companies should gradually begin to publicly communicate the effects of conversion to IFRS two years prior to the adoption of IFRS for the first time. The CESR had stated that the disclosures should include the status and nature of a company’s conversion plan and, when completed, the expected quantified effect that IFRS will have on its financial statements.

As of the time of finalizing this publication, none of the regulatory authorities in India had prescribed the requirement for such a communication. Considering the extent of change involved, it will be better if companies devise a process in this regard so that relevant Ind AS matters are considered for timely communication to investors.

**Ind AS conversion methodology**

Considering that conversion to Ind AS is a business-wide change-management exercise, it should be approached using a structured methodology encompassing the best practices of project management. Such a methodology ensures that conversion assignments are properly planned and executed. It also ensures that the typical pitfalls for an inexperienced conversion team are avoided by:

- Promoting the reuse of knowledge
- Avoiding costly dead-ends stemming from poor planning and coordination
- Ensuring the efficient use of staff time
- Allowing a mix of experienced and less-experienced staff, thereby facilitating knowledge transfer
- Improving the quality of the work

To fully capitalize on the opportunities arising from the conversion to Ind AS, the conversion methodology needs to be flexible and customized to the needs of a company. A sample methodology for conversion is provided below:

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<th>Workstreams</th>
<th>Program execution</th>
<th>Diagnostic</th>
<th>Design and planning</th>
<th>Solution development</th>
<th>Implementation</th>
<th>Post implementation</th>
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<td>Accounting and reporting</td>
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<td>Tax</td>
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<td>Business processes and systems</td>
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<td>Regulatory and industry</td>
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As a starting point, the methodology considers that an Ind AS conversion project needs to address more than just accounting issues and that a conversion project is sufficiently complicated to warrant professional project management. It is for these reasons that the methodology comprises five phases, each of which deals with a specific part of the conversion. Further, throughout the project, it recognizes five different work streams, each dealing with a specific aspect of the conversion process. This is to facilitate the involvement of professionals based on need. However, it is important to recognize that these phases may overlap, and companies need not wait for the completion of one phase to end before beginning another. Moreover, a clear breakdown of all activities by work stream is not always possible as a mandatory allocation of activities by phase. Thus, this methodology should be tailored according to factors such as project brief, the starting point and existing project structure.

Key goals and outputs of each phase

- **Diagnostic**
  
  This phase involves the high-level identification of accounting and reporting differences and the consequences to the business, IT, processes and tax. The major outcome that the management should expect from this phase is an impact-assessment report detailing the implications on these areas. It also entails determining a high-level road map for future phases of the conversion. This phase will also help the management identify potential interdependencies between the Ind AS conversion project and the current or planned organization-wide initiatives (for example, new accounting system implementations such as ERP and finance transformations), as well as help assess whether the company has adequate resources to complete a conversion.

- **Design and planning**
  
  This phase involves establishing the project infrastructure and the project management function, which includes the conversion roadmap and the change-management strategy. The aim of this phase is to set up a core Ind AS team, framing conversion timetables and deciding on a thorough way forward. The typical outputs of this phase are project structure, project charter, communication plan, training plan and expanded conversion roadmap.

- **Solution development**
  
  The objective of this phase is to identify solutions to various issues identified in relation to accounting and reporting, tax, business process and system changes. The typical outputs from this phase include Ind AS accounting manuals, group reporting packages, Ind AS skeleton accounts, group accounting policies and technical papers on Ind AS accounting issues. Companies will also be able to crystalize the impact on current and deferred tax, develop solutions for tax functions and identify processes that need to be re-designed, modified or developed.

- **Implementation**
  
  This phase involves the rollout of solutions developed in the previous phase. In this phase, companies should conduct a dry run of financial statements to ensure that it is geared up to prepare Ind AS financial statements before the reporting deadline. After the dry-run accounts, companies should roll out final deliverables, i.e., the opening Ind AS balance sheet and the first Ind AS quarterly or annual financial statements. All business and process solutions developed will also be implemented to facilitate companies’ transition to the new reporting framework.

- **Post-implementation**
  
  This phase involves an assessment of how the various solutions developed operate in the implementation phase as well as the identification of any issues in the operational model. These issues are tackled in this phase to ensure the successful functioning of ongoing systems and processes in the Ind AS reporting regime. Companies need to provide ongoing update training to ensure that company personnel are updated with the latest Ind AS developments and that changes in systems and processes are executed smoothly. Companies also need to regularly update Ind AS manuals.
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