

Converging with IFRS - Challenges and Opportunities in Real Estate

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Introduction:

International Financial Reporting Standards (IFRS) is fast becoming the global accounting language. Over 125 countries have now adopted IFRS and many more have committed to make the transition in the next few years. The benefits of global standards are widely acknowledged. For companies, however, the conversion to IFRS is a major change both for the finance function and for the wider business. India is one of the largest jurisdictions that are currently going through the process of convergence with IFRS.

The present scenario in Indian Real Estate is:

A) Companies revenues are higher by as much as 30% as compared to the work done by them. According to the percentage of completion method, developers can recognise revenues in proportion to the construction cost incurred in a year, provided the ownership of the apartment has been transferred to the buyer. Furthermore, land cost is allowed to be part of construction cost and the agreement of sale between buyer and seller is supposed to transfer the ownership to the buyer.

B) Revenues recognised by leading Indian Real Estate companies are significantly higher than the cash received from customers. Ideally, revenues should be close to the cash received from customers especially because most customer payments are construction-linked but they can exceed the cash received from customers.

C) Revenue growth is not in line with the growth in projects (area) delivered. For Indian real estate companies, revenues and project (area) delivered are not growing at the same pace. A survey done by the Evaluateserve depicts that while revenues of DLF increased by 447% in FY 08, projects completed decreased by 3.3%. Similarly for Unitech, in 2007 the growth in area delivered was much lower than its revenue growth.

The Impact of IFRS on Indian Real Estate Industry The adoption of International Financial Reporting Standards (IFRS) will reflect more appropriately the revenues of Indian real estate developers and their ability to deliver projects. IFRS deals with market risks that are related to real estate projects more effectively than the percentage completion method.

IFRS link revenue recognition to project delivery According to IFRS guidelines on real estate that will be

adopted in India in 2011 (IFRIC 15), revenues can be recognised only when the risk and rewards of ownership have been transferred. IFRS allows the use of the percentage completion method only if one of following conditions is met:

- * If the contract is a construction contract
 - * If the contract is for rendering services
 - * If the control, risks, and rewards of ownership of the work-in-progress passes on a regular basis to the buyer
- IFRS address market risk and execution risks more effectively

IFRS addresses the following two key risks involved in revenue recognition with respect to the sale of real estate projects (under-construction).

Market Risk

- A fall in real estate prices below the purchase prices would result in homebuyers' asking for a refund of their payment amount. Most builders allow refund after deducting a penalty. Therefore, if sales are recognised at the time of signing of sale agreement, sales will have to be reversed at the time of cancellation. For some companies, cancellation and revenue restatements can be material.

Execution Risk

- Execution risk becomes critical, especially during an economic downturn when most projects get delayed because the builders have little or no cash. For partially completed projects, recognising a portion of the total revenues may not properly reflect the execution risk inherent in these projects. Since IFRS allows revenue recognition only if the project has been delivered, an IFRS compliant company's financial statement will provide a better perspective of its execution capabilities.

Advantages for Real Estate industry

An IFRS conversion is not primarily an exercise in reshuffling the chart of accounts, nor is it principally a technical accounting and financial reporting matter. In fact, the company is likely to spend significant amounts of time addressing concerns around tax, valuation, treasury, legal, people, technology, and communications. Clearly, a great deal of work lies ahead. Yet, despite these challenges, one may find that the benefits of reporting under IFRS outweigh the costs.

* Companies with global operations or properties usually grapple with numerous statutory reporting require-

ments under different accounting standards in each country. In such cases, there are significant benefits that can be gained from transitioning the financial reporting of all global subsidiaries and affiliates to IFRS. e.g. reduced lead time in preparing consolidated financial statements, reduced consolidation issues, improved controls etc.

* Geographically-dispersed finance offices could be drastically reduced or even eliminated in favor of a central finance function, strategically located to take advantage of tax incentives, payroll savings, and facilities cost reductions.

* A decentralized structure can sometimes lead to reduced oversight and weakened controls. IFRS offers the opportunity to implement standardized frameworks and processes to enhance the overall control environment.

* IFRS provides a refresh exercise for accounting policy implementation, with the aim of more accurate and timely financial reporting.

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* IFRS can potentially improve liquidity and access to capital by offering greater transparency, in the form of full and better disclosure, to investors. Access to capital may also be enhanced by virtue of aligning with a common standard.

Conclusion:

The real estate industry continues to be a good example of the differences that can arise from the application and interpretation of apparently straightforward accounting standards. Where diversity in practice is substantial, the users of financial statements rely more than ever on appropriate and concise disclosure of accounting policies and other information. Whilst it does appear that some areas would benefit from improvement in this respect, we recognise that IFRS already requires substantial disclosures. The skill of the preparer and the auditor, therefore, is to ensure that compliance with IFRS does not take attention away from what really matters.

REFERENCE

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Financial inclusion for Banks in India

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ABSTRACT

The three major aspects of Financial Inclusion are to make people access financial and credit markets and financial education. Empirical evidence shows that economic growth follows financial inclusion. The benefits of financial inclusion are equitable growth, reduced poverty, inflating national income, easy and safe financial transactions and bundling of savings with financial services. Currently, India has the second-highest number of financially excluded households in the world. The Reserve Bank of India set up Khan Commission in 2004 to look into financial inclusion and the recommendations of the commission were incorporated in the mid-term review of the policy (2005-06). In January 2006, the Reserve Bank permitted commercial banks to make use of the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions and other civil society organizations as intermediaries or business facilitators (BF) for providing financial and banking services. RBI's vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on IT.

Introduction

Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups at an affordable cost in a fair and transparent manner by mainstream institutional players. As banking services are in the nature of a public good, it is essential that the availability of banking services to the entire population without discrimination is the prime objective of public policy. It is estimated by the Reserve Bank of India that about 40% of Indians lack access even to the simplest kind of formal financial services.

Expectations of poor people from the financial system is safety of deposits, low transaction costs, convenient operating time, minimum paper work, and quick and easy access to credit and other products, including remittances suitable to their income and consumption. Taking into account their seasonal inflow of income from agricultural operations, migration from one place to another, and seasonal and irregular work availability and income, the existing financial system needs to be designed to suit their requirements. The major barriers to serve the poor, apart from socio-economic factors such as lack of regular income, poverty, illiteracy, etc., are the lack of reach, higher cost of transactions and time taken in providing those services. The existing business models do not pass the test of scalability, convenience, reliability, flexibility and continuity.

National Commitment

RBI has been taken multiple steps like nationalization of banks, priority sector lending requirements for banks, lead bank scheme, establishment of regional rural banks (RRBs), service area approach, self-help group-bank linkage programme, etc., to increase ac-

cess to the poorer segments of society. Bank branches in rural areas of the country have expanded from around 8,000 in 1969 to more than 89,000 in 2011. Nonetheless, there is a wide variation across states. For instance, the ratio for the state of Kerala is as high as 89% while North Eastern States is marked by a low coverage of 21%. To achieve the ultimate objective of reaching banking services to all the 600,000 villages, the delivery model needs to be devised carefully so as to move from a cost-centric model to a revenue-generation model.

In order to achieve greater financial inclusion, RBI has initiated the following measures :

* Opening of no-frills accounts with nil or low minimum balance coupled with low charges and small overdrafts in such accounts.

* Relaxation on know-your-customer (KYC) norms for small accounts was introduced in August 2005. Applicant can submit letter issued by the Unique Identification Authority of India containing details of name, address and Aadhaar number. * Engaging business correspondents (BCs) and business facilitators (BFs) as intermediaries for providing financial and banking services was permitted by RBI in January 2006. The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions, thus addressing the last-mile problem. With effect from September 2010, for-profit companies have also been allowed to be engaged as BCs.

* Recognizing the use of technology possessing the potential to address the issues of outreach and credit delivery in remote areas in a viable manner, banks have been advised to make effective use of information and communications technology (ICT), to provide doorstep banking services through the BC model where the accounts can be operated by even illiterate customers by