

# International Financial Reporting Standards (IFRS) in Indian context



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# IFRS – IN VIEWS

## Introduction

Convergence with IFRS has gained momentum in recent years all over the World. 110+ countries including European Union, Australia, China, New Zealand, and Russia currently require or permit the use of IFRS. Apart from India, countries like Japan, Sri Lanka, Canada and Korea have also committed to adopt IFRS from 2011. United States of America has announced its intention to adopt IFRS from 2014 and it also permits foreign private filers in the U.S. Stock Exchanges to file IFRS complied Financial Statement, without requiring the presentation of reconciliation statement.

In this scenario of globalisation, India cannot insulate itself from the developments taking place worldwide. In India, so far as the ICAI is concerned, its aim has always been to comply with the IFRS to the extent possible with the objective to formulate sound financial reporting standards. The ICAI, being a member of the International Federation of Accountants (IFAC), considers the IFRS and tries to integrate them, to the extent possible, in the light of the laws, customs, practices and business environment prevailing in India. The Preface to the Statements of Accounting Standards, issued by the ICAI, categorically recognises the same. Now, as the world globalizes, it has become imperative for India also to make a formal strategy for convergence with IFRS with the objective to harmonize with globally accepted accounting standards.

## IFRS - Global Context

In the present era of globalization and liberalization, the World has become an economic village. The globalization of the business world and the attendant structures and the regulations, which support it, as well as the development of e-commerce make it imperative to have a single globally accepted financial reporting system. A number of multi-national companies are establishing their businesses in various countries with emerging economies and vice versa. The entities in emerging economies are increasingly accessing the global markets to fulfill their capital needs by getting their securities listed on the stock exchanges outside their country. Capital markets are, thus, becoming integrated consistent with this World-wide trend.

The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalization of capital markets call for a single set of high quality accounting standards. High standards of financial reporting underpin the trust investors place in financial and non-financial information. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS.

## IFRS - Indian Context

The paradigm shift in the economic environment in India during last few years has led to increasing attention being devoted to accounting standards as a means towards ensuring potent and transparent financial reporting by any corporate.

ICAI, being a premier accounting body in the country, took upon itself the leadership role by establishing ASB, more than twenty five years back, to fall in line with the international and national expectations. Today, accounting standards issued by the Institute have come a long way.

The ICAI as the accounting standard - setting body in the country has always made efforts to formulate high quality Accounting Standards and has been successful in doing so. Indian Accounting Standards have withstood the test of time. As the world continues to globalize, discussion on convergence of national accounting standards with International Financial Reporting Standards (IFRS) has increased significantly.

At present, the ASB of ICAI formulates the AS based on IFRS. However, these standards remain sensitive to local conditions, including the legal and economic environment. Accordingly, AS issued by ICAI depart from corresponding IFRS in order to ensure consistency with legal, regulatory and economic environment of India.

As the world continues to globalize, discussion on convergence of Indian GAAP with IFRS has increased significantly. A few developments are set forth hereunder -

- Formation of IFRS Task Force by the Council of ICAI
- Recommendation of the IFRS Task Force submitted to the Council
- Full adoption of IFRS from accounting period commencing on or after 1 April 2011
- Proposed to be applicable to listed entities and public interest entities such as banks, insurance companies and large sized entities
- Involvement of various regulators (MCA, RBI, IRDA, Tax authorities and SEBI)
- Draft Schedule VI and Accounting Standard 1 (Exposure Draft) consistent with IFRSs
- Convergence Strategy presented by Technical Directorate of ICAI on 02.02.2009:
  - ICAI has begun the process of issuing IFRS equivalent AS with following proposed changes:
    1. Removal of alternative treatments
    2. Additional disclosures, where required
    3. AS number will continue but IFRS number will be given in parenthesis
    4. IFRICs will be issued as appendices
  - ICAI has constituted a Group in liaison with government & regulatory authorities and this group has constituted separate core groups to identify inconsistencies between IFRS and various relevant acts.

## Proposed definition of Public Interest Entity

An entity:

- i Whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India; or
- ii Which is a bank (including a cooperative bank), financial institution, a mutual fund, or an insurance entity; or
- iii Whose turnover (excluding other income) exceeds rupees one hundred crore in the immediately preceding accounting year; or
- iv Which has public deposits and/or borrowings from banks and financial institutions in excess of rupees twenty five crore at any time during the immediately preceding accounting year; or
- v Which is a holding or a subsidiary of an entity which is covered in (i) to (iv) above

## Benefits of adopting IFRS

The forces of globalisation prompt more and more countries to open their doors to foreign investment and as businesses expand across borders the need arises to recognise the benefits of having commonly accepted and understood financial reporting standards. Following are some of the benefits of adopting IFRS -

- Improved access to international capital markets
- Lower cost of capital
- Benchmarking with global peers
- Enhanced brand value
- Avoidance of multiple reporting
- Reflecting true value of acquisitions
- Transparency in reporting

## Challenges in adopting IFRS

- Regulatory endorsement and acceptance
- Shortage of skilled resources
- Huge cost of enhancement of IT systems
- Acceptance by tax authorities
- Managing market expectations and investor relationships
- Managing day to day business issues – MIS, tax planning, performance indicators, mergers and acquisitions, etc.

## Key Divergences

The key divergences between Indian GAAP and IFRS have arisen due to:

- Conceptual differences
- Legal and regulatory requirements
- Present economic conditions
- Level of preparedness

The divergences are both in terms of accounting treatment as well as disclosures in the financial statements. Some of the divergences between Indian GAAP and IFRS are summarized as under:

- Special Purpose Entities (SPE) falling under the definition of 'control' as per IAS 27 on "Consolidated and Separate Financial Statements" shall be consolidated
- 'Potential Voting Rights' that are currently exercisable or convertible shall be considered to assess the existence of 'control'
- All business combinations shall be accounted as per purchase method at fair values
- Contingent liabilities, taken over in a business combination, shall be included in Net Assets, measured at fair value, if contingencies have since been resolved, a reliable estimate can be made and payment is probable
- Negative goodwill arising on business combinations / consolidation shall be accounted as income instead of capital reserve
- Goodwill shall not be amortised. It shall only be tested for impairment
- PP&E and Intangible assets shall be measured either at cost or at revalued amount. Periodical valuation of entire classes of assets is required when revaluation option is chosen
- Intangible assets can be revalued only when there is an active market for the same
- Depreciation on revalued portion cannot be recouped out of revaluation reserve
- Depreciation to be calculated based on useful life, which along with residual value and depreciation method shall be reviewed annually
- Intangible assets may have an indefinite life e.g. Trademarks, Goodwill, Franchise
- Investment property, i.e. land or building held to earn rentals or for capital appreciation, shall be measured either at cost or fair value
- If fair value model is adopted, changes in fair value, measured annually, shall be recognised in the income statement
- No distinction shall be made between integral and non-integral foreign operations. All foreign operations to be consolidated using non-integral approach
- Exchange differences shall not be capitalised except to the extent of that allowed by IAS 23 *Borrowing Costs*
- Share Based Payments shall be measured at fair value
- Deferred tax shall be created on temporary difference instead of timing differences
- Liability portion of compound financial instruments, such as convertible debentures, shall be separately accounted for

- Financial assets and liabilities shall be classified and measured accordingly as per the requirements of IAS 39 Financial Instruments: Recognition and Measurement
- All derivative financial assets and liabilities including embedded derivatives shall be accounted for as on the balance sheet items
- Derivatives classified as 'hedge' shall have to comply with various requirements of IAS 39 viz. documentation, hedge effectiveness testing and ineffectiveness measurement
- Derecognition of financial assets, as in the case of securitization, shall be based on risks and rewards, transfer of 'control' being a secondary test
- Provisions shall be created only to the extent they relate to a specified risk that can be measured reliably and for incurred losses. No provisions are permitted for future or expected losses i.e. general provisions
- Interest income / expense on financial assets and liabilities, such as loans, shall be recorded on an effective interest rate basis after considering associated income and expenses e.g. agency commission, loan processing fees, etc.
- Prior period errors shall be adjusted in the opening balances of assets, liabilities and equity of the earliest period presented i.e. the figures relating to prior years are restated

## Transition to IFRS – Things to remember

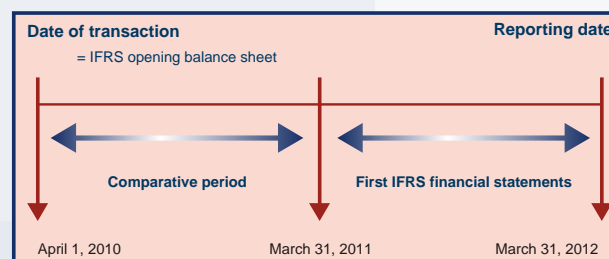
**First year of reporting:** Accounting period commencing on or after 1 April 2011 (Normally 1 April 2011 – 31 March 2012)

**Date of adoption:** The first day of the first reporting financial year (1 April 2011)

**Date of reporting:** The last day of the first reporting financial year (31 March 2012)

**Comparative year:** Immediately preceding previous year (1 April 2010 – 31 March 2011)

**Date of transition:** The beginning of the earliest period for which an entity presents full comparative information (1 April 2010)



First time adoption of IFRS on the date of reporting envisages-

1. Restatement of opening balances as at 1 April 2010
2. Presentation of comparative financial statements for the year 2010-11
3. Preparation and presentation of financial statements for the first year of reporting 2011-12
4. Explicit and unreserved statement of compliance with IFRS

All the above statements (as stated in 1 to 3 above) have to be drawn as per the IFRS in force on the date of reporting.

## About BDO Haribhakti

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- Sincerity and Integrity
- Accountability
- Building strong & sustainable relationships
- Mutual support

**BDO International** - The BDO story begins in 1963. Accounting firms from the UK, Netherlands, Germany, US and Canada saw the opportunity to combine and thus expand their knowledge base and relative strength. The resulting Binder Seidman International Group worked together as a network of firms until 1973, when the common name of Binder Dijker Otte & Co was adopted. In 1988, a world wide structure was formed and to ensure that local strength retained its prevalence as one of the network's underlying goals, the acronym of BDO was agreed upon, placed before each local Member Firm's name. At the same time, a logo and corporate identity was created that promoted consistency throughout the network. Since then, the BDO network has undergone a transformation that now sees a combined workforce of more than 44,000 people continues to promote and extend the values and objectives foreseen from the outset. BDO is known for client rapport and partner accessibility, for extensive local knowledge combined with a global outlook, and for partners and staff who are challenging, ethical and practical in their approach and advice to clients. The organization's growth has continued year on year and the international network continues to serve BDO and its clients well in changing economic and market conditions. BDO has weathered the accountancy scandals around the world and embraced the new regime of Sarbanes-Oxley. BDO Member Firms use a best practice approach to methodology and international collaboration and this, along with an unchallenged knowledge and understanding at a local level, makes them able to do this in a manner which preserves both our reputation and our transparency to the market.

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