

# IFRS-CONVERGED IND ACCOUNTING STANDARDS – PROCEDURAL ISSUES

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## ABSTRACT

*The stakeholders of business enterprises are depending on the Financial Statements for the purpose of taking their decisions. These Financial Statements shall be prepared in accordance with the Accounting Regulations and Rules more so with the Accounting Standards. Due to the substantial improvement in the international contacts and dependence, the need for common set of Accounting Standards throughout the World called, International Financial Reporting Standards. India has made a beginning to converge its Accounting Standards with IFRSs. However, there are many challenges in the area of procedure of convergence. This paper makes an analysis of these issues together with other related aspects.*

**Keywords:** Accounting Standards, Carve-outs, Convergence, IFRSs, Ind ASs

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## INTERNATIONAL FINANCIAL REPORTING STANDARDS – WHY?

The utility of corporate financial reports to the stakeholders of business enterprises is well established. This is because of the reason that the quality of decisions that informed or knowledgeable stakeholders take differs from that of a situation wherein the stakeholders take decision without necessary information. It may be noted here that the objective of corporate financial reports is primarily to provide the necessary information to the stakeholders to enable them to take appropriate decisions after judging the pros and cons of each of alternatives. However, the format and contents of these reports are influenced more by the legal and regulatory provisions of the country of the company. As is known very well, these regulations normally differ from one country to another at least with respect to some aspects. As a result, the financial performance and financial position of corporate enterprises of

different countries lack comparability. This is due to the fact that both financial performance and financial position are influenced only by their activities and functions but also by the legal and regulatory provisions of the country. This is hampering the international movement of funds and international business which, in the present globalized economy, is a necessity for any country for one reason or the other. This is true with respect to all countries - whether the country is a developed economy or least developed economy. Hence, one can find the substantial increase in the international contacts and activities, and this is more so in the corporate world in the forms of international business, investments, transfer of technical know-how, labour mobility, etc.

The increased international business and financial transactions among the business enterprises world over has resulted in substantial changes and developments in accounting area. One of the outcomes of these developments is the realization



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by different countries and their business enterprises of the need for common financial reporting procedure. To put it alternatively, today's business environment demands common or uniform financial reporting practices and procedure as a pre-requisite for increased international business operations and the need to have a common reporting practices and procedure using common Accounting language is a drive to a large number of countries to move towards acceptance of International Financial Reporting Standards (IFRSs) as the relevant regulations governing the preparation and presentation of annual reports which include, among others, two important statements viz., Profit and Loss Account, and Balance Sheet. This is not only desirable but also necessary as the diverse accounting practices and procedure impair the comparability feature of accounting results of companies of different countries. It may be noted at this stage that these IFRSs are considered, at present, as high quality global accounting standards. This global harmonization of Accounting Standards improves the quality of financial reports at the global level. Further, it is believed that the adoption of IFRSs improves the financial performance of business entities. As a result of all these, now there is a shift towards IFRSs and already more than 100 countries have made transition and many more, including India, are in the movement.<sup>1</sup>

## **ALTERNATIVES**

There are two important alternatives available to the countries and their companies to prepare and present their financial statements in accordance with the provisions of IFRSs. They are,

01. Adoption, by a country, of IFRSs as they are in totality without modifying any of the Provisions, and
02. Convergence of its Accounting Standards with IFRSs after making necessary modifications which are desirable and/or necessary either to make the reports more qualitative or to comply with the provisions of the law which cannot be amended.

And it may be noted here that the countries are free to opt for any one of these two alternatives. India has opted for convergence of its accounting Standards with IFRSs instead of adopting IFRSs in toto.

## **DEVELOPMENTS AND PROGRESS IN INDIA**

In the year 2006, the Union Government of India Government took a decision to converge its Accounting Standards with IFRSs and proposed 1<sup>st</sup> April, 2011 as the date of implementation for some specific entities. This decision to converge the Indian Accounting Standards with IFRSs is considered to be an appropriate one as it enables its business enterprises to explore global capital markets with less difficulty. Further, the decision to converge rather than full adoption of IFRSs provides the standard setters more avenues to modify the standards to suit the country's local economic environment without allowing the quality of financial reports to impair.<sup>2</sup> Aligning with IFRSs enables Indian companies to enjoy several benefits including the reduction in the cost of capital, making foreign listings easy and setting up of subsidiaries and joint ventures abroad easily.

It may be noted here that the Institute of Chartered Accountants of India (ICAI) which is a member of the International Accounting Standards Board has set up on 21<sup>st</sup> April, 1977 a separate of board called, Accounting Standards Board (ASB). One of the important of functions of this Board is to formulate Accounting Standards with a view to assisting the Council of the ICAI in evolving and establishing Accounting Standards in India. Further, the Board is required to examine how far the relevant International Accounting Standard/International Financial Reporting Standard can be adapted while formulating the Accounting Standard and to adapt the same. In effect, ICAI is responsible for setting and issuing Accounting Standards in India. This institute has been working continuously to converge Indian Accounting Standards with IFRSs and also making revisions to the existing Indian Accounting Standards from time to time. In its way

towards convergence, it has issued a **concept paper on convergence of IFRSs** in 2007 which helped the interested parties to know more about the need for, and strategy of, convergence of Indian Accounting Standards with IFRSs.

ICAI, ASB of ICAI, the National Advisory Committee on Accounting Standards (NACAS) and the Ministry of Corporate Affairs (MCA) of Government of India (GoI) have joined their hands in finalizing the IFRS-converged Indian Accounting Standards.<sup>3</sup> The new standards are termed as **Indian Accounting Standards (Ind ASs)** and have been notified by the Ministry of Corporate Affairs of India in February 2011.<sup>4</sup> Based on the work of ASB of ICAI, already 35 Indian Accounting Standards (Ind ASs) converged with IFRSs are being notified and placed on the website of the ministry.

However, the effective date of implementation of Ind ASs has not yet been announced. It may be noted that as per the original commitment, the effective date for implementation of IFRS-converged Indian Accounting Standards was 1<sup>st</sup> April, 2010 and this has been postponed by a year to 1<sup>st</sup> April, 2011 in phased manner. However, it may not be possible for the country to follow even this date of implementation. It is on account of few important reasons such as the failure to complete the IFRS-converged Indian Accounting Standards. This may be a good news for the companies but it sends a wrong message about country's capability which is recognized for its IT and Accounting skills at the global level.

### **CONVERGENCE STRATEGY IN INDIA**

In India, Accounting Standards, as already stated, are formulated by the ASB of ICAI. In this task of setting the Standards, the Board (i.e., ASB) gives due consideration to IASs (i.e., International Accounting Standards)/IFRSs issued by IASB/IASB<sup>5</sup> and try to integrate them, as much as possible, to the conditions prevailing in India. Many new Accounting Standards and Exposure Drafts were issued, and revised as per the requirements of IAS/IFRS in recent years. Further, the

accounting professionals were required to undergo training programmes and to possess thorough knowledge of IFRSs.

Implementation of IFRS-converged Ind ASs requires some amendments to the relevant Provisions of Companies Act, Income Tax Rules, etc. In this regard, the statement, **the government is willing to introduce new company legislation aligning Indian Accounting standard with IFRSs** In the same year, the Council of ICAI has announced a plan to converge Indian Accounting Standards with IFRSs. It also stressed the need to make modifications to IFRSs to suit to the Indian conditions and 1<sup>st</sup> April, 2011 was decided as the effective date of implementation of new Standards ICAI has decided that IFRSs should be adopted for the public interest entities such as listed companies, banks, insurance companies and large sized entities.

Reserve Bank of India also set up a working group to address the issues pertaining to the implementation of IFRSs in the same year.<sup>6</sup> The Ministry of Corporate Affairs, Union Government of India has issued a roadmap to adopt IFRS-converged Indian Accounting Standards by Banks, Insurance Companies and Non-Banking Financial Companies (NBFCs).

ICAI published the near final draft of Indian Accounting Standards. In February 2011, the Ministry of Corporate Affairs of Union Government of India has issued 35 Indian Accounting Standards (Ind AS) that are converged with IFRSs.<sup>7</sup> It also announced their **phased implementation**, once certain tax related and other issues have been resolved.<sup>8</sup> But it has not yet notified the date of implementation.

### **PHASE-WISE APPLICABILITY**

For the purpose of implementation of IFRS-converged Ind ASs, phase-wise Approach is proposed depending upon the category to which the companies belong to. The details are as follows.

01. Phase - 1: Opening Balance Sheet as at 1<sup>st</sup> April, 2011:

- Companies which are part of NSE Index Nifty 50
- Companies which are part of BSE Sensex BSE 30

- a. Companies whose shares or other securities are listed on a stock exchange outside India
- b. Companies, whether listed or not, having net worth of more than ₹ 1,000 crores
02. Phase - 2: Opening Balance Sheet as at 1<sup>st</sup> April, 2012: Companies not covered in Phase - 1 and having net worth exceeding ₹ 500 crores.
03. Phase - 3: Opening Balance Sheet as at 1<sup>st</sup> April, 2014: Listed companies not covered in the earlier phases

If the financial year of a company commences at a date other than 1<sup>st</sup> April, then it shall prepare its opening balance sheet at the commencement of immediately following financial year.

### MAJOR CARVE-OUTS BETWEEN IFRSS AND IND ASS

For one reason or the other, the IFRSs adopted and/or IFRS-converged country-specific Accounting Standards differ from the IFRSs finalized by IASB. This is due to many a number of reasons including conceptual, legal and practical issues. This is true even in the case of India and its IFRS-converged Accounting Standards. The country-specific IFRSs, therefore, deviate from the IFRSs and this departure is technically termed as **carve-outs**. A carve-out, therefore, represents a divergence of principles and practices of country-specific Accounting Standards from that of IFRSs. Since India decided to converge its Accounting Standards with IFRSs, the country made many carve-outs and these carve-outs are grouped under the following four heads.<sup>9</sup>

01. Elimination of options provided under IFRSs,
02. Addition of options not available under IFRSs,
03. Inclusion of additional guidance in Ind ASs which is not present in IFRSs, and
04. Prescription of accounting rules that are different from IFRSs.

Some of the areas of carve-outs are real estate, business combinations, fair value liabilities, investment property, first time adoption, employee benefits, unrealized exchange differences, etc. The carve-outs may also fall into any of the following categories.<sup>10</sup>

01. **Mandatory deviations** from IFRSs which may affect relatively a smaller number of companies.
02. **Optional deviations** from IFRSs which can be avoided if a company does not adopt the diluted options given under Ind ASs.
03. **Removal of choices** given under IFRSs which do not result in non-compliance with IFRSs.
04. **Others** - Certain Accounting Standards that have not been issued under Ind ASs and may become applicable at a date subsequent to the transition date.

### IMPLEMENTATION OF IFRSS – FEW CHALLENGES FOR INDIA

Convergence of Indian Accounting Standards with IFRSs involves not only the technical exercise of convergence but also the shift from one set of Accounting Standards to another set of Accounting Standards.<sup>11</sup> It, therefore, calls for overall change. Even after the implementation of IFRS-converged Ind ASs, all those who are directly or indirectly associated with the companies such as accountants, auditors, business enterprises, governments and their agencies, regulators, users of financial reports, tax authorities, etc., may face few more problems and/or challenges. In this background, the experts at the Confederation of Indian Industries (CII) IFRS Summit 2011 which was held in Mumbai provided many suggestions to face the situation in India. Both the challenges and suggestions are presented below very briefly.<sup>12</sup>

01. **Consideration of Legal and Regulatory Issues:** Accounting in India is governed not only by the Accounting Standards alone but also by various legislations and governing bodies like Income Tax Act, Companies Act, Securities Exchange Board of India (SEBI), Insurance Acts, Reserve Bank of India (RBI), Ministry of Corporate Affairs (MCA), etc. In this regard, for example, it is necessary for the issue of appropriate notifications by the Ministry of Finance (MoF) as to how income tax including Minimum

Alternate Tax (MAT) shall be computed by those companies that follow Ind ASs.

02. It is also necessary to resolve certain inconsistencies and conflicts between the proposed Ind ASs and the relevant Provisions of the Indian Companies Act. For example, it requires the regulators to spell out about the manner of determining distributable profits subsequent to transition to Ind ASs.
03. The Banks, Insurance Companies and many other entities are regulated by the Provisions of respective Acts. It is, therefore, for the relevant industry regulators to resolve the conflicts between Ind ASs and industry-specific financial reporting principles. In this regard, both the Reserve Bank of India and the Insurance Regulatory Development Authority (IRDA) have formed working groups to assess the impact of Ind ASs convergence process on Banks and Insurance Companies.
04. Management of carve-outs is another major issue in the convergence process. Ind ASs include certain deviations from IFRSs as issued by IASB. Care shall be exercised while deciding about the required carve-outs or deviations as the excessive number of carve-outs may affect the credibility and comparability of financial statements. It may also deprive the Indian companies of reaping the full fruits of transition to IFRSs. The IASB strongly recommends for the 'adoption of IFRSs' approach rather than 'convergence with IFRSs' approach. It is, therefore, necessary to manage the carve-outs in a structured manner and international stakeholders shall be reassured with India's standard setting process.
05. Experts also recommend that Indian companies shall be provided freedom either to adopt IFRSs in toto or to adopt the IFRS-converged Ind ASs.
06. Under-estimation of the complexity involved in the implementation strategy by the corporate entities acts as a major challenge for the smooth transition from existing Accounting Standards to the proposed Ind ASs.<sup>13</sup> Hence, the business

enterprises should comprehend the problem properly and make necessary attempts promptly in the initial years. In this regard, experts suggest that the top management of business enterprises to devise a detailed strategy for this purpose and provide continuous support. Companies should first understand their existing financial reporting principles and policies. The staff of all the departments should be involved in this exercise evaluating the complexity of transition and identifying their capabilities. Responsibility for implementation should be assigned to the concerned staff after providing all necessary assistance and support.<sup>14</sup> If necessary, the companies may obtain the assistance of external experts. Financial reporting and auditing framework shall be reviewed and necessary changes shall be incorporated to implement Ind ASs. Based on these preparations, draft financial statements may be prepared and the entire process shall be reviewed on continuous basis. And a flexible transition plan shall be devised to address any changes occurring in Ind ASs.

The above aspects shall be kept in mind by the companies and make necessary preparation to ensure easy and smooth transition from the existing set of Accounting Standards to Ind ASs.

#### **IFRS-CONVERGED IND ASS – AN EVALUATION**

As already stated, the country preferred the convergence process – converging the present Indian Accounting Standards with the IFRSs instead of adopting IFRSs in toto. Many chartered accountants support this convergence approach as achieving convergence and its effective implementation is reckoned as the first step towards IFRSs. However, if the deviations in Ind ASs from the IFRSs are many and substantial with material effect, the very purpose of transition may be defeated. And the country may not be able to reap the full benefits of IFRSs. Many experts in accounting profession support this view and they are against the convergence strategy of India. For instance, Ernst and Young's partner Dolphy D'Souza opines,<sup>15</sup>

**(Ind AS financial statements would not be accepted in cross border transactions.** Further, he says, **moving to Ind ASs is like moving from one set of Indian GAAP to another set of Indian GAAP and will not have much value. Either we accept IFRS in toto or stay with Indian GAAP.** He argues that **the original incentive of IFRSs adoption of raising capital overseas would not be achieved through convergence**). Sri. Prabhakar Kalavacherla, IASB Board member, also strongly opposes India's approach to convergence with IFRSs. He calls for unmodified IFRS option in India. All the agencies in India which have assumed the responsibility of setting Standards should keep these observations and/or criticisms.

## CONCLUSION

IFRSs, if adopted by all the countries, ensure the availability of financial statements and reports which can be used for comparative evaluation and to take appropriate decisions by the interested parties. Further, they ensure many benefits to the companies and the countries. However, the carve-outs should be kept at the minimum level as otherwise the very purpose will be defeated.

The country is still in its way towards IFRS convergence. Though Ministry of Corporate Affairs of Union Government of India has notified the converged Accounting Standards, it is yet to announce the date of effective implementation. Hence, it is necessary to complete the process at the earliest and notify the date of implementation in advance so that the business enterprises can plan properly for the transition without much difficulty.

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