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ROAD MAP TO IFRS CONVERGENCE IN INDIA–REALISTIC OR FANTASY?

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ABSTRACT

India's convergence with International Financial Reporting Standards (IFRS) was to take place in three phases. Large Companies, included in the Nifty 50, the top 50 stocks listed on the National Stock Exchange, or the Bombay Stock Exchange Sensitivity Index, or that have a net value over Rs1000 crores ($224 million), were supposed to convert their balance sheets in line with IFRS, beginning April 1, 2011. Companies, not covered in the initial phase with more than Rs500 crores, are to make the switch in April of 2013 while the other listed companies are to follow in 2014. Despite issuing the IFRS-Converged Standards in February 2011, Indian Regulators did not implement the new standard on April 1, 2011. The delay can be attributed to concerns over a lack of resolution on taxation issues. The missed target date for convergence, has left many people wondering when India will begin to converge. It has been suggested that the date for mandatory convergence could be pushed back to April 1, 2012. However, because changes to IFRS would be implemented in 2013, it could make the switch to IFRS in 2012 a costly waste of energy and resources. In addition, India's proposed Direct Tax Code, that is due in 2012, does not reference the IFRS.

Keywords : *IFRS Convergence, Accounting Standard, IASC, IASB, ICAI*

Introduction

International Financial Reporting Standards1,2,3, are accounting standards issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC). The IASB uses a principles based approach in developing accounting standards. Principles based standards focus on establishing general principles derived from the IASB framework. As a result, there is limited guidance while applying general principles to entities or industries and the use of professional judgement is advised. The IASB has taken this approach to promote substance over form. That is to say, to encourage companies and auditors to step back and consider the underlying accounting principle rather than simple compliance to the letter of the rule.

Brief History of IAS

Several institutions have had a noticeable impact on the efforts to synchronise accounting standards. Two of the most important contributors were the International Accounting

Standards Committee (IASC), which would later become the International Accounting Standards Board (IASB), and the International Organization of Securities Commissions (IOSCO).

International Organization of Securities Commissions (IOSCO)[4]

The International Organization of Securities Commissions was established in 1974 to provide a framework in which securities agencies in the Americas, could provide information and advice to agencies of emerging markets. In 1986, the IOSCO allowed other regulatory agencies to join its membership. Today, the IOSCO is the leading organization for securities regulators around the world, with 177 members from 100 different countries.

The goal of the IOSCO is to ensure better regulation of the markets on both the domestic and international levels. IOSCO works towards facilitating cross-border securities offerings and listings by multinational issuers. IOSCO has advocated the adoption of a set of international accounting standards for cross-border listings to facilitate a greater market for foreign securities.

International Accounting Standards Committee (IASC)

The leading professional accounting bodies of 10 countries established the International Accounting Standards Committee in 1973 to formulate a set of international accounting standards. The IASC was funded by contributions from member bodies, multinational companies, financial institutions, and accounting firms.

During its lifetime, the IASC approached harmonization with the lowest common denominator mentality. This often allowed companies to choose from a variety of options on how to report different activities. This approach, which lasted until 1993, introduced little to no comparability of financial statements across countries. In 1987, the IOSCO became a member of the IASC's Consultative Group. In 1993, the IOSCO and IASC began to develop a core set of 30 international standards. By 1998, the IASC had completed the development of its 30 core standards and in May of 2000, the IOSCO recommended that securities regulators permit foreign issuers to use the core IASC standards while listing their securities.

International Accounting Standards Board (IASB)[5]

The IASC faced many criticisms. Among those criticisms were the accusations that the IASC had questionable independence and technical expertise. In 1999, the IASC Strategic Working Party designed a solution and the result was the International Accounting Standards Board (IASB) on April 1, 2001. The IASB took over from the IASC as the formulator of international accounting standards. The formation of the IASB shifted the focus from a harmonization effort to a new mentality of global standard setting.

The IASB is organized under an independent foundation called the IFRS Foundation.The governance and oversight of the activities, undertaken by the IFRS Foundation and its standard-setting body, rest with its Trustees, who are also responsible for safeguarding the independence of the IASB and ensuring the financing of the organization. The Trustees are publicly accountable to a Monitoring Board of public authorities.

History of The Institute of Chartered Accountants of India[6,7]

The Institute of Chartered Accountants of India (ICAI) is a statutory body established under the Chartered Accountants Act of 1949 for the purpose of regulating the profession of Chartered Accountants in India. The origin of the ICAI can be traced back to the 1930s. The Indian Accountancy Board (IAB) was created in 1932 and was one of the main institutes involved in the creation of the ICAI. The IAB intended to develop into an autonomous accounting profession, independent of the Government. By the time India received its independence, the IAB's plan had not come to fruition. The IAB pushed hard to create an independent private accounting institute but the Ministry of Commerce (MC) and the Ministry of Finance (MF) inserted themselves into the creation process and the result was a very different institutional structure than that envisioned by the IAB.

The ICAI gained some authority from its statutory basis and from the governmental backing but the ICAI wanted to establish itself as the leader of a "reputable profession." The ICAI attempted to do this through strong procedures and processes and strong regulation of its members. The ICAI did this in an attempt to pre-empt any interference by the Government and to prevent the development of a rival professional accounting organization. As a result, the ICAI modeled itself after the British design, that of a private sector professional body, setting its own examinations and training regulations.

Today the ICAI is the second largest accounting body in the world, with 167,000 members spread throughout India and around the globe. The role of the ICAI today has been refined to include:

- To Regulate the Profession of Accountancy
- Education & Examination of Chartered Accountancy
- Exercise Disciplinary Jurisdiction
- Input to Government on Policy Matters
- Ensuring Standards of Performance of Members
- Formulation of Accounting Standards
- Prescription of Engagement and Quality Control Standards
- Laying down Ethical Standards
- Continuing Professional Education
- Financial Report Review
- Monitoring Quality through Peer Review
- Conducting Post Qualification Courses

Road to Convergence with IFRS[8,9]

India's convergence with IFRS was to take place in three phases. Large companies, included in the Nifty 50, the top 50 stocks listed on the National Stock Exchange, or the Bombay Stock Exchange Sensitivity Index, or that have a net value over Rs1000 crore ($224 million), were supposed to convert their balance sheets in line with IFRS beginning April 1, 2011.

Companies, not covered in the initial phase with more than Rs500 crore, are to make the switch in April of 2013 while the other listed companies are to follow in 2014.

Despite issuing the IFRS-Converged Standards in February 2011, Indian Regulators did not implement the new standard on April 1, 2011. The delay can be attributed to concerns over a lack of resolution on taxation issues. The missed target date for convergence, has left many people wondering when India will begin to converge. It has been suggested that the date for mandatory convergence could be pushed back to April 1, 2012. However, because changes to IFRS would be implemented in 2013, it could make the switch to IFRS in 2012 a costly waste of energy and resources. In addition, India's proposed Direct Tax Code is due in 2012 and does not reference IFRS.

Tax Concerns[10]

One of the biggest potential problems for convergence is the country's tax system. Currently it is lagging behind. Tax strategy, with regards to IFRS, is not yet clear and even though the change is expected to be tax neutral, it is still a major concern.

Jamil Khatri, head of KPMG's IFRS practice in India, said, "Companies may need to maintain separate records for tax purposes. The need to maintain dual records and get them audited could be a problem." Others contend that it is unlikely that the few companies in Phase One will be taxed based on IFRS numbers. In addition, many of the smaller companies will not be covered by any of the phases and will continue to apply India GAAP.

India's proposed Direct Taxes Code is due in 2012 and does not mention IFRS. The ambiguity caused by the lack of guidance is a major concern for those preparing to converge with IFRS.

Prabhkar Kalavacherla, a member of the IASB, admits that there would be some short-term pains moving to IFRS but that the "long-term benefits outweigh the short-term costs." The road to convergence cannot be completed without clear tax impacts. It is imperative that policy makers do more to relieve the fears of taxpayers by providing more guidance and clarity on tax issues. The key differences between Ind AS and IFRS are listed in **Table- 1**.

Ind AS 101: First-time Adoption of Indian Accounting Standards

Date of transition

Under the IFRS, the date of transition is the beginning of the earliest period for which an entity presents full comparative information. Ind AS sets a mandatory transaction as the beginning date of the financial year on or after April 1, 2011. However, under Ind AS, entities have an option to present a memorandum of comparative information. If a company chooses to present comparative information, it would have two transition dates, one for the comparative period for memorandum reporting and another for the primary reporting period, as well as other additional obligations to present comparative reclassified numbers.

Comparative Requirements

Under both Ind AS options, companies would be required to present earlier year financial information prepared under the previous

GAAP. The previous GAAP statements should be reclassified to the extent practicable.

Ind AS 103: Business Combinations

Common control transactions

Under IFRS 3, common control transactions are excluded from the scope. Under Ind AS, common control transactions are included in the scope and are given additional guidance. The additional guidance states that business combination transactions should be accounted for under the "pooling of interest" method. Because IFRS 3 excludes common control transactions, companies have two main options to elect as their accounting policy: pooling interest method, or the fair value method. A difference occurs while using the pooling interest method under Ind AS or IFRS. Under Ind AS, the excess of the consideration given over the amount of share capital is recorded as goodwill and the shortfall is treated as capital reserve. Under the IFRS, no new good will arises while using the pooling interest method. Instead, the excess or short consideration given over aggregate book value of the assets and liabilities is included either in retained earnings or in a separate reserve.

Gain of bargain purchase

Under Ind AS, any gain arising from a bargain purchase should be recognized in Other Comprehensive Income (OCI) and accumulated in equity as a capital reserve. Under the IFRS, a gain on a bargain purchase should be recognized in profit or loss.

Ind AS 1: Presentation of Financial Statements

Presentation of Statement of Comprehensive Income (SOCI)

IFRS also allows for a single statement approach or a two statement approach to prepare the Statement of Comprehensive Income (SOCI). The single approach requires all items of income and expense to be recognized in the Statement of Comprehensive Income. The two statement approaches require one statement to display components of profit or loss and the other to display components of Other Comprehensive Income. Ind AS requires the SOCI to be stated in a single statement.

Classification of expense recognized in profit and loss

Under the Ind AS, companies are required to recognize expenses in profit or loss classified by the nature of the expense. Under the IFRS, the company has an option to recognize the expense using either nature or function on the expense within the company.

Ind AS 7: Statement of Cash Flow

Classification of interest and dividend in cash flow statement

IAS 7 allows the option to classify dividends paid as an item of operating activity for financial entities. In the case of "other" entities, not financial entities, IAS 7 allows the option to classify interest paid and interest and dividends received as operating or financing cash flow. Ind AS does not allow these options and requires the classification as found in **Table -2**.

Ind AS 11: Construction Contracts

Construction of real estate

Under the current Indian GAAP, companies recognize revenue from construction of real estate based on percentage of completion method. Ind AS allows developers to continue to use the same accounting method. Under IAS 11, revenue from agreements for construction of real estate should be recognized on completion of contract. Percentage of completion is only allowed if the contract meets specific criteria. If companies use Ind AS 11, it would lead to a significant departure from IAS. This would prevent the financial reports from being comparable with other international real estate developers.

Ind AS 19: Employee Benefits

Recognition of actuarial gains and losses

Under the IFRS, actuarial gains and losses for defined benefit plans can be accounted for using three different methods: recognize immediately in the income statement, recognize in Other Comprehensive Income (OCI), or using the corridor approach. Ind AS allows only actuarial gains and losses to be recognized in Other Comprehensive Income (OCI).

Discount rate for employee benefit obligation

IAS states that the discount rate used to discount employee benefit obligations should be determined by market yields on high quality corporate bonds. Ind AS requires the discount to be measured at the market yield on government bonds. Ind AS justifies by claiming that there is not a deep market for high quality corporate bonds in India. This is mostly significant because of the impact it will have on foreign subsidiaries of Indian Companies where market yields are available for high quality corporate bonds.

Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance

IAS 20 allows the measurement of non-monetary government grants under two methods: at fair value or nominal value. Ind AS 20 requires government grants to be measured at their fair value. In addition, IAS 20 allows grant related assets to be presented either as deferred income or by deducting the grant in arriving at the carrying amount. Under Ind AS, grant related assets are required to be set up as deferred income. This should not create any significant problems because IFRS allows the method that Ind AS requires.

Ind AS 21: Effects of Changes in Foreign Exchange Rates

Exchange differences arising on translation of long term monetary items in equity

Ind AS 21 provides companies with the option to recognize unrealized exchange differences arising on translation of long-term monetary assets and liabilities in equity or in profits and loss. If recognized in equity, the accumulated amount should be transferred to profit or loss over the period of maturity in “an appropriate manner”. Once exercised, it is irrevocable and it is applied for all long term monetary items. IFRS does not give companies options on how to recognize unrealized exchange differences. IFRS requires the unrealized exchange differences arising from long term monetary assets and liabilities to be recognized immediately in profit or loss.

Ind AS 27: Consolidated and Separate Financial Statements

Format of consolidated financial statements

Ind AS 27 has set out specific formats for the presentation of consolidated financial statements. It has set the minimum requirements for disclosure on the face of Consolidated Balance Sheet at the end of the period and a Consolidated Statement of Changes in Equity for the period as a part of the Consolidated Balance Sheet. It has also set standards for the Consolidated Statement of Profit and Loss for the period as well as for notes to the accounts. IAS 27 requires the presentation of consolidated financial statements but does not specify a format for the presentation of financial statements.

Ind AS 28: Investments in Associates

Uniform accounting policies

Under IAS 28, investors' financial statements should be prepared using uniform accounting policies for like transactions and events in similar circumstances. Ind AS provides exemptions from the use of uniform accounting policies if it is impracticable to do so. Ind AS has made the exemption available claiming that because the investor does not control the associate, it might be problematic to obtain the information necessary to comply with IAS 28. However, impracticability is a high threshold and it is unlikely to create many problems.

Gain on bargain purchase

There is also a difference in the way Ind AS and IAS account for gain on bargain purchases. Ind AS has gain on bargain purchase on an acquisition of investment in associates recognized in capital reserve while IAS has it recognized in profit or loss.

Ind AS 32: Financial Instruments: Presentation

Conversion option embedded in foreign currency convertible bonds

Ind AS 32 allows a conversion option where a fixed number of equity shares for a fixed amount of cash in any currency is treated as equity and it is not required to re-measure fair value every reporting date. Under IAS 32, the cash received for the equity shares must be the entity's functional currency. If it is not the functional currency, the conversion option should be treated as an embedded derivative and should be re-measured every reporting period.

Ind AS 33: Earnings per Share

Compulsory disclosure of EPS

IAS 33 states that when both a consolidated financial statement and separate financial statements are presented, EPS related information can only be provided in the consolidated statements. Ind AS 33 requires EPS related information to be disclosed in both the consolidated and separate financial statements.

Ind AS 39: Financial Instruments: Recognition and Measurement

Changes in fair value of a liability due to the entity's own credit risk

In an attempt to prevent the recognition of unrealized gains or losses resulting from the changes in fair value of financial liabilities, Ind AS 39 has amended the measurement of financial liabilities so as to ignore changes in the fair value subsequent to changes in the entity's own credit risk. IFRS 9 has attempted to prevent volatility in profit or loss but is vastly different from Ind AS 39. IFRS 9 requires financial liabilities to be recognized at fair value but with changes due to own credit being recognized in Other Comprehensive Income. The fair value through profit or loss designation is optional under Ind AS, which means that the conflict could be avoided by following IFRS guidance.

Ind AS 40: Investment Property

Elimination of option to recognize investment properties at fair value

IAS 40 allows investment property to be measured under either the cost model, or the fair value model. Ind AS 40 requires that investment property be measured using the cost model. Since the cost model is an acceptable method under IAS, there should be no conflicting issues.

Table -3 presents information where there are no significant differences between the Ind AS and IFRS.

Conclusion

India has made progress on the path to convergence. However, carve-outs intended to ease the adoption, have raised concerns that significant differences between Ind AS and IFRS might lessen India's ability to influence future IFRS changes. Changes to IFRS are due soon and it is uncertain how these changes would be included in Ind AS. The concern over tax issues is also a major hurdle for the convergence with IFRS. Government agencies and administrators need to provide clearer guidance in order to enable Indian Companies to make the switch less painful. Convergence cannot be achieved without clear goals and strong leadership.

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Table -1
Key Differences between Ind AS and IFRS [a, b]

Significant differences observed				
		Corresponding IFRS		
Notified Ind AS	**Title of Ind AS**	**IAS/IFRS**	**IFRIC**	**SIC**
Ind AS 101	First Time Adoption of Indian Accounting Standards	IFRS 1	-	-
Ind AS 103	Business Combinations	IFRS 3	-	-
Ind AS 107	Financial Instruments: Disclosures	IFRS 7	-	-
Ind AS 1	Presentation of Financial Statements	IAS 1	-	-
Ind AS 7	Statement of Cash Flows	IAS 7	-	-
Ind AS 11	Construction Contracts	IAS 11, 18	IFRIC 12, 15	-
Ind AS 19	Employee Benefits	IAS 19	IFRIC 14	-
Ind AS 20	Accounting for Government Grants and Disclosure of Government Assistance	IAS 20	-	SIC 10
Ind AS 21	The Effects of Changes in Foreign Exchange Rates	IAS 21	-	-
Ind AS 27	Consolidated and Separated Financial Statements	IAS27	-	SIC 12
Ind AS 28	Investments in Associates	IAS 28	-	-
Ind AS 31	Interests in Joint Ventures	IAS 31	SIC 13	-
Ind AS 32	Financial Instruments: Presentation	IAS 32	-	-
Ind AS 33	Earnings Per Share	IAS 33	-	-
Ind AS 39	Financial Instruments: Recognition and Measurement	IAS 39	IFRIC 9, 16, 19	-

a. Decoding the differences : Comparison of Ind AS with IFRS
b. Ind AS vs IFRS : Overview of key differences.

Table- 2
Classification in Statement of Cash Flows under Ind AS

For Financial entities	
Item	**Classification in cash flow statement**
Interest and dividends received	Operating Activities
Interest paid	Operating Activities
Dividends paid	Financing Activities

For other entities	
Item	**Classification in cash flow statement**
Interest and dividends received	Investing Activities
Interest paid	Financing Activities
Dividends paid	Financing Activities

Table –3

Areas of Convergence between Ind AS and IFRS

No significant differences observed				
		Corresponding IFRS		
Notified Ind AS	**Title of Ind AS**	**IAS/IFRS**	**IFRIC**	**SIC**
Ind AS 102	Share-based Payments	IFRS 2	-	-
Ind AS 104	Insurance Contracts	IFRS 4	-	-
Ind AS 105	Non-current Assets Held for Sale and Discontinued Operations	IFRS 5	-	-
Ind AS 108	Operating Segments	IFRS 8	-	-
Ind AS 2	Inventories	IAS 2	-	-
Ind AS 8	Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8	-	-
Ind AS 10	Events after the Reporting Period	IAS 10	IFRIC 17	-
Ind AS 12	Income Taxes	IAS 12	-	SIC 21, 25
Ind AS 16	Property, Plant, and Equipment	IAS 16	IFRIC 1	-
Ind AS 17	Leases	IAS 17	IFRIC 4	SIC 15, 27
Ind AS 18	Revenue	IAS 18	IFRIC 13, 18	SIC 29, 31
Ind AS 23	Borrowing Costs	IAS 23	-	-
Ind AS 24	Related Party Disclosures	IAS 24	-	-
Ind AS 29	Financial Reporting in Hyperinflationary Economies	IAS 29	IFRIC 7	-
Ind AS 34	Interim Financial Reporting	IAS 34	IFRIC 10	-
Ind AS 36	Impairment of Assets	IAS 36	-	-
Ind AS 37	Provisions, Contingent Liabilities and Contingent Assets	IAS 37	IFRIC 5, 6	-
Ind AS 38	Intangible Assets	IAS 38	-	SIC 32