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Applicability of International Financial Reporting Standards in India: Some Key Issues and Challenges

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Abstract: Financial reporting system, providing indispensable financial information about the company to its shareholders and other stakeholders, needs to be reliable, free from bias and should enable comparison on the basis of common benchmarks. The growing inter-linkages in the world economy and the recent global financial meltdown have thrown up important challenges that the world community must meet jointly and there is growing realization across the world of the need for enabling a single set of high quality global Accounting Standards, which would be based on common accounting principles while providing reliable and comparable financial information. This paper addresses the adoption and applicability of International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB) to India. Specifically, in Indian context, the paper highlights some major areas where the country lacked harmonization with International Accounting Standard (IAS) and the rapid congruence with IAS in the decade that followed.

Keywords: IFRS; India; International Accounting Standards; ICAI.

1. Introduction:

The liberalization of the Indian economy since 1991 has uncovered Indian firms to foreign competition and foreign investment. As a result, the information needs required by both managers and investors have altered. A preliminary step in this course is the demand for transparency in the financial reporting. This transparency is speedily occurring in India as the country propels into becoming a major economic power pushed on by the combined forces of the technological revolution, the opening up of its borders and the privatization of many infrastructure industries such as transportation and communication.

Financial reporting system which provides indispensable financial information about the company to its shareholders and other stakeholders requires to be reliable, free from bias and should enable comparison on the basis of common benchmarks. This, in turn, necessitates an appropriate financial reporting system that incorporates sound accounting principles and reflects a true and fair view of the financial health of the company while ensuring legally enforceable accountability. In a globalised world, such a system should also be uniform across borders so that there is comparability on the basis of common benchmarks. The growing inter-linkages in the world economy and the recent global financial meltdown have thrown up important challenges that the world community must meet jointly. In the aftermath of the financial crisis, there is growing realization across the world of the need for enabling a single set of high quality global Accounting Standards, which would be based on common accounting principles while providing reliable and comparable financial information. With this in view, G-20 had called upon the international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting-processes; and complete their convergence projects by 2011. International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), are increasingly being recognized as global accounting standards, and are in use in over 100 countries with about 40 more countries (including India) being in the process of converging with them.

Since the beginning of 2005, the global corporate financial reporting landscape has been transformed in a major way – a record number of countries and enterprises around the world adopted international financial reporting standards (IFRS) as basis for the preparation of financial statements. All member States of the European Union have adopted IFRS endorsed in European Union for the preparation of consolidated financial statements of listed companies their respective jurisdictions. The benefits of a common set of high-quality financial reporting standards are very significant. Nevertheless, depending on the general economic situation, existing regulatory framework and financial reporting tradition of a given member State, practical implementation of IFRS poses considerable challenges. These practical challenges relate to the coherence of the regulatory framework and the state of preparation of relevant institutions, enforcement and technical capacity. When IFRS are adopted in a given jurisdiction, they become part of existing laws and regulations. However, the provisions of relevant national laws and regulations might not be amended in due time to recognize the introduction of IFRS. In some cases, situations arise where IFRS requirements contradict applicable provisions in national laws and regulations. Relevant institutions needed for ensuring a smooth transition to a global set of financial reporting standards might be inexistent or weak. Rigorous enforcement of such global standards at the national level poses practical challenges due to absence of adequately resourced enforcement institutions and of adequate coordination mechanisms among relevant institutions. Many member States, particularly developing countries and countries with economies in transition, lack a critical mass of competent accountants and auditors capable of applying highly sophisticated and voluminous global standards such as IFRS. In general, training materials on IFRS are scarce, particularly in languages other than English. Furthermore, proper application of certain measurement requirements in IFRS requires input from competent professionals in other areas such as actuary, property valuation and others. Lack of technical capacity poses a significant barrier to the successful implementation of IFRS.

In this backdrop, this paper addresses the adoption and applicability of International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB) to India. Specifically, the paper highlights some major areas where the country lacked harmonization with IAS in 1993 and the rapid congruence with IAS in the decade that followed. The attempt to achieve congruence with IAS appears to be more a by-product of the country's rapid economic growth rather than its catalyst. However, continued growth and the attraction of foreign capital to domestic ventures will depend on the transparency of the financial dealings.

2. Accounting Standards Setting in India:A Sequential Standpoint

The accounting profession in India was among the earliest to develop, as the Indian Companies Act was introduced in the mid-1800s, giving the accounting profession its set up. Since then, substantial efforts have been made to bring into line Indian accounting and auditing standards and practices with internationally accepted standards. Indian accounting and auditing standards are developed on the basis of international standards and the country has many accountants and auditors who are highly skilled and capable of providing international-standard services. The Institute of Chartered Accountants of India (ICAI) set up the Accounting Standards Board in 1977 to prepare accounting standards. In 1982, ICAI set up the Auditing and Assurance Standards Board (initially known as the Auditing Practice Committee) to prepare auditing standards. ICAI became one of the associate members of the International Accounting Standards Committee (IASC) in June 1973. ICAI also became a member of the International Federation of Accountants (IFAC) at its inception in October 1977. While formulating accounting standards in India, the ASB considers IFRS and tries to integrate them, to the extent possible, in the light of the prevailing laws, customs, practices and business environment in India. The Accounting Standards Board has worked hard to introduce an overall qualitative improvement in the financial reporting in the country by formulating accounting standards to be followed in the preparation and presentation of financial statements. So far, the board has issued 35 accounting standards. In addition, it has also issued various accounting standards interpretations and announcements, so as to ensure uniform application of accounting standards and to provide guidance on the issues concerning the implementation of accounting standards which may be of general relevance. Appendix A contains a comparative statement of international accounting standards/international financial reporting standards and Indian accounting standards.

As accounting standards in India are formulated on the basis of IFRS issued by the IASB,
ICAI interacts with the IASB(International Accounting Standard Board) at various levels, namely:

Sending comments on the various draft IFRS issued by the IASB;

Active participation in the meetings of the global standard-setters with the IASB;

Active participation in the meetings of the regional standard-setters with the IASB;

Contribution in the discussions on various ongoing projects of the IASB, e.g. on the IASB management commentary project;

ICAI is approaching the IASB to take up projects to be carried on by India, e.g. IFRS for regulated enterprises.

3.Regulatory framework and enforcement of Accounting Standards

In the following paragraphs, the regulatory framework of financial reporting and enforcement of accounting standards will be discussed.

(A) Legal Recognition of accounting standards issued by ICAI under the Companies Act (1956)

The Companies Act (1956) offers the basic requirements for financial reporting of all companies in India. The Act requires the preparation, presentation, publication, and disclosure of financial statements, as well as an audit of all companies by a member-in-practice certified by the Institute of Chartered Accountants of India (ICAI). Under the Act, the Central Government has the power, by notification in the *Official Gazette*, to constitute the National Advisory Committee on Accounting Standards to advise the Central Government on the formulation and laying down of accounting standards for adoption by companies or class of companies. For this purpose, the Act requires the committee to consider accounting standards issued by ICAI when recommending accounting standards to the Government. While, as stated earlier, ICAI bases its accounting standards on the corresponding IAS/IFRS, the committee also specifically considers any deviations from– and reasons, if any, for them – the corresponding IAS/IFRS when reviewing ICAI accounting standards. Where the committee is not satisfied by any deviation, it requests ICAI to amend the standard to comply with IFRS. ICAI generally deviates from the corresponding IAS/IFRS because of the following factors:

Legal and regulatory environment prevailing in the country;

Alternatives permitted in IFRS would lead to incomparable financial information;

Economic environment within the country;

Level of preparedness of industry.

The committee has recommended to the Government all 35 accounting standards issued by ICAI, with the exception of accounting standard No. 8 on accounting for research and development (which has already been withdrawn pursuant to accounting standard No. 26 on intangible assets), which will become mandatory for notification under the Companies Act (1956). These include the revised accounting standard No.15 on employee benefits, recently issued by ICAI in line with IAS 19 on employee benefits. Notification by the Government of these standards is expected shortly. Until then, the Companies Act (1956) specifically provides that companies must adhere to ICAI accounting standards.

(B) Legal recognition of accounting standards by other regulators

(i)Reserve Bank of India

The Reserve Bank of India was established to regulate the issue of banknotes and the keeping of reserves to secure monetary stability in India, as well as to generally operate the currency and credit system of the country to advantage. The Banking Regulation Act (1949) empowers the bank to regulate financial reporting of the financial sector, including banks and financial institutions**.** One of the schedules to the Banking Regulation Act prescribes formats for general-purpose financial statements (e.g. balance sheet, and profit and loss accounts) and other disclosure requirements. Banks are also required to comply with the requirements of the Companies Act (1956), provided that they are consistent with the Banking Regulation Act. The Reserve Bank has issued circulars requiring banks to comply with the accounting standards issued by ICAI.

(ii)Securities and Exchange Board of India

The Securities and Exchange Board of India Act protects investors and regulates the securities market. Listed companies in India are required to comply with the requirements prescribed by the board in its 1992 Act and the Securities Contracts (Regulation) Act of 1956, which provides for the regulation of securities transactions. To protect investor interests, the board has issued a listing agreement which specifies disclosures applicable to listed companies, in addition to other applicable auditing and accounting requirements. In particular, it requires compliance with the accounting standards issued by ICAI.

(iii)The Insurance Regulatory and Development Authority

The Insurance Regulatory and Development Authority regulates the financial reporting practices of insurance companies under the Insurance Regulatory and Development Authority Act (1999). This authority has been constituted to regulate, promote and ensure orderly growth of the insurance business and reinsurance business. Insurance companies and their auditors are required to comply with the requirements of the authority's 2002 regulations, entitled "Preparation of Financial Statements and Auditor's Report of the Insurance Companies", when preparing and presenting their financial statements and the format and content of the audit report. The authority's regulations require compliance with the accounting standards issued by ICAI.

(iv)The Institute of Chartered Accountants of India as a regulator

ICAI requires its members to ensure compliance with all the accounting standards that it issues while discharging their attesting function. Further, ICAI members are required to follow a detailed code of ethics**,** as prescribed under the Chartered Accountants Act (1949). The ICAI council is also entrusted with the disciplinary powers that are exercised through its disciplinary committee. Recently, extensive changes have been introduced into the Act through the Chartered Accountants (Amendment) Act (2006), which has made the ICAI disciplinary mechanism more stringent. ICAI, with a view to further improving and strengthening financial reporting practices in India, has also constituted the Financial Reporting Review Board**.** The board reviews general purpose financial statements of certain selected enterprises with a view to ensuring compliance with, *inter alia,* the accounting standards. In cases, where non-compliance is observed, appropriate action is taken by ICAI and/or the case is referred to an appropriate authority for the action. This step definitely helps improve the quality of financial reporting in the country.ICAI introduced a peer review of audit firms by establishing an 11-member peer review board in March 2002. The peer review board provides guidance on enhancing the quality of services provided by ICAI members. In the first phase, peer review focuses on the review of firms that audit major enterprises at least once in a three-year period. The peer review does not lead to any disciplinary or regulatory mechanism. Peer review certification is either given or not given according to the findings of the review. Peer reviewers are practitioners with at least 15 years' audit experience.

The Chartered Accountants (Amendment) Act (2006) created a quality review board to replace of the peer review board; the new board will be make recommendations to the ICAI council on the formulation of standards regarding the quality of services provided by the members. Further, the proposed quality review board would also review the quality of services provided by ICAI members, including audit services, and guide ICAI members in improving the quality of services and compliance with the various statutory and other regulatory requirements.

4. The justification behind International Financial Reporting Standards: Why Financial Reporting needs to be harmonized?

Although basic accounting principles such as the accrual basis and the going-concern assumption are widely accepted, the application of these principles in different economic and cultural environments has led to significant differences in how accountants report similar transactions. Local differences exist in, for example, the treatment of goodwill, the definition of a group, treatment of borrowing costs, measurement of impairment, and the treatment of deferred taxes. For entities that are globally active, these differences in financial reporting requirements create extra complications in terms of preparing, consolidating, auditing, and interpreting financial statements. This is because financial statements have to be reconciled before consolidated financial statements can be prepared, the analysis of potential acquirees in a foreign country increases the costs of the mergers and acquisitions department because they have to familiarize themselves with a foreign accounting system, and investors have to be informed about differences in financial reporting. In general, the differences in accounting treatments create non-optimal information for users of financial statements, which in turn leads to less than optimal allocation of resources. The need for a harmonized, high-quality set of accounting rules is not new. Several initiatives have been taken to arrive at a globally accepted set of financial reporting standards.

A financial reporting system supported by strong governance, high-quality standards and a sound regulatory framework is the key to economic development. Indeed, high-quality standards of financial reporting, auditing and ethics form the foundations of the trust that investors place in financial information and therefore play an integral role in contributing to a country's economic growth and financial stability. As the forces of globalization prompt more and more countries to open their doors to foreign investment and as businesses expand across borders, both the public and private sectors are increasingly recognizing the benefits of having a commonly understood financial reporting framework, supported by strong globally accepted standards. The benefits of a global financial reporting framework are numerous and include:

Greater comparability of financial information for investors;

Greater willingness on the part of investors to invest across borders;

Lower cost of capital;

More efficient allocation of resources; and

Greater economic growth.

However, before these benefits can be fully apprehended, there must be greater convergence with a single set of globally accepted high-quality standards. International convergence is a goal that is embraced in the mission of the International Federation of Accountants (IFAC) and shared by IFAC members, international standard-setters and many national standard-setters. As a member body of IFAC, India has recognized in its preface to the statements of accounting standards that "ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, *inter alia*, to actively promote the International Accounting Standards Board's (IASB) pronouncements in the country with a view to facilitating global harmonization of accounting standards. Accordingly, while formulating the accounting standards, the Accounting Standards Board will give due consideration to International Accounting Standards (IAS) issued by the International Accounting Standards Committee (predecessor body to the IASB) or international financial reporting standards (IFRS) issued by the IASB, as the case may be, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India". Accordingly, the accounting standards issued by ICAI are generally in conformity with IFRS. Indeed, with respect to certain recently issued/revised Indian accounting standards, there are no differences between the Indian accounting standards and IFRS. For example, accounting standard No. 7 on construction contracts and accounting standard 28 on impairment of assets are identical to the corresponding IFRS. However, in exceptional cases, when a departure from IFRS is warranted by conditions in India, the major areas of difference between the two are pointed out in the appendix to the accounting standard. ICAI endeavours to bridge the gap between Indian accounting standards and IFRS by issuing new accounting standards and ensuring that existing Indian accounting standards reflect any changes in international thinking on various accounting issues. In this regard, it should be noted that ICAI is making a conscious effort to bring the Indian accounting standards into line with IFRS by revising existing accounting standards. ICAI has so far issued 35 Indian accounting standards corresponding to IFRS. In view of the above, Indian accounting standards are largely in step with IFRS. This is also recognized in the following extracts of article from an Indian financial daily, *Hindu Business Line*, on 5 November 2005:

"Indian Companies can now get listed on the London Stock Exchange (LSE) by reporting their financial results based on Indian accounting standards. Until now, these companies had to report their financial data in accordance with the international financial reporting standards (IFRS)."

This is an indication of the growing convergence of Indian accounting standards with IFRS.

5. Introduction of IFRS convergence in India

International Financial Reporting Standards (IFRS) are principles-based Standards, Interpretations and the Framework (1989) adopted by the International Accounting Standards Board (IASB).A financial statement should reflect true and fair view of the business affairs of the organization. As these statements are used by various constituents of the society / regulators, they need to reflect true view of the financial position of the organization.

A financial reporting system supported by strong governance, high quality standards, and firm regulatory framework is the key to economic development. Indeed, sound financial reporting standards underline the trust that investors place in financial reporting information and thus play an important role in contributing to the economic development of a country. The Institute of Chartered Accountants of India (ICAI) as the accounting standards-formulating 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.

5.1. Meaning of 'Convergence' with IFRS

In general terms, 'convergence' means to achieve harmony with IFRS; in precise term, convergence can be considered "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRS". In this context, attention is drawn to paragraph 14 of International Accounting Standard (IAS) 1, Presentation of Financial Statements, which states that financial statements shall not be described as complying with IFRS unless they comply with all the requirements of IFRS. Thus, 'convergence with IFRSs' means adoption of IFRS.

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 setting of globalisation, India cannot shield 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 view of the laws, customs, practices and business environment prevailing in India. The Preface to the Statements of Accounting Standards, issued by the ICAI, categorically recognizes 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.

5.2.IFRS - Global relevance:

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 multinational 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.

5.3. Convergence of Indian accounting standards with IFRS:

In the year 2007, ICAI developed a 'Concept Paper on Convergence' with IFRS in India with the objective of exploring the approach and strategy for achieving convergence with IFRS. In 2008, the Government announced the policy that the Indian Accounting Standards are expected to be fully convergent with IFRS w.e.f April 1, 2011. While some countries have adopted the IFRS without modifications, others have modified the IFRS to their country-specific conditions during the process of convergence. India decided to go in for ‘convergence’ rather than ‘adoption’. Convergence with IFRS would allow India to consider local economic conditions and business environment while preparing converged accounting standards, thus enabling an orderly transition while safeguarding the interests of Indian enterprises and providing them enough time for transition. Government of India has been following a consultative approach for the purpose of achieving convergence of national accounting standards with IFRS.

In July 2009, with a view to designing a definitive roadmap for convergence with IFRS and coordinating the process, a Core Group was set-up under the Chairmanship of the Secretary, Ministry of Corporate Affairs with participation from Ministry of Finance, C&AG, RBI, SEBI, IRDA, PFRDA, ICAI, NACAS and industry representatives.

In January 2010, the Ministry of Corporate Affairs, Government of India announced the roadmap for convergence, according to which the Indian Accounting standards converged with IFRS shall be applied to specified classes of companies, in phases, beginning with the financial year 1.4.2011 to 2014.

5.4. Path-way for convergence of Indian accounting standards with IFRS:

As per the roadmap announced by the Ministry of Corporate Affairs, there will be two separate sets of Accounting Standards u/s 211(3C) of the Companies Act, 1956. First set would comprise of the Indian Accounting Standards which are converged with the IFRS which shall be applicable to the specified classes of companies. The second set would comprise of the existing Indian Accounting Standards and would be applicable to other companies, including Small and Medium Companies (SMCs).

The first set of Accounting Standards (i.e. converged accounting standards) will be applied to specified classes of companies, in phases, beginning with the financial year 1.4.2011 to 2014 as per following schedule:-

The Institute of Chartered Accountants of India (ICAI) has announced that IFRS will be mandatory in India for financial statements for the periods beginning on or after 1 April 2011. This will be done by revising existing accounting standards to make them compatible with IFRS.

Reserve Bank of India has stated that financial statements of banks need to be IFRS-compliant for periods beginning on or after 1 April 2011.

The ICAI has also stated that IFRS will be applied to companies above Rs.1000 crore from April 2011. Phase wise applicability details for different companies in India:

Phase-1: Opening balance sheet as at 1 April 2011*
i. Companies which are part of NSE Index – Nifty 50
ii. Companies which are part of BSE Sensex – BSE 30

a. Companies whose shares or other securities are listed on a stock exchange outside India

Phase- 2: Opening balance sheet as at 1 April 2012*

All insurance companies.

Phase-3: Opening balance sheet as at 1 April 2013*
Companies not covered in phase 1 and having net worth exceeding INR 500 crore.

Phase 4: Opening balance sheet as at 1 April 2014*.
Listed companies not covered in the earlier phases.

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

On January 22, 2010 the Ministry of Corporate Affairs issued the road map for transition to IFRS. It is clear that India has deferred transition to IFRS by a year. In the first phase, companies included in Nifty 50 or BSE Sensex, and companies whose securities are listed on stock exchanges outside India and all other companies having net worth of Rs 1,000 crore will prepare and present financial statements using Indian Accounting Standards converged with IFRS. According to the press note issued by the government, those companies will convert their first balance sheet as at April 1, 2011, applying accounting standards convergent with IFRS if the accounting year ends on March 31. This implies that the transition date will be April 1, 2011. According to the earlier plan, the transition date was fixed at April 1, 2010.

Table:1 :Statement showing Roadmap for Convergence

2011	2012	2013	2014

NSE – Nifty 50 BSE – Sensex 30 Whose shares or other securities listed outside India Whether listed or not, having networth in excess of Rs. 1000 Cr. (Excluding Banking, Insurance and NBFCs)	All insurance companies	Listed or not, having a networth of more than Rs. 500 Cr. but not exceeding Rs.1000 Cr. (Excluding Banking, Insurance and NBFCs)	Listed and having a networth of Rs 500 Cr. or less (Excluding Banking, Insurance and NBFCs)
All scheduled commercial banks			
Urban Co-operative Banks having networth in excess of Rs.300 Cr.		Urban Co-operative Banks having networth in excess of Rs.200 Cr. but not exceeding Rs.300 Cr.	
NBFCs being: NSE – Nifty 50 BSE – Sensex 30 Whether listed or not, having networth in excess of Rs. 1000 Cr.		All listed NBFCs and those unlisted NBFCs having networth in excess of Rs.500 Cr. but not exceeding Rs. 1000 Cr.	

Notes:
1. When the accounting year ends on a date other than 31st March, the conversion of the opening Balance Sheet will be made in relation to the first Balance Sheet which is made on a date after 31st March.
2. Companies which do not fall in the above categories including the Small and Medium Companies (SMCs) and Regional Rural Banks will not be required to follow the IFRS converged Indian Accounting standards, though they may voluntarily opt to do so, but need to follow only the notified Indian Accounting Standards which are not converged with IFRS.

The press note does not clarify whether the full set of financial statements for the year 2011-12 will be prepared by applying accounting standards convergent with IFRS. The deferment of the transition may make companies happy, but it will undermine India’s position. Presumably, lack of preparedness of Indian companies has led to the decision to defer the adoption of IFRS for a year. This is unfortunate that India, which boasts for its IT and accounting skills, could not prepare itself for the transition to IFRS over last four years. But that might be the ground reality. Transition in phases Companies, whether listed or not, having net worth of more than Rs 500 crore will convert their opening balance sheet as at April 1, 2013. Listed companies having net worth of Rs 500 crore or less will convert their opening balance sheet as at April 1, 2014. Un-listed companies having net worth of Rs 500 crore or less will continue to apply existing accounting standards, which might be modified from time to time. Transition to IFRS in phases is a smart move. The transition cost for smaller companies will be much lower because large companies will bear the initial cost of learning and smaller companies will not be required to reinvent the wheel. However, this will happen only if a significant number of large companies engage Indian accounting firms to provide them support in their transition to IFRS. If, most large companies, which will comply with Indian accounting standards convergent with IFRS in the first phase, choose one of the international firms, Indian accounting firms and smaller companies will not benefit from the learning in the first phase of the transition to IFRS. It is likely that international firms will protect their learning to retain their competitive advantage. Therefore, it is for the benefit of the country that each company makes judicious choice of the accounting firm as its partner without limiting its choice to international accounting firms. Public sector companies should take the lead and the Institute of Chartered Accountants of India (ICAI) should develop a clear strategy to diffuse the learning. Size of companies The government has decided to measure the size of companies in terms of net worth. This is not the ideal unit to measure the size of a company. Net worth in the balance sheet is determined by accounting principles and methods. Therefore, it does not include the value of intangible assets. Moreover, as most assets and liabilities are measured at historical cost, the net worth does not reflect the current value of those assets and liabilities. Market capitalisation is a better measure of the size of a company. But it is difficult to estimate market capitalisation or fundamental value of unlisted companies. This might be the reason that the government has decided to use ‘net worth’ to measure size of companies. Some companies, which are large in terms of fundamental value or which intend to attract foreign capital, might prefer to use Indian accounting standards convergent with IFRS earlier than required under the road map presented by the government. The government should provide that choice. Conclusion The government will come up with a separate road map for banking and insurance companies by February 28, 2010. Let us hope that transition in case of those companies will not be deferred further.

5.5. IFRS - Indian perspective

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.

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, IAS 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 national accounting standards with International Financial Reporting Standards (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.

5.6. Applicability of IFRS

ICAI has decided that IFRSs should be adopted for public interest entities from the accounting periods commencing on or after 1st April, 2011.

Accordingly, the ICAI is of the view that a public interest entity should be 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 crores 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 crores 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.

5.7.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 recognize 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.

6. Challenges and issues involved in convergence with IFRS in India:

6.1. Legal and regulatory considerations

In some cases, the legal and regulatory accounting requirements in India differ from the IFRS; in such cases, strict adherence to IFRS in India would result in various legal problems. The examples below exemplify this point.

IAS 1 – Presentation of Financial Statements

In India, laws governing companies (e.g. the Companies Act of 1956), banking enterprises (e.g. the Banking Regulation Act of 1949) and insurance enterprises (formats of financial statements for insurance companies as prescribed by the Insurance Regulatory and Development Authority regulations) in the document “Preparation of Financial Statements and Auditor’s Report of the Insurance Companies” (2002), prescribes detailed formats for financial statements to be followed by respective enterprises. At this stage, lawmakers/regulators may not be willing to accept IAS 1 in its present form and change the existing law. Therefore, full adoption of IAS 1 may not be possible at this stage. However, it is proposed that the corresponding accounting standard being developed by ICAI, would have an appendix containing suggested detailed formats of financial statements which, while complying with IAS 1, would also contain other disclosures prescribed in the formats laid down by various legislations to address the concerns of the legislature.

IAS 21 – The Effects of Changes in Foreign Exchange Rates:

If IAS 21 is adopted in India it would result in violation of schedule VI to the Companies Act of 1956. Schedule VI requires foreign currency fluctuations in respect of foreign currency loans raised to acquiring foreign assets to be reflected in the cost of the fixed assets, whereas IAS 21 requires the same to be charged to the profit and loss account. The corresponding Indian accounting standard prescribes the accounting treatment contained in IAS 21; however, through a separate announcement issued by ICAI, it is recognized that law will prevail.

IAS 34 – Interim Financial Reporting:

The disclosures requirements of IAS 34 are not in accordance with the formats of unaudited quarterly/half-yearly results prescribed in the listing agreement issued by the Securities and Exchange Board of India. The corresponding Indian standard prescribes disclosure as per IAS 34, but also recognizes that the law will prevail insofar as presentation and disclosure requirements are concerned.

Alternative treatment:

IFRS allow alternative treatments a number of cases. The implications of adopting IFRS as they are would be that it would lead to presentation of incomparable financial information by various enterprises. The following examples illustrate this aspect:

IAS 23 – Borrowing Costs:

IAS 23 on borrowing costs prescribes expensing of borrowing costs as the benchmark treatment; however, it also allows capitalization of borrowing costs as an allowed alternative. If this standard is followed (and it is), some enterprises then charge borrowing costs to the profit and loss account, while others capitalize these costs as part of the cost of the assets acquired/constructed using the borrowings. In India, however, the corresponding accounting standard No. 16 does not allow any alternative and borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized. However, the IASB has issued an exposure draft of proposed amendments to IAS 23 in May 2006, in which it has decided to eliminate the option of immediate recognition of the borrowings costs as an expense and allow only capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of the assets. Thus, once this exposure draft is finalized, no difference would remain between accounting standard No. 16 and IAS 23.

IAS 19 – Employee Benefits:

IAS 19 allows the following options with regard to the treatment of actuarial gains and losses:

Immediate recognition in the profit and loss account in the year in which such gains and losses occur;

Adjustment against the retained earnings, whereby the current year's profit and loss account is not affected at all; or

Recognition of a part of the actuarial gains and losses in the profit and loss account which exceeds the specified percentage (known as the "corridor approach").

The corresponding Indian accounting standard No. 15 on employee benefits requires only the first alternative, however: i.e. immediate recognition in the profit and loss account.

The above are only some of the examples that could be presented. To facilitate comparability, it is imperative that there should be no options in the accounting standards, otherwise the investors and other users of financial statements cannot take decisions based on comparable information. Indian accounting standards do not ordinarily permit any option, but prescribe one of the most appropriate options permitted by the corresponding IAS/IFRS. The IASB recently issued the "Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters", which states that removing optional treatments does not mean any non-compliance with IFRS.

Economic environment:

The economic environment and trade customs and practices prevailing in India may not, in a few cases, be conducive for adoption of an approach prescribed in an IFRS. For example, in a country whose markets do not have adequate depth and breadth for reliable determination of fair values, it may not be advisable to follow a fair value-based approach prescribed in certain IFRS. Certain IAS/IFRS assume an economic environment with mature markets. For example, IAS 41 on agriculture is based on the fair value approach presuming that fair values are available for various biological assets such as plants, crops and living animals. The standard is relevant only if the fair values are reliable; this may not be true in India as, in some instances, market data may not be reliable in view of markets not being mature enough. Conceptually, ICAI is in agreement with the fair value approach followed in various IFRS. However, there is always the risk of misuse of this approach as was reportedly the case in Enron. ICAI has so far been cautious in adopting the fair value approach in its accounting standards, although certain accounting standards recognize this approach, (for example, accounting standard No. 28 on impairment of assets), and ICAI has decided to follow this approach in its proposed accounting standard on financial instruments (recognition and measurement) corresponding to IAS 39.

Level of preparedness:

In a few cases, the adoption of IFRS may cause hardship to the industry. To avoid the hardship, some companies have gone to the court to challenge the standard, for example:

When ICAI issued accounting standard No. 19 on leases, which is based on the corresponding IAS, leasing companies are of the view that it may cause hardship to them. To avoid this, the Association of Leasing Companies approached the courts to receive context to the standard.

When ICAI issued accounting standard No. 22 on accounting for taxes on income to introduce the international concept of deferred taxes in India for the first time, a number of companies challenged the standard in court, as they were concerned about the effect it may have on their bottom lines.

In view of the above, to avoid hardship in some genuine cases, ICAI has deviated from corresponding IFRS for a limited period until such time as preparedness is achieved. In addition to the above-mentioned technical differences, there are a few conceptual differences between Indian accounting standards and IFRS. For example, IAS 37 deals with constructive obligation in the context of creation of a provision. The effect of recognizing provision on the basis of constructive obligation is that, in some cases, provision will need to be recognized at an early stage. For instance, in case of a restructuring, a constructive obligation arises when an enterprise has a detailed formal plan for the restructuring and the enterprise has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. It is felt that merely on the basis of a detailed formal plan and announcement thereof, it would not be appropriate to recognize a provision, since a liability cannot be considered to be crystallized at this stage. Furthermore, the judgment whether the management has raised valid expectations in those affected may be a matter for considerable argument. Accordingly, the corresponding Indian accounting standard, accounting standard No. 29, does not specifically deal with constructive obligation. Accounting standard No. 29 does, however, require a provision to be created in respect of obligations arising from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. In such cases, general criteria for recognition of provision must be applied. The treatment prescribed in accounting standard No. 29 is also in consonance with the legal requirements in India.

Frequency, volume and complexity of changes to the international financial reporting standards:

It has clearly been a very challenging time for preparers, auditors and users of financial statements, following the publication of new and revised IFRS. The following changes evidence the frequency, volume and complexity of the changes to the international standards:

The IASB Improvements Project resulted in 13 standards being amended, as well as consequential amendments to many others. In India, a project to examine of IAS revisions, pursuant to the IASB improvement project, has been launched to determine whether corresponding Indian accounting standards need revision.

Repeated changes of the same standards, including changes reversing the previous stances of the IASB, and changes for the purpose of international convergence.

Complex changes on accounting standards, such as those on financial instruments, impairment of assets and employee benefits, require upgrading of skills of those professionals who implement them, in order to keep up with the changes.

Challenges for small and medium-sized enterprises and accounting firms

In emerging economies like India, a significant part of the economic activities is carried on by small and medium-sized enterprises (SMEs). SMEs face problems in implementing the accounting standards because:

Resources and expertise within the SMEs are scarce; and

Cost of compliance is not commensurate with the expected benefits.

To address the issue of applicability of accounting standards to SMEs, ICAI has provided certain exemptions/relaxations for such companies. For the purpose of applicability of accounting standards, enterprises are classified into three categories: level I, level II and level III. Level I enterprises are large and publicly accountable entities. Level II enterprises are medium-sized enterprises and level III are small enterprises. Level II and level III enterprises are considered as SMEs**.** Level I enterprises are required to comply fully with all the accounting standards issued by ICAI. The relaxations/exemptions are provided for level II and level III enterprises from accounting standards. Level II and level III enterprises are fully exempted from certain accounting standards which primarily lay down disclosure requirements, such as accounting standard No. 3 on cash flow statements, accounting standard No. 17 on segment reporting, accounting standard No. 18 on related party disclosures and accounting standard No. 24 on discontinuing operations. In respect of certain other accounting standards, which also lay down disclosure requirements, level II and level III enterprises are exempted from some of its disclosure requirements, such as accounting standard No. 19 on leases, accounting standard No.20 on earnings per share and accounting standard No. 29 on provisions, contingent liabilities and contingent assets. Generally, ICAI does not favour exemptions to be given in respect of recognition and measurement requirements. However, considering rigorous measurement requirements in accounting standard No. 15 (revised 2005) on employee benefits and accounting standard No. 28 on impairment of assets, simplified measurement approaches have been allowed to the SMEs.

While the movement towards common accounting standards is gaining strength across the world, equally strong is the concern at the need for ensuring sound and responsible corporate governance. Failures of businesses in which deficiencies of financial reporting and corporate disclosure have figured prominently are not new phenomena. The collapse of Business Empires and the related auditor issues are seen by many as the event that initiated the changed perception of the reliability of financial reporting. It might be better to consider such failures as the event that confirmed a trend and, by its sheer size, awoke many issues that had been significant for some time. Failures of large global corporations gave the issues greater visibility. Almost all the high profile failures are the result of the combined effect of failures in business, failures in governance and failures in reporting. The business issue that should be communicated to the users of financial statements is not properly disclosed, governance structures fail to prevent or detect this, and a reporting failure results. As an entity moves closer to business failure, the incentive to distort reporting increases and, therefore, the chance of reporting failure increases.

Corporate entities, today, are of an unprecedented size with operations spanning the entire globe. They are raising and utilizing resources at levels that could affect the common future of all mankind in the days to come. Therefore today, the concern is towards the triple bottom line- people, profits and environment. Therefore, while promoting confidence in corporate reporting is vital to the healthy functioning of business entities and capital markets and makes a significant contribution to the overall economic growth, and, while strong connections exist between corporate governance, corporate financial reporting and auditing, this synergy needs to be further developed so that it can build faith in the actions of the business entities and also protect our common future. The responsibilities of the Company Boards to ensure credible governance have increased in view of the expansion of the definition of ownership from the shareholders to the stakeholders. Stakeholders beyond the shareholders including workers communities etc. are becoming increasingly vocal about the issues related to the responsible business governance. The added responsibilities for the Board arise from the issues of sustainability and sustainable development which is engaging various stakeholders including governments during the last few years. A regulatory regime in which high standards of corporate reporting and governance are intelligently and diligently applied, would underpin the healthy functioning of markets to the benefit of business, investors and other stakeholders alike.

One of the basic features of IFRS is that they are *principle-based* and not rule-based. IFRS involve extensive use of judgement in selection of appropriate accounting policies and alternative treatments, including at the time of adoption. Also, IFRS require fair valuations and future forecasts, which will involve use of estimates, assumptions and management's judgements. It has been observed that the combination of all these factors can have a significant impact on the reported earnings and financial position of an enterprise. The audit committees and board members will have to handle this challenge in an effective manner and specifically focus on how well companies are geared for the transition to IFRS.

Another challenge is in the field of accounting for derivatives. The Institute of Chartered Accountants of India, in co-ordination with the Reserve Bank of India, has been working on devising standards on this. ICAI has already issued accounting standards dealing with accounting of derivatives but these are yet to be notified by the Government of India. Leaders of the G-20 had called upon accounting standard setters to take action to reduce the complexity of accounting standards for financial instruments by end of 2009. The IASB had planned to address the G-20 Leaders call through development of three new standards, based on exposure drafts issued in 2009. The IASB had, in November 2009, issued a new IFRS on the classification and measurement of financial assets. Publication of the IFRS represented completion of the first part of a three-part project to replace IAS 39 Financial Instruments: Recognition and Measurement with a new standard – IFRS 9 Financial Instruments. It is expected that once the IASB finalizes its position, the relevant accounting standards would also be notified in India in accordance with the schedule of convergence with IFRS. But, all this may pose further challenges for the regulatory bodies and others in terms of risk assessment and mitigation strategies of the enterprises.

Following the widespread international adoption of IFRS, it has been observed that various stakeholders, including regulators, preparers & users of financial statements and auditors continue to encounter practical implementation challenges. These challenges typically relate to issues of institutional development, enforcement and the capacity for technical implementation. Apart from financial reporting issues, convergence to IFRS in India will have implications in terms of taxation, compliance and enforcement, level of preparedness of the Indian industry and professionals etc.

The process of transition involves substantial efforts, particularly by preparers of financial statements and their auditors. A key message to the preparers of accounts is that it is never too early to start the transition process. It is a major change management project for organizations, requiring a broad range of changes to systems, processes and people which must be carefully managed, and they need to learn from the experience of Indian and global companies who have already transitioned to IFRS reporting and how organizations can capitalize on opportunities to improve operational excellence and overcome critical business challenges. A robust project plan from the outset would be a pre-requisite for a smooth transition to IFRS.

6.2.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 amortized. 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.

•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.

6.3.Convergence with IFRS–Stage-wise Approach

As a convergence of the statutory application of the new accounting standards, the financial results of the companies, as reflected in their statutory financial statements, may undergo a change. Normally, such changes arising out of changes in law are treated as neutral for tax purposes. There are significant tax issues, in addition to accounting and other business issues, needing to be resolved especially, in view of the phased approach for transition. CBDT and ICAI have constituted a joint study group to identify and address taxation issues arising out of convergence with IFRS in India.

In view of the phased approach of moving towards IFRS converged accounting standards in India, suitable taxation provisions that allow appropriate treatment for two sets of accounting standards that would increasingly be applied during the transition process are needed to be explored. As per IFRS requirements, there are many items in the profit & loss account which are treated differently and would need tax clarifications in the Indian context. On transition to IFRS,

The ICAI examined whether convergence with IFRS can be achieved stage wise as below:

Table: 2: Convergence with IFRS – Stage-wise Approach

Stage I		**Stage II**			**Stage III**	**Stage IV**
I		II	III		IV	V
IA	IB	IAS 18	IIIA	IIIB	IAS 1	IAS 29
IAS 11	IAS 2	IAS 21	IAS 17	IAS 12	IAS 8	
IAS 23	IAS 7	IAS 26	IAS 19	IAS 24	IAS 10	
	IAS 20	IAS 41	IAS 27	IAS 41	IAS 16	
	IAS 33	IFR S2	IAS 28	IFRS 3	IAS 32	
	IAS 36	IFRS 5	IAS 31	IFRS 6	IAS 34	
	IAS 38		IAS 37	IFRS 8	IAS 39	
					IFRS 1	
					IFRS 4	
					IFRS 7	

Table:3: Summary of stage wise approach

Stage I:	Convergence with IFRS falling in Category I immediately.
Stage II:	Convergence with IFRS classified in Category II and Category III after a certain period of time, say, 2 years after various stakeholders have achieved the level of technical

	preparedness and after conceptual differences are resolved with the IASB.
Stage III:	Convergence with IFRS classified in Category IV only after necessary Amendments are made in the relevant laws and regulations.
Stage IV:	Convergence with IFRS classified in Category V by way of adoption on full convergence.

6.4. Evaluation:

Convergence of accounting standards in all countries, including India, is duly recognized as the future of global accounting standards. In the past, different views of the role of financial reporting made it difficult to encourage convergence of accounting standards, but there now appears to be a growing international consensus that financial reporting should provide high quality financial information that is comparable, consistent and transparent, in order to serve the needs of investors. Convergence is possible in two ways, either by adopting or adapting a standard. As discussed in earlier sections, IAS and IFRS in India are being adapted while the legal and other conditions prevailing in India are borne in mind. The major lessons learned during such adaptation are:

(a) Implementation of certain requirements of IFRS should be a gradual process:

India has learned that adapting IFRS is not just an accounting exercise. It is a transition that requires everyone concerned to learn a new language and new way of working. While formulating accounting standards on the basis of IFRS, one should consider that, in certain cases, it may cause undue hardship to the industry, at least at the beginning. In other words, Indian industry may not be prepared to apply the provisions of the standards immediately and some transitional measures are needed to be introduced for them. For example, in the following cases, India has decided to implement accounting standards prepared on the basis of IFRS gradually:

(i) Accounting standard No. 10 (revised) – Tangible Fixed Assets:

This standard is being revised on the basis of IAS 16. IAS 16 follows the components approach in accounting for property, plant and equipment. Under this approach, each part of a tangible fixed asset with a cost that is significant in relation to its total cost is depreciated separately. Accounting standard No. 10 (revised) also recognizes the components approach, yet does not at present require full adoption of the said approach on the lines of IAS 16. Doing so may require an enterprise to segregate one asset into several parts, which may not be practicable in certain circumstances, at least at the beginning. It is therefore proposed that the components approach may be followed as an option until the industry is ready. ICAI also proposes to discuss the matter with the IASB to explore the possibility of providing guidance on the extent to which an asset can be divided into different components.

(ii) Accounting standard No. 15 – Employee Benefits (revised 2005): In respect of termination benefits, the revised accounting standard No. 15 (2005), considering that industry in India is currently passing through a restructuring phase, specifically contains a transitional provision stating that – where an enterprise incurs expenditure on termination benefits on or before 31 March 2009 – it may choose to follow the accounting policy of deferring such expenditure over its pay-back period. However, expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1 April 2010. IAS 19 does not provide such a transitional provision. These are given in India, in view of the interests of the industry at large.

(iii) Accounting standard No. 22 – Accounting for Taxes on Income:

ICAI issued accounting standard No. 22 in 2001 to introduce the international concept of deferred taxes in India for the first time. A number of companies challenged the standard in the courts, primarily because it affected their bottom line and the retained earnings particularly in the year in which the standard is introduced. It is an important lesson, as it is a new concept which has been met with widespread acceptance as companies are prepared to go to the courts to obtain relief; such standards should be therefore introduced gradually so that their impact may be softened. The legal cases pertaining to accounting standard No. 22 are still pending in the court.

(b) Lessons learned in addressing differences in the accounting treatment prescribed in IFRS and law:

As a standard-setter, ICAI has learned a lesson that where the conceptually superior accounting treatments prescribed in various IFRS are in conflict with the corresponding legal requirements, there are various ways to deal with it, including the following:

(i) Change the accounting requirements as per the law:

This approach has generally been followed in some of the earlier ICAI accounting standards. The disadvantage of this approach is that the correct accounting treatment does not even get recognized in the country. Furthermore, if this approach is followed it becomes difficult to persuade legal authorities to change the law subsequently on the basis of the conceptually superior accounting treatment prescribed in an IFRS. Accordingly, this approach has not normally been followed in recent accounting standards and is followed sparingly when the legal position is so well-entrenched that giving a different accounting treatment in a standard is considered totally unacceptable. Increasingly, the approach proposed in the paragraph (ii) below is currently being adopted. Where the accounting treatment is conceptually superior in an IFRS compared to the treatment prescribed in a law, the standard lays down the approach recommended by the IFRS, while recognizing that the law will prevail until a change is made in the relevant legal requirements. The advantage of this approach is that while the correct accounting treatment is recognized in an accounting standard in the country, it is also recognized that a change in law is imperative. For example, in the recently issued exposure draft of the proposed accounting standard on financial instruments (presentation), while the exposure draft recognizes that certain financial instruments such as preference shares should be classified as equities or liabilities depending upon their substance, it is also recognized that schedule VI to the Companies Act (1956), which lays down the presentation and disclosure requirements for the companies, and accordingly requires that the preference shares to be classified as equity, will have to be followed by the companies until it is amended.

(c) Guidance needs to be provided in various cases for effective implementation of accounting standards

Adequate guidance needs to be provided for effective implementation of accounting standards. In some cases, where accounting standards require management of the enterprises concerned to use judgement in making accounting estimates etc., various issues arise in the actual implementation. To address those issues, ICAI has issued accounting standards interpretations, guidance notes and other explanatory material. For example, accounting standard No. 16 on borrowing costs corresponding to IAS 23, defines the term “qualifying asset” as “an asset that necessarily takes a substantial period of time to get ready for its intended use or sale”.The issue as to what constitutes “substantial period of time” has been addressed by issuance of accounting standard interpretation 1 on substantial period of time. Furthermore, ICAI has also undertaken various projects for providing guidance on accounting matters arising from issuance of a new accounting standard, for example, it has recently undertaken to prepare a guide on estimating future cash flows and discount rates in the context of accounting standard No. 28 on impairment of assets.

(d) Capacity-building required before issuance of some of the newer accounting standards or revision of accounting standards corresponding to IFRS

Nowadays, with the issuance of newer accounting standards or revision of existing ones on the basis of IFRS, various new concepts are being introduced in India for which preparers and auditors need to be adequately trained; by organizing workshops, conducting seminars, etc. It is increasingly recognized that the preparers and auditors should be given training even before final issuance of a new standard, at the exposure draft stage itself, so that when the standard is finally issued, they are ready to effectively implement the standard.

7. Conclusion

Since the IFRS are principle based, it will require exercise of judgment by the company management. In doing so, there will be a need for managements to exercise their judgment in the best interest of the stakeholders. On the other hand, companies also need to be given enough time to understand and assess the impact of the change, proposed to be brought about by the IFRS based accounting standards, and consider it for communication with the stakeholders like the Government agencies, lenders etc. All the regulatory bodies involved in the implementation of the roadmap for convergence with IFRS must also, well in time, establish the necessary legal and regulatory environment that sets the direction for and enables convergence with IFRS in order to meet the set deadlines. Irrespective of various challenges, adoption of IFRS in India has significantly changed the contents of corporate financial statements as a result of:
– More refined measurements of performance and state of affairs, and
– Enhanced disclosures leading to greater transparency.

With the rapid liberalization process experienced in India over the past decade, there is now a huge presence of multinational enterprises in the country. Furthermore, Indian companies are also investing in foreign markets. This has generated an interest in Indian GAAP by all concerned. In this context, the role of Indian accounting standards, which are becoming closer to IFRS, has assumed a great significance from the point of view of global financial reporting. Indian companies using the Indian accounting standards are experiencing fewer difficulties accessing international financial markets, as Indian accounting standards are becoming closer to IFRS. Indian standards are expected to converge even further in the future, especially after the challenges mentioned in study which are to be addressed over the next few years.

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