Project Dissertation Report

on

INDIAN GAAP VS IFRS

Submitted By:

Mehul Mittal

(2K16/MBA/28)

Under the Guidance of:

Dr. Sonal Thukral

Assistant Professor

DELHI SCHOOL OF MANAGEMENT

Delhi Technological University

Bawana Road Delhi 110042

DECLARATION

I, **Mehul Mittal**, student of MBA **2016-2018** at Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-110042 declares that the dissertation on **"INDIAN GAAP vs IFRS"** have been submitted in partial fulfillment of Degree of Masters of Business Administration is the original work conducted by me.

The information and data given in the report is authentic to best of my knowledge.

This dissertation is not being submitted to any other university for award other Degree, Diploma and Fellowship.

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CERTIFICATE FROM THE INSTITUTE

This is to certify that the “**INDIAN GAAP vs IFRS**”, is a bonafide work carried out by **Mr. Mehul Mittal** of **MBA 2016-2018** and submitted to Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-110042 in partial fulfillment of the requirement for the award of the Degree of the Masters of Business Administration.
The matter embodied in this report is original and has not been submitted for the award of any degree.

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Mehul Mittal

(2K16/MBA/28)

EXECUTIVE SUMMARY

Tata Motors is performing better or Toyota International!!!

Chevron is performing better or Reliance!!!

To answer these, we first need a single platform which is being provided by IFRS. With the business being global and an easy access to international capital market, there is need for single global reporting financial language to enhance the confidence of stakeholders, facilitate international acquisitions and to maintain quality of MIS across global industries. The International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) are recognized as Global Reporting Standards.

Presently, Institute of Chartered Accountants of India (ICAI) formulates Accounting Standards (ASs) based on the IFRSs keeping in view the local conditions including legal and economic environment, which have been notified by the Central Government under the Companies Act, 2013. Accordingly, the ASs departs from the corresponding IFRSs to maintain consistency with legal, regulatory and economic environment, and keeping in view the level of preparedness of the industry and the accounting professionals. In some cases, departures are made because of conceptual differences with the treatments prescribed in the IFRSs.

Valuation of financial statements of Infosys bring out that there is a huge gap of results between Indian GAAP and IFRS because of Fair Value approach mainly as this approach takes into account present market conditions which provide result that is more accurate, transparent and realistic.

Table of Contents

CHAPTER-1

INTRODUCTION

Last decade has observed various changes of doing business across the world. The process of financial reporting of business activities also underwent a great change. This started in 2005 when European Union made it mandatory for publicly traded companies to present consolidated financial statements in conformity with International Financial Reporting Standards (IFRS) starting from January 01, 2005. Earlier, since the late 1990s, companies in some European and Asian countries were allowed to use International Accounting Standards (IAS) as a substitute for their respective domestic Accounting Standards. But IFRSs were adopted legally first time in 2005 by European Union. Other countries with developed capital markets have adopted or in the process of adopting IFRS for reporting purposes. Many countries are replacing their national standards with IFRSs while some other countries have adopted this approach of first reviewing the IFRSs, ensure their suitability with their economic, political and social conditions and then adopt these IFRSs verbatim or with minor changes.

India, in 2007 announced that it would fully adopt IFRS by 2011 which is to be done in phases. First phase will include the companies which are part of Nifty 50 Index, Sensex 30, the companies which have shares or other securities listed on stock exchange outside India and the companies (whether listed or not) which have a net worth in excess of Rs.10 Billion. The companies covered in this phase will prepare an Opening Balance Sheet in accordance with IFRS converged standards as of April 01, 2011 and follow the IFRS converged standards from this date. The second phase will cover the Firms (listed or not) with a net worth in excess of Rs.5 Billion but less than Rs.10 Billion. These firms prepare an opening Balance Sheet in accordance with IFRS converged standards as of April 01, 2013 and follow IFRS converged standards from this date. Rest of the firms follow the process from April 01, 2014 when these prepare their opening Balance Sheet as on that date .

Researchers have given various opinions on the utility of adoption of IFRSs across the globe as a single set of Reporting Standards. Existing literature supports this view of researchers that adoption of IFRS as single set of reporting standards improves the quality of financial information and also ensures timely loss recognition. Summarily, adopting single set of Financial Reporting Standards bring many benefits to reporting entities, Investors, Bankers and other interested parties as in this period of international boundaries getting eliminated, they will not have to refer to Reporting Statements prepared on the basis of different Reporting standards .

The study is primarily qualitative in nature and do not use any quantitative tool to analyze the data. It has been conducted mainly on the basis of literature survey and secondary Information .

1.1 Objective of the Study

The objectives of a study are the ultimate goal which a researcher aspires to achieve. The real worth of any research depends on the objectives laid down for the same. In fact, the objectives of the research are the goal which a researcher aspires to achieve. To carry out this study in scientific manner the researcher has considered the following objectives-

a) To understand the work done by institutional standard setters viz. the Accounting Standards Board (ASB) of India, the Financial Accounting Standards Board (FASB) of US and the International Accounting Standards Board (lASB).
b) To make a comparative assessment of due process (standard setting process) of the ASB, the FASB and the lASB.
c) To study Indian Accounting Standards (AS), AS-1 - Disclosure of Accounting policies, AS-3 - Cash Flow Statements, AS-20 - Earnings Per Share and AS-25 - Interim Financial Reporting in detail and to compare and contrast financial reporting practices under corresponding US-GAAP and IFRS.
d) To measure the disclosure compliance under I-GAAP per standard, per year over the period of the study i.e. from 2001-02 to 2006-07, and comparing the trend (performance) over the period of the study.

e) To measure the disclosure compliance under US-GAAP and IFRS per standard, per year; over the period of the study i.e. from 2001-02 to 2006-07, and to compare the disclosure compliance under I-GAAP, US-GAAP and IFRS per selected standard.
f) To measure the disclosure compliance for voluntary prescriptions under I-GAAP, US-GAAP and IFRS per selected standard, over the period of the study i.e. from 2001-02 to 2006-07, and to compare the disclosure compliance for voluntary prescriptions under I-GAAP, US-GAAP and IFRS per selected standard.
g) To suggest measures to improve the effectiveness of Indian accounting standards.
h) To suggest ways (measures) for harmonization / convergence of Indian accounting standards with IFRS.

1.2 Rationale of the Study

The Council of the Institute of Chartered Accountants of India, has decided to fully converge with International Financial Reporting Standards (IFRSs) issued by the International accounting Standards Board from the accounting periods commencing on or after 1st April, 2011.With a view to ensure smooth transition to the IFRSs from April 1, 2011, the Institute of Chartered Accountants of India will take up the matter of convergence with IFRSs with the National Advisory Committee on Accounting Standards (NACAS) established by the Ministry of Corporate Affairs, Government of India, and various regulators such as the Reserve Bank of India, the Insurance Regulatory and Development Authority and the Securities and Exchange Board of India .

There is also a Framework for the Preparation and Presentation of Financial Statements which describes of the principles underlying IFRS. A framework is nothing but the foundation of accounting standards. The framework states that the objectives of financial statements are to provide information about the financial position, performance and changes in the financial position of an entity that is useful to a wide range of users in making economic decisions, and to provide the current financial status of the entity to its shareholders and public in general .

Some researches in USA & UK concluded in their research that due to changes in principles under IFRS there is an impact on profitability of companies and earnings available for equity shareholders and other benefits to all other beneficiaries.

In the light of above discussion, the researcher has undertaken the study entitled, "Convergence of Accounting Standards with International Financial Reporting Standards in India: Impact on Profitability of selected companies."

1.3 Globalization and Financial Reporting in India

In recent past, India has seen a sea change in its way of financial reporting. The process of changes started in the late 1980s with the initiation of economic reforms and globalization process in India. Since independence in 1947 to mid-1980s, Indian industries were in complete control of the state. Price and quantity restrictions were in place and any entrepreneur interested in starting a new business venture (or, expansion of its existing capacity) had to take multiple permissions from various government departments. Rent seeking activity and excess capacity used to be the normal feature of the then Indian industries.

Foreign Investment was negligible and funding for business was coming mainly in the form of loan from public sector commercial banks and financial institutions (e.g., IDBI). In the aftermath of liberalization program initiated in 1991, India faced severe Balance of Payments crisis and had to pledge its gold reserve to the Bank of England to overcome the crisis. The then Congress Government took some revolutionary steps with regard to opening up of Indian economy to foreign competition and inviting foreign investments in various industrial sectors. Both the industrial and financial sectors were deregulated and rupee was made convertible on Current Account. Capital Markets were made more accessible for Indian companies.

Corporate houses were allowed to tap the foreign financial markets for their fund requirement. Insurance, banking, telecom, retail, and software, among many others were opened for foreign investments. These developments have encouraged foreign companies to invest in India. These increasing investment trends in India from abroad demand a corporate financial reporting system fully harmonized with the one being used worldwide. The demand is further supported by the Indian companies which were either buying foreign companies or entering into joint ventures with foreign companies. Goldman Sachs (2003) also supported this phenomenon through a study on BRIC (Brazil, Russia, India & China) in which it suggested that these countries will become among the four most dominant economies by the year 2050.Currently, Indian Companies are reporting their financial statements based on Indian Accounting Standards prepared by Institute of Chartered Accountants of India (ICAI).

ACCOUNTING STANDARD

Accounting standard are the policy document relating to various aspects of measurement, treatment, presentation and disclosure of accounting transactions and events.

There are many different accounting standards in use in the world, ranging from full-accrual based accounting standards to cash- and tax-basis accounting standards. Each is known as Generally Accepted Accountancy Principles, or GAAP. Some significant GAAPs are as follows:

- IFRS - International Financial Reporting Standards - used for European Union listed entities, many other EU entities, Australian companies and others.
- US GAAP - used by US companies.
- UK GAAP - used by UK and Irish companies that has not adopted IFRS.
- Canada GAAP - used by Canadian companies.
- Indian GAAP - used by Indian companies.

In commercial and non-profit accounting in the United State of America, the standard setter is the Financial Accounting Standards Board. For governmental accounting, GAAP is determined by the Governmental Accounting Standards Board. Both of these entities are sections of the Financial Accounting Foundation.

The use of GAAP for publicly held business entities in the United States is mandated by the Securities and Exchange Commission, a federal agency. Other business entities may find that other accounting standards may meet the needs of the users and therefore not adopt GAAP due to the extra costs required. Accounting Standards in

India are developed by Accounting Standards Board and these are issued by The Institute of Chartered Accountants of India.

ACCOUNTING PROCESS FOLLOWED IN INDIA

The Institute of Chartered Accountants of India (ICAI) being a member body of the IASC, constituted the Accounting Standards Board (ASB) on 21st April, 1977, with a view to harmonies the diverse accounting policies and practices in use in India. After the avowed adoption of liberalization and globalization as the corner stones of Indian economic policies in Early '90s, and the growing concern about the need of effective corporate governance of late, the Accounting Standards have increasingly assumed importance.

While formulating accounting standards, the ASB takes into consideration the applicable laws, customs, usages and business environment prevailing in the country. The ASB also gives due consideration to International Financial Reporting Standards (IFRSs)/ International Accounting Standards (IASs) issued by IASB and tries to integrate them, to the extent possible, in the light of conditions and practices prevailing in India.

Corresponding to the IASs/IFRSs, so far, 30 Indian Accounting Standards on the following subjects have been issued:

AS 1 Disclosure of Accounting Policies
AS 2 Valuation of Inventories
AS 3 Cash Flow Statements
AS 4 Contingencies and Events Occurring after the Balance Sheet Date
AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
AS 6 Depreciation Accounting
AS 7 Construction Contracts

AS 8 Accounting for Research and Development (Withdrawn pursuant to AS 26 becoming mandatory)
AS 9 Revenue Recognition
AS 10 Accounting for Fixed Assets
AS 11 The Effects of Changes in Foreign Exchange Rates
AS 12 Accounting for Government Grants
AS 13 Accounting for Investments
AS 14 Accounting for Amalgamations
AS 15 Employee Benefits
AS 16 Borrowing Costs
AS 17 Segment Reporting
AS 18 Related Party Disclosures
AS 19 Leases
AS 20 Earnings Per Share
AS 21 Consolidated Financial Statements
AS 22 Accounting for Taxes on Income
AS 23 Accounting for Investments in Associates in Consolidated Financial Statements
AS 24 Discontinuing Operations
AS 25 Interim Financial Reporting
AS 26 Intangible Assets
AS 27 Financial Reporting of Interests in Joint Ventures
AS 28 Impairment of Assets
AS 29 Provisions, Contingent Liabilities and Contingent Assets

AS 30	Financial Instruments: Recognition and Measurement
AS 31	Financial Instruments: Presentation

IFRS

- IFRS are issued by International Accounting Standard Board (IASB).
- The International Accounting Standard Board (IASB) based in London.
- The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements.
- IFRSs are developed through a formal system of due process and broad international consultation.

Structure of IFRS

IFRSs are considered "principles based" set of standards in that they establish broad rules as well as dictating specific treatments. International Financial Reporting Standards comprise:

- International Financial Reporting Standards (IFRS) - standards issued after 2001.
- International Accounting Standards (IAS) - standards issued before 2001.
- Interpretations originated from the International Financial Reporting Interpretations Committee (IFRIC) - issued after 2001.
- Standing Interpretations Committee (SIC) - issued before 2001.

WORLDWIDE ADOPTION OF IFRS

In the last few years, the international accounting standard-setting process has been able to claim a number of successes in achieving greater recognition and use of IFRS. A major breakthrough came in 2002 when the European Union (EU) adopted legislation that requires listed companies in Europe to apply IFRS in their consolidated financial statements. The legislation came into effect in 2005 and applies to more than 8,000 companies in 30 countries, including countries such as France, Germany, Italy, Spain, and the United Kingdom. The adoption of IFRS in Europe means that IFRS has replaced national accounting standards and requirements as the basis for preparing and presenting group financial statements for listed companies in Europe. Outside Europe, many other countries also have been moving to IFRS.

By 2005, IFRS had become mandatory in many countries in Africa, Asia, and Latin America. In addition, countries such as Australia, Hong Kong, New Zealand, Philippines, and Singapore had adopted national accounting standards that mirror IFRS. According to one estimate, about 80 countries required their listed companies to apply IFRS in preparing and presenting financial statements in 2008. Many other countries permit companies to apply IFRS.

The adoption of standards that require high-quality, transparent, and comparable information is welcomed by investors, creditors, financial analysts, and other users of financial statements. Without common standards, it is difficult to compare financial information prepared by entities located in different parts of the world. In an increasingly global economy, the use of a single set of high-quality accounting standards facilitates investment and other economic decisions across borders, increases market efficiency, and reduces the cost of raising capital. IFRS are increasingly becoming the set of globally accepted accounting standards that meet the needs of the world’s increasingly integrated global capital markets.

CHAPTER 2

REVIEW OF LITERATURE

A Review of Literature is an evaluative report of information found in the literature related to your selected area of study. The review should describe summaries evaluate and clarify this literature. It should give a theoretical base for the research and help determine the nature of your research. Use or purpose of the review of literature:

- To identify gaps in the literature.
- To avoid reinvesting the wheel (at the very least this will save time and it can stop you from making the same mistakes as others).
- To carry on from where others have already reached (review the field allow you to build on the platform of existing knowledge and ideas).
- To identified other people working in the same field (a researcher network is a valuable resource).
- To increase your breath of knowledge of your subject area.
- To identify seminal works in your area.
- To provide the intellectual context for your own works, enabling you to position your project relative to other work.
- To identify opposing view.
- To put your work in to perspective.
- To identify information and ideas that may relevant to your project.
- To identify methods that could be relevant to your project.

Extensive review of literature has been gone through the for the research purpose to ensure better understanding of the concept and avoiding application as previous work in concerned area the of convergence with or adoption of the IFRS.

Classification of Review of related literature

The review of related literature is based upon key aspects of the research related to Financial Reporting Practices as per Indian GAAP, IFRS and forthcoming IND AS

Convergence as per Indian Prospective. Thus, the review of literature is classified as under:

1. **INDIAN GAAP**
2. **INTERNATIONAL FINANCIAL REPORTING STANDARDS**
3. **INDIAN ACCOUNTING STANDARDS (IFRS CONVERGED)**

2.1 Indian GAAP

According to Ahuja,2006 wrote in paper that "Preparation and presentation of financial statements based on accounting standards usually known as Indian GAAP has emerged as an effective way of harmonizing different accounting practices followed in India. Besides other benefits, financial statements prepared on the basis on these standards are considered to show a true and fair value of financial results of the enterprises.

As per section 132(1) of The Companies Act, 2013 The Central Government may, by notification, constitute a National Financial Reporting Authority to provide for matters relating to accounting and auditing standards under this Act.

As per section 132(2) of The Companies Act, 2013 Notwithstanding anything contained in any other law for the time being in force, the National Financial Reporting Authority shall:

a) Make recommendations to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be ;

b) Monitor and enforce the compliance with accounting standards and auditing standards in such manner as may be prescribed ;

c) Oversee the quality of service of the professions associated with ensuring compliance with such standards, and suggest measures required for improvement in quality of service and such other related matters as may be prescribed; and

d) Perform such other functions relating to clauses (a), (b) and (c) as may be prescribed.

As per section 133 of The Companies Act, 2013 The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

(ICAI, 2015) In the book of CA Final, Financial Reporting, it is given that "Accounting Standards (ASs) are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, measurement, treatment, presentation and disclosure of accounting transactions in the financial statements. Accounting standards attempt to elaborate the accounting principles, the valuation techniques and methods of executing the accounting principles in the preparation financial statements so that they may give a true and fair view. By applying the accounting standards the accountant has the following benefits:

1. Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
2. There are certain areas where important information is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
3. The application of accounting standards would, to a limited extent, facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards adopted in different countries.

However, there are few limitations of executing of accounting standards:

o Alternative solutions to certain accounting problems may each have arguments to recommend them. Therefore, the choice between different alternative accounting treatments may become difficult.

o There may be a trend towards rigidity and away from flexibility in applying the accounting standards.

o Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

2.2 International Financial Reporting Standards

(IASB, 2010) mentioned in the Conceptual Framework that “The objective of general purpose financial reporting forms the foundation of the Conceptual Framework”. Other aspects of the Conceptual Framework – a reporting entity concept, the qualitative characteristics of, and the constraint on, useful financial information, elements of financial statements, recognition, measurement, presentation and disclosure—flow logically from the objective.

(IASB, 2010) given qualitative characteristics of financial information that The Financial Information must be having qualitative characteristics like Relevance, Materiality, Faithful Representation, Comparability, Verifiability, Timeliness, and Understandability.

International Financial Reporting Standards comprise:

- “International Financial Reporting Standards (IFRS) – Standards issued after 2001.
- International Accounting Standards (IAS) – Standards issued before 2001.
- Interpretations originated from the International Financial Reporting
- Interpretations Committee (IFRIC) – Issued after 2001.
- Standing Interpretations Committee (SIC) – issued before 2001.
- Framework for the Preparation and Presentation of Financial Statements (1989).”

“International Financial Reporting Standards are set by the International Accounting Standards Board (IASB). The mission of IASB is to develop, in the public interest, a single set of high quality, understandable and International Financial Reporting Standards (IFRS) for general purpose financial statements. IASB is an independent standard-setting board, appointed and overseen by a geographically and professionally diverse group of Trustees of the IASC Foundation who are accountable to the public interest. It is supported by an external advisory council (SAC) and an interpretations committee (IFRIC) to offer guidance wherever divergence in practice occurs. The IASB cooperates with national accounting standard setters to achieve convergence in accounting standards around the world."

(Parmanand Barodiya, 2015) Concluded in their article that "International Financial Reporting Standard focuses on quality, reliability & relevancy aspects of the information to all its users all over the globe while setting a new standard. Harmonization of Accounting Standard is a need to create & develop global economy. Harmonization wills result into true & fair presentation of financial statement that can be easily accessible to all the potential users including potential investors. IFRS provided detailed guideline for presentation of financial statement & it gives more insights about the financial information of the entity so that investor can compare it with other entity to find out best investment option. For MNC s adoption of IFRS will result into reduction in the cost of preparation of financial statement & also overcome the difficulty of consolidation of financial statements working in different country".

2.3 Indian Accounting Standards

(Adukia, 2013) gave in his article that "Converged IFRS or Indian Accounting Standards (Ind AS) are the near final Indian Accounting Standards issued by Institute of Chartered Accountants of India and notified by the Government of India. While the draft of 36 standards issued by ICAI, are converged with IFRS, only 35 standards have been notified. The date of implementation of the Ind AS will be notified by the Ministry of Corporate Affairs at a later date. Ind AS standards are still not notified under Companies Accounting Standard Rules, 2006 therefore the hitherto accounting standards are still applicable. These standards do not resemble IFRS. Both by presentation and measurement principles they are new set of accounting standards developed in the line of IFRS”.

(Agarwal, 2013) revealed in his article that “The term IFRS refers to International Financial Reporting Standards issued by International Accounting Standards Board (IASB). There are many jurisdictions which have adopted IFRS with very few modifications and thus described accordingly e.g. IFRS has adopted by EU, IFRS as adopted by Australia. However, in international parlance, the term IFRS refers to pronouncements issued by International Accounting Standards Board (“IASB”). Until Ind-AS is mandatory, the present framework of Accounting Standards, Interpretations, Guidance notes and various Industry practices are collectively referred as Indian GAAP”.

2.4 Conclusive Remarks

In regard to the impact of IFRS adoption on the quality of financial reports, some studies reported positive outcomes through improvements in the value relevance of accounting reports post-IFRS adoption, and reductions in the number of firms engaging in earnings management. Available research evidence has further supported the adoption of the IFRS goodwill impairment regime as improving accounting quality. Other studies, however, suggested that measures of accounting quality have remained stable or consistent with AGAAP and that prior AGAAP treatments for identifiable intangible assets were more appropriate.

- Some studies reported positive results in terms of the promotion of the comparability of Australian financial reporting practices with their global peers. Not all studies, however, reported the same results.
- In general, IFRS adoption by Australian companies appears to have had a positive outcome for investors and analysts based on research revealing improved analyst forecast accuracy and dispersion.
- Survey research around the time of IFRS adoption revealed a degree of pessimism by managers from listed Australian companies towards many of the possible benefits from accounting convergence.

From the above review of existing literature, it can be concluded that much study has been done all across the world so far as the IFRS adoption or convergence is concerned in the countries like Russia, U.S., European Union, China, Australia, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Thailand, Vietnam, Fiji, Brazil, Argentina, Mexico, ASEAN Countries, G-20 Countries, French Economy, Italian Economy etc. Countries are having different issues and experiences whether it's a pre - IFRS scenario or post - IFRS scenario depending on their economical diversities, business environment, cultures, traditions, legal environment etc. After studying the experiences of all these developed or developing economies, there is a need to address positioning of Indian Economy and issues regarding convergence in this pre – convergence period.

Therefore, the researcher has selected this study of issues related to converging Indian Accounting Standards into International Financial Reporting Standards. Not only issues regarding convergence but there is a need to study domestic and international accounting standards for getting better idea and clarity to address some conceptual differences and issues which will be probably there when the Indian Economy will be actually driven towards this make over process. Much many things to come and to experience for India as Indian Economy is fastest growing and switching economy in the world market.

"Problems cannot be solved at the same level of awareness that created them."
- **Albert Einstein**

CHAPTER 3

RESEARCH METHODOLOGY

3.1. Introduction

Modern enterprises operate in multilingual accounting world Not only the reporting languages but also the reporting requirements differ per country, contents of the financial reports are different, terms used m financial statements are different and the underlying principles used in the preparation of the financial reports are different all over the world. This results in producing totally no comparable financial figures under each set of accounting assumptions Indian companies report different amounts of profits for the same year under different accounting regimes, UK or British companies also report large variations in shareholders' equity for the same years under domestic GAAP and USGAAP French insurer AXA reported Net profit of 949 million euros under French GAAP and Net loss of 2,588 million Euros under US-GAAP for the year 2002

One thing proved from these illustrations is that there are major differences in financial reporting around the world, resulting into different figures of profits or shareholders' equity for the same years but under different accounting regimes. All companies registered in India follow accounting standards issued by the Institute of Chartered Accountants of India (ICAI) while preparing financial statements Companies registered at US stock exchanges prepare their financial statements using US Generally Accepted Accounting Principles (GAAP) and those registered at London stock exchange (LSE) are using International Financial Reporting Standards (IFRS) from the year 2006. An Indian company registered at New York and London stock exchanges will have to prepay its financial statements using Indian accounting standards US-GAAP and IFRS.

This variety leads to great complications for those preparing, consolidating, auditing and interpreting published Financial Statements lASB's Leisenrmg acknowledges that, "It is investors who pay the greatest price, trying to compare investment alternatives while using financial information that is not comparable. " To combat this, an attempt has been made in this study to understand these differences. The number and magnitude of the differences make clear the scope for utility of this study.

A global comparative study should involve comparison of all domestic GAAP, USGAAP and IFRS. This is also required for another reason and that reason is, now companies have choices about where they do their transactions, list their shares and keep their staff. There is talk of "regulatory arbitrage" meaning that companies look for the most favorable environments to operate in. According to Choi and Meek (2007, p. 23), advances in information technology are causing a radical change in the economics of production and distribution. Typically, a global company would have Its manufacturing plant in China, its IT services will be outsourced to India, finances will be managed from London and sales will be to the whole world.

However, this study is planned keeping Indian situation at the center Ken Livingston, Mayor of London, calls India as the greatest sources of world growth and capital ' The Economist, in its special issue on business in India, dated 3-06-2006 Editorial 'Can India Fly '^' - 'Indian business has secured a niche in the world economy that can only grow in importance. ' The question is no longer whether India can fly, but how high in 2006. India incorporations' 147 cross border acquisitions aggregated to $ 20 billion.' Indian companies are now expanding abroad TATA Motors Ltd bought Land Rover and Jaguar from Ford Motor Company for $ 2 3 billion, Tata Steel Ltd acquired Anglo-Dutch Corns Group Pic Steel Co for $ 12 billion, Bharat Forge, now the world's second largest forging company, used merger and acquisition activities to obtain vital technologies. For these international mergers and acquisitions to succeed it is necessary for Indian managers to understand international financial reporting before taking a decision to buy or sell. They have to offer proper valuations for the assets to successfully sell our financial plans to international client’s. Comparative study of financial reporting is therefore very important in modern Indian Context an attempt has been made in this thesis to compare Indian Accounting Standards AS-1, AS-3, AS-20 and AS-25 with their counterparts of US-GAAP and IFRS I GAAP, IFRS and US-GAAP.

3.2. Statement of the Problem

To reap the benefits of Globalization 3 0, Indian managers must understand international financial reporting practices and must use the rules that are clear to international investors Present study is important in this context.

This comparative study examines financial reporting under this title

Financial Reporting ~ Comparative Study of Indian Accounting Standards U S A -GAAP and International Accounting Standards

CHAPTER 4

COMPARITIVE ANALYSIS

4.1 Convergence of Accounting Standards

The Institute of Chartered Accountants of India (ICAI) and the Government of India have affirmed that the country will converge with International Financial Reporting Standards (IFRS). This would mean that over a very short period of time, Indian GAAP will transition into IFRS and IFRS will be the GAAP of India.

The single implementation date approach would help in achieving consistency and comparability of the financial statements in a planned manner and the companies can also take the advantage of IFRS 1 exemptions at the time of implementation. On the other hand, if the multiple-dates approach is used, the financials would remain inconsistent throughout the implementation period and this would significantly affect the usefulness of the financials.' However, the multiple-dates approach provides some breathing time between implementing numerous standards.

If an Indian company adopts all the new standards and amendments as introduced by the Institute using a single implementation date, the financial statements may still not be fully compliant with IFRS as issued by IASB. In the absence of IFRS, the difference between financial statements prepared under future Indian GAAP and IFRS as issued by IASB would not be bridged for a considerable timeframe as the basis of preparation will be divergent.

India should learn from the challenges and successes of its peers who have already adopted IFRS in their countries. We should adopt IFRS as prescribed by IASB as there are significant benefits of this approach. In South Africa, SA GAAP started converging with IFRS. However, quickly realizing that unless IFRS is fully adopted there would be a gap between SA GAAP and IFRS, steps were taken and IFRS was adopted in for all listed companies If a similar approach is used, it would not be inconsistent with the view expressed by the Institute in its concept paper and all stakeholders need to work jointly to help India transition to IFRS.

4.2 Comparision

4.2.1 COMPARISION OF INDIAN GAAP AND IFRS

- **Historical Costing** – IGAAP and IFRS permits revaluation in contrast to Historical Cost convention. Only securities and derivatives can be valued at Fair Value under IFRS.

- **True & Fair View:** Under IFRS and IGAAP framework, "There is an assumption that adoption of IFRS /IGAAP leads to a true and fair presentation".

- **Comparative Position:** Under IGAAP and IFRS, comparative financial facts and figures are to be provided for one previous year.

- **Over-riding of Standards** – In rare cases, IFRS permits that "A company may withhold application of IFRS if it is felt that application of IFRS would defeat the very objective of financial reporting. The reason has to be disclosed. There is no such provision in IGAAP".

- **Reporting Elements:** IFRS prescribes the minimum structure and content of financial statement including Statement of Changes in equity.

4.2.2 Comparison of Balance Sheet

"Balance sheet is a statement of assets and liabilities".

- The IGAAP provides two format of Balance Sheet- Horizontal and Vertical format. Vertical format requires details of each item in separate schedule, read with notes. IFRS does not prescribe any format.

- IFRS does not prescribe any format, but stipulates minimum line items like PPE, Investment property, Intangible assets, financial assets, Biological assets, inventory, receivables etc. Additional line items, subheadings and subtotals shall be presented on the face of BS if relevant. The order of presentation within the group or otherwise in not mandatory.

- IGAAP does not prescribe any current and non-current classification. The line items are listed in increasing order of liquidity as sources and application of funds.
    - Under IAS, an organization has an option to adopt Current or Non-current classification of assets and liabilities. Deferred Tax Assets not to be shown as Current assets, if Current /noncurrent classification adopted. Some items like Biological assets, Tax Liability, Minority Interest have to be disclosed on the Balance Sheet.
    - Order of line items: IFRS (if Current and non-current order followed) and IGAAP, line items are presented in increasing order of liquidity.
- IFRS permits an enterprise to disclose any long term interest bearing liability due for settlement within 12 months, as long term liability' if the same is likely to be refinanced and can be supported by adequate documentary evidence.
- Consolidation of Financial statements of subsidiaries is not compulsory until it is required under some other law or regulation.

4.2.3 Comparison of Income statement

- Format: Under Indian GAAP no format is prescribed, but minimum line items have been specified in Part II of schedule VI to Companies Act, 1956 including Aggregate Turnover, Gross Service revenue for Commission paid to Sole selling agent, Brokerage and discount on sales, depreciation, consumption of stores and spare parts, power and fuel, rent, repairs, rates and taxes etc.

  IFRS does not prescribe any standard format for income statement but prescribes minimum disclosure includes revenue, finance costs, share of post-tax results of JV and associates using equity method, pretax gain/loss on asset disposal, discontinued operation tax charge, and Net profit or loss etc.

- Indian GAAP requires any item of expenditure which exceeds 1% of total revenue or Rest 5000/- whichever is higher should be shown as a distinct item and should not be clubbed as miscellaneous expenses.

- Indian GAAP requires separate disclosure of exceptional and non-recurring items.

- Under IFRS, the reporting entity has an option to prepare income statement either by nature of expenses or by Function (Cost of sales method).

- Under IFRS, Income is defined as Revenue and gains and expenses are defined to include losses and are decreases in economic activity that result in decrease in equity.

- Change in accounting policy: Under IGAAP effect for change in accounting policy is given with prospective effect, if the same is material. Only in case of change in method of depreciation, the same has to be applied with retrospective effect. Other disclosures required like need for change etc.

  IFRS requires retroactive application for the earliest period practical and adjustment of opening retained earnings. Exemptions given for prospective application, if resulting adjustment are not reasonably determinable.

  Prior period items**:** IGAAP requires separate disclosure of prior period in the current financial statement either as part of current year's results or as an alternative approach after determination of current net profit or loss. No restatements of retained earnings are required. However complete disclosure of prior period and its impact on financial statements should be disclosed.

IFRS requires that a prior period item/error should be corrected by retrospective effect by restatement of opening balance of assets, liabilities or equities for the earliest period practicable. Entity should also disclose nature of error and the amount of correction for each financial line item.

- Discounting: IFRS provides that where the inflow of cash is significantly deferred without interest, discounting is needed, while there is no concept of discounting under IGAAP.

- Others: There are significant differences in the IGAAP on measurement and disclosure of various heads of Income and Expenditure including forex losses, extinguishment of debts, Employee benefits, ESOP, Dividend Tax, Loss on investments etc. leading to reconciliation issues between IGAAP results vis a vis IFRS.

4.3 Key Differences

4.3.1 Acquisitions and consolidated financial statements

Currently, only listed Indian companies and banks are required to prepare consolidated financial statements. All other entities issue only standalone financial statements. Adoption of IFRS would require all defined entities (which include large-sized entities that are not listed on stock exchanges) to prepare and present consolidated financial statements.

Under Indian GAAP, there is no comprehensive standard that addresses accounting for acquisitions where one entity obtains control of another entity. The accounting for such transactions is largely dependent on the form of the acquisition. For example, the accounting treatment may differ dependent on whether the acquired company is retained as a separate legal entity, whether it is legally merged with the acquirer or whether a group of assets constituting a business is acquired.

To add to the complexity and confusion, if the acquired company is merged with the acquirer through a court-approved scheme, the scheme itself may prescribe an accounting treatment that is required to be followed, which may be in variation with the accounting standards. Thus, depending on the form of the arrangement and other factors, goodwill may be computed based on the book value of the assets of the acquired company or the fair value of the assets of the acquired company. Similarly, depending on the form of the arrangement, the resultant goodwill may either be over a period or not, but tested for impairment.

Another key area of difference relates to the date of acquisition from which the results of the acquired company are included in the consolidated financial statements. While conceptually, both Indian GAAP and IFRS prescribe consolidation from the date when control is obtained or the investment is acquired, in certain specific situations (for example, court-approved schemes), the scheme may provide for an acquisition date that precedes the date of investment or the date that control is actually obtained. For most companies, application of the purchase accounting principles discussed above would result in an adjustment to the value of the assets and liabilities recorded recognition of previously unrecorded intangible assets and consequent adjustments to goodwill balances. These adjustments would subsequently affect the post-acquisition consolidated results, generally through increased amortization and depreciation. Additionally, the ability of companies to include, in the consolidated financial statements, the revenues and profits of the acquired companies, prior to the date of the investment or prior to the date that control is obtained, would also be restricted.

4.3.2 Intangible assets acquired

Under Indian GAAP intangible assets are generally recognized only if they are acquired separately. All intangible assets are over their useful lives (and tested for impairment) and there is a rebuttable presumption that the useful life cannot exceed 10 years. Under IFRS, intangible assets are recorded either while accounting for acquisitions using the purchase method, or when intangible assets are acquired separately. IFRS acknowledges that certain intangible assets may have indefinite useful lives (for example, brands that demonstrate certain characteristics) and accordingly, such intangible assets are not, but tested for impairment annually. Additionally, consistent with the treatment of all other depreciable assets, intangible assets are over their estimated useful lives and there is no presumption that restricts the useful life. On adoption of IFRS, Indian companies that may acquire certain long-lived brands and similar intangible assets may reach a conclusion that these intangible assets, which are under Indian GAAP, are no longer required to be amortized or that these assets can be amortized over longer periods of time that represent their economic useful lives.

4.3.3 Presentation of financial statements

Financial statements presentation formats under Indian GAAP are primarily driven by regulatory requirements specified in the Indian Companies Act and other regulation for specific industries (for example, banking and insurance). Under IFRS, IAS 1 sets out detailed requirements for presentation of financial statements, including their structure and minimum requirements for content. Under IFRS, in addition to the balance sheet, income statement and cash flow statement, either a statement of changes in equity (SOCIE) or a statement of recognized income and expenses (SORIE) with supplementary notes is required.

> A SORIE is a subset of SOCIE. An entity includes in SORIE revaluation reserve, unrealized gains or losses on valuation of available-for-sale investments, which are not reported through the income statement, but are directly adjusted to equity. When an entity elects to present a SORIE, the additional information regarding capital transactions with owners (issuance of equity, distribution of dividends), movements in accumulated profit and loss and a reconciliation of all other components of equity is presented in the notes to the financial statements.

No such statements are required under Indian GAAP. However, the movement in capital and reserves and appropriation of profit and loss account is resented in the income statement and the balance sheet. IFRS generally requires the balance sheet to clearly distinguish between current and non-current assets and liabilities. Schedule VI to the Indian Companies Act follows current-non-current distinction only to a limited extent. Under IFRS, expenses can be classified by nature (salary, rent, power and fuel) or by function (cost of revenues, selling expenses, general and administrative). Schedule VI requires classification by nature. Companies would need to carefully evaluate the presentation requirements of IFRS to identify incremental disclosures and changes to presentation requirements.

4.4 Purpose of Convergence

4.4.1 Global Harmonization

In the present era of globalisation and liberalisation, the world has become an economic village. A number of MNCs are establishing their businesses in various countries. The entities are entering in the global markets to fulfil their capital needs.

- The idea of global harmonization of accounting standards stems from lack of comparability of financial statement across the country. In particular, a company having presence in different countries have to prepare financial reports as per generally accepted accounting principle of the country of operation and then it is required to reconcile all such reports for the purpose of consolidation as per GAAP of the country to which the parent belongs. This increase the cost of preparing the financial report and also performance measurement across the geographical region becomes difficult because of non-comparable accounting rules.
- As global diversification of portfolio has become an important issue of fund management with more and more countries accept capital account convertibility or restricted fund flow on capital account a uniform GAAP thought out the world would have helped to increase understandability of financial statement. This would also help in cross border rising of funds. The expanding globalization of business and investment is driving increase interest and as well as pressure, to enhance the quality of financial reporting throughout the world – to compare apples with apples, so to speak- so that effective evaluation between companies can be made.
- The enterprises are getting their securities listed on the stock exchanges outside their country. Capital markets are, thus, becoming integrated. In such a scenario, there is a need for Financial Reporting Standards which are

globally acceptable. IASs/ IFRSs, issued by the IASB are now being recognised as Global Financial Reporting Standards. Keeping this in view, nearly 100 countries currently require or permit the use of, or have a policy of convergence with, IFRSs.

4.5 Benefits of Convergence to IFRS

4.5.1 IFRS significantly improves the comparability of entities

IFRS provides more comparability among sectors, countries and companies. Due to its universal appeal, it can both improve and initiate new relationships with investors, customers and suppliers across the globe, since financial statements in accordance with IFRS cut across borders. IFRS will facilitate better comparability of performance with other businesses and reporting under IFRS may also result in greater transparency about a company's activities to outsiders such as investors, customers and other business partners. As Indian businesses become more global in terms of their operations and investor base, IFRS would enable a comparison of Indian companies with global peers.

4.5.2 IFRS gives access to global capital markets and reduces the cost of capital

IFRS are accepted as a financial reporting framework for companies seeking admission to almost all of the world's bourses. Currently, several companies that seek to raise capital and list securities in the U.S. capital markets or other exchanges such as the London Stock Exchange or the Alternative Investment Market in London may be required to convert their financial statements to IFRS to meet with the regulatory requirements or to meet expectations of the investment bankers and investors. IFRS eliminates barriers to cross-border listings, by ensuring that financial statements are more transparent. Even in cases where listing on overseas exchanges is permitted using local (Indian) GAAP, international investors generally ascribe an additional risk premium if the underlying financial information is not prepared in accordance with international standards. Thus, adoption of global standards such as IFRS may reduce the risk premium and consequently the cost of capital. Similarly, even companies raising capital and listed only on the local exchanges in India would be able to better attract international investors and reduce risk premium, by providing financial information that is more transparent and understandable for the international investor community. Further, IFRS financial information can also result in more accurate risk evaluations by international lenders and lower risk premium for international debt offerings.

4.5.3 IFRS provides impetus to cross-border acquisitions

By providing transparent and comparable financial information, IFRS reporting provides an impetus to cross-border acquisitions, enables partnerships & alliances with foreign entities, and lowers the cost of integration in post-acquisition periods. Currently, if an Indian company acquires a foreign entity, the financial position on the date of acquisition and post-acquisition results of the foreign entity have to be converted from its local GAAP (which may be IFRS) to Indian GAAP. Similarly, if an overseas entity that follows IFRS acquires an Indian company, the post-acquisition financial information would need to be converted from Indian GAAP to IFRS, thereby increasing post-acquisition financial integration efforts and costs.

4.5.4 Improve the quality and consistency of information, avoid multiple reporting and reduce cost of the finance function

Currently, different entities within the group, that reside in different jurisdictions may be required to prepare a dual set of financial statements for external financial reporting; one for local statutory financial reporting in the home country and second for reporting to the parent company (assuming that the parent company follows IFRS). This increases the efforts of the finance function, introduces complexity in financial reporting and increases costs of the finance function. IFRS reporting actively contributes to effective management of the business. When applied throughout a group's accounting processes, IFRS harmonizes internal and external reporting by creating a single accounting language across the business. This puts an end to the problems of interpretation associated with using different accounting standards in each country of operation. The group-wide adoption of IFRS also provides an opportunity to streamline reporting processes and systems, with consequent improvements in the quality of management information and the speed with which it is produced. This also has the potential to deliver cost savings.

4.5.5 Economic growth and opportunities for accounting professionals

Convergence with IFRS and to a globally accepted standard will result in growth in international business, higher cross-border capital flows and transactions and will provide an impetus to economic growth One of the key findings of the survey is that "convergence to a single set of both international accounting and auditing standards is very important to a country's economic growth and development". Additionally, convergence with IFRS would also benefit the large pool of Indian accounting professionals who can develop IFRS skills and provide these skills to a global marketplace.

4.6 IFRS Convergence: Banking System

IFRS: ARE INDIAN BANKS READY?

While regulators, standard setters and law makers sit together to rollout the road map for implementation of International Financial Reporting Standards (IFRS) in India, a wide section of the industry is already debating the impact and the implementation challenges of transitioning into IFRS.

A remarkable and important element of smooth transition into IFRS is the convergence of RBI guidelines with the principles laid down in IFRS. In other words, the successful adoption of IFRS is based on flexibility and acceptability of IFRS by RBI. Banks will have to soon adjust to accounting changes that are enforced by IFRS.

The Following are a few areas of impact:

- Banks may not find much leeway for cheap loans — often pushed by the government for political reasons — once they adopt International Financial Reporting Standards (IFRS) in 2011.
- Accounting procedures specified through IFRS would leave banks with no option but to transparently reflect the impact of such loans on their bottom line. To comply with IFRS, banks have to use their prudence to ascertain the risk associated with such loans and do provisioning where defaults are anticipated.

- Adopting the new practices would cast a shadow on the balance sheets of banks which often extend loans to certain categories to fulfil the political objectives of the government, but do correctly indicate the risk associated with such loans or make provisions. Profitability would be diminished when corrective measures are undertaken by Indian banks, analysts feel.
- In tune with IFRS, banks will have to factor in creditors who may default in their repayment of debts. This is distinct from the present policy where banks do not adequately provision for anticipated defaults. Experts feel this might affect the profit margins of the banks which are already under huge pressure due to rising non-performing assets.
- Under the new norms, banks will have to use their judgment to foresee possible defaults by creditors and treat such expected losses as a liability in their books of accounts. Presently, banks deploy judgment in a limited way in setting aside amounts to neutralize such possible losses. The IFRS framework, which is fair-value driven, would mandate banks to provision for possible defaults of their creditors.
- To bring the domestic banking sector in sync with the IFRS framework well before time, banking regulator RBI is soon come out with guidelines on IFRS convergence for banks. The Institute of Chartered Accountants of India has also stressed the need to bring changes to certain RBI guidelines that will come in the way of convergence with the new accounting norms. While certain public sector banks have initiated the process of convergence, majority of the banks are yet to take their stride forward.
- A recent study by KPMG has indicated that the financial performance of banks including their capital adequacy ratio (CAR) can be adversely affected due to the IFRS convergence. CAR is the ratio of the banks' capital to its risk, and is indicative of a bank's ability to maintain sufficient capital to pay its depositor's dues.
- Convergence to IFRS is likely to pose significant challenges for banks, as shown by global experience. Certain large Indian banks, which have the benefit of going through the process of international GAAP such as US GAAP in the past,

have recognized the challenges of convergence and have already started planning their detailed roadmap to achieve a smooth convergence. It is time for other banks to take the cue and follow suit.

- Critical to the successful implementation of IFRS in the Indian context would be the level of regulatory sponsorship, the appropriate level of investment in systems and processes and consistency in market practices for areas where judgment is critical. A move to IFRS can be as compared to the mountain peak which can certainly be scaled if well planned and appropriately executed.
- It is believing that for banks in India, the financial impact of convergence with IFRS will be significant, particularly in areas relating to loan loss provisioning, financial instruments and derivative accounting. This is likely to have a significant impact on the financial position and financial performance, directly affecting key parameters such as capital adequacy ratios and the outcomes of valuation metrics that analysts use to measure and evaluate performance.
- In addition to the financial accounting impact, the convergence process is likely to entail several changes to financial reporting systems and processes adopted by banks in India. These changes would need to be planned, managed, tested and executed in advance of the implementation date. Such changes are likely to be time consuming. In view of this, banks in India would need to start considering a roadmap for convergence to IFRS, at the earliest.

CHALLENGES FOR THE BANKING SECTOR

In addition to the several challenges along the path to convergence that are applicable to all companies, banking companies in India face certain additional challenges. These include:

- In addition to the general accounting standards and practices that constitute Indian GAAP, banking companies are currently required to adhere to accounting policies and principles that are prescribed by the Reserve Bank of India (RBI). For example, financial reporting policies for provision for loan and investments are specified by the RBI. Our experience indicates that adoption of IFRS requires a significant change to such existing policies and could have a material impact on the financial statements of banking companies.

- Application of IFRS in areas such as provision for loan losses and impairment of investments generally requires a high level of judgment and would require significant changes in the financial reporting processes (for example, to estimate cash flows that will be recovered including through sale of collateral). Our experience indicates that banking companies that are currently using accounting models that require limited judgment (for example, due to prescribed loss / provision rates) would face significant challenges in incorporating some of the revised accounting models into their financial reporting systems.
- Assuming that India converges with IFRS using the transition provisions of IFRS 1, First-time Adoption of International Financial Reporting Standards (currently, there is discussion regarding whether IFRS 1 would be adopted for subject to available exemptions under IFRS 1. Current information systems (including IT systems) of several banking companies may not be sufficient to readily generate information required to retroactively apply these standards.
- International Accounting Standard 39 (IAS 39) on Financial Instruments Recognition and Measurement along with its related guidance, is one of the most complex and comprehensive accounting pronouncements under IFRS Substantially all the assets and liabilities of banking companies comprise financial instruments that would be governed by the provisions of IAS 39. Our experience indicates that this poses significant complexity and application challenges and results in significant volatility in the income statement.
- Similarly, IAS 39 requires extensive use of fair valuation. Given the economic environment in India and lack of relatively developed financial markets for certain foreign exchange and interest rate instruments, application of these required fair valuation techniques poses additional implementation challenges.

- By virtue of operating in a regulated industry, banking companies are subject to regulatory reviews and inspections and are also subject to minimum capital requirements. As highlighted earlier, IFRS requires increased use of judgment and extensive use of unobservable valuation inputs and assumptions. The regulator y review process would need to be adjusted to acknowledge the inherent judgments involved in the application of IFRS. Additionally, our experience indicates that application of IFRS may result in higher loan losses and impairment charges, thereby impacting available capital and capital adequacy ratios. Similarly, use of fair values would introduce additional volatility in reported capital with its consequent impact on capital adequacy.

4.7 IFRS Convergence: Indian Corporates

Top TECHNICAL ACCOUNTING CHALLENGES FOR COMPANIES:

Loan/investment impairment:

IFRS prescribes an impairment model that requires a case by case (for significant exposures) assessment of the facts and circumstances surrounding the recoverability and timing of future cash flows relating to a credit exposure. Should there be an expectation that all contractual cash flows would not be recovered (or recovered without full future interest applications), an account would be classified as impaired and impairment be measured on present value basis using the effective interest rate of the exposure as the discount rate. For groups of loans that share homogenous characteristics (such as mortgage and credit card receivables), impairment can be assessed on a collective basis. The aim of an individual or collective assessment is to capture the incurred loss for a specified portfolio. General provisions are permissible only to extent that they relate to a specified risk that can be measured reliably and for incurred losses. No provisions are permitted for future or expected losses. For investments, a similar analysis is conducted, the key difference being that the fair value of the investment is also considered as an input in addition to the financial / credit standing of the issuer.

The bedrock of this impairment assessment is a system that considers all the facts and circumstances and requires the use of informed judgment. This aspect represents the most significant difference from Indian GAAP for banks in India. Current Indian GAAP / RBI guidelines require a limited use of judgment and are mechanistic in nature with prescribed provisioning rates.

What should companies focus on to meet this challenge?

- Develop / strengthen a data capture system to enable the impairment assessment after determining tactically where information will be collected/ who will make the impairment assessment / templates and information gathering and storage systems etc.
- Use and align this process of information gathering and assessment to strengthen the credit risk management function and feed into other strategic initiatives such as internal ratings, Basel II compliance and potential application of internal ratings based / advanced approaches.
- Improve and strengthen the loss forecasting mechanisms within the organization in parallel with fine tuning risk adjusted pricing for fresh loans being sanctioned by the bank.
- Certain system changes would need to be made for accounting for impairment; for example, computation of discounted future cash flows to facilitate the booking of the required accounting adjustments.

Required use of fair value for more financial instruments

Fair value measurement is infrequently used under Indian GAAP and in most cases where it is, the aim is primarily to capture a lower of cost or fair value measurement base. Under IFRS, there may be a significant increase in the extent that fair value measurement needs to be used. For instance, all financial assets and liabilities will need to be initially measured at fair value. While in a number of instances, fair values may be represented by transaction prices, the onus on banks will be to prove that transaction prices represent fair value. In addition, there will be a number of instances where unrealized gains can / should be recognized; for example, trading instruments and those where the bank elects the fair value option. Further, due to the stringent criteria prescribed under IFRS, a Held to Maturity (HTM) classification, (which currently results in an amortized cost valuation basis for a significant part of most Indian banks' investment portfolio), is unlikely to be available leading to fair value measurement for a substantial part of the portfolio. Again, this is a significant shift from current accounting treatment under Indian GAAP.

What should companies focus on to meet this challenge?

- Fair valuation methodologies and practices would need to be re-examined to ensure that they are current, up to date and are validated and back tested in the current market conditions.
- Adequately trained personnel need to be made responsible for this significant area of expertise and judgment.
- Profit planning and budgeting need to be fine-tuned to incorporate the expected increase in income statement volatility arising of the increased use of fair values as a measurement attribute.

Derivatives and hedge accounting

Under IFRS, all derivatives are recognized on the balance sheet at fair values with changes in fair values being recognized generally in the income statement other than in the case of a qualifying cash flow hedge relationship. Application of hedge accounting does reduce the income statement volatility induced by the fair value measurement of derivatives but comes with significant strings attached in the form of documentation, hedge effectiveness testing and ineffectiveness measurement. In addition, embedded derivative contracts (such as equity conversion options embedded in a convertible debenture – the most common situation found in India) require to be separated from their host contracts and be accounted for separately. In contrast, current Indian GAAP does not specifically address the more 'difficult to apply' provisions of fair value and hedge accounting

What should companies focus on to meet this challenge?

- Derivative valuation models need to be validated and back tested – their use will be much more significant in the IFRS world. Hedge relationships are a specialized area of accounting and it is crucial that organizational awareness of the rules are enhanced.

Certain process and system changes need to be made (for example, to designate hedging relationships at a ‘gross’ level and not at a ‘net’ level given that many interest rate, foreign exchange and liquidity positions are monitored only on a ‘net’ basis), documentation and hedge effectiveness testing processes need to be incorporated.

- Certain strategic decisions will need to be made as to where and when hedge accounting is to be applied (even perhaps what contracts are transacted in where individual banks will be comfortable with the income statement volatility as it does not see value in the cost benefit analysis of applying hedge accounting.

De-recognition of financial assets

Under IFRS, de-recognition of financial assets is a complex, multi-layered area with the de-recognition decision dependent largely on whether there has been a transfer of risks and rewards. If the assessment of the transfer of risks and rewards is not conclusive, an assessment of control and the extent of continuing involvement is required to be performed. In many cases, this cannot be restricted to qualitative assessments and needs to be necessarily a quantitative assessment.

A major area impacted would be securitization activity – most Indian securitization vehicles are currently structured to meet Indian GAAP de-recognition norms. Substantially all those securitization vehicles would collapse into the transferor’s balance sheet and assets would fail the de-recognition test under IFRS. For example, securitization transactions where credit collaterals are provided guarantee is provided to cover credit losses in excess of the losses inherent in the portfolio of assets securitized, may not meet the unrecognition principles enunciated in IAS 39.

Given that the IFRS position is significantly different from that followed under Indian GAAP, application of the new norms would in general lead to more instances of transfers failing the de-recognition criteria thereby resulting in large balance sheets and capital adequacy requirements, lower return on assets and deferral of gains / losses on such securitization transactions.

What should companies focus on to meet this challenge?

Assess the impact of transactions that would fail de-recognition and consider the potential impact on capital adequacy and ratios such as return on assets.

Work towards new securitization structures that are designed to meet the de recognition norms under IFRS.

Assess at a strategic level if the organization is willing to compromise on credit ratings for securitized pools in order to achieve the desired capital and accounting result of de-recognition.

Certain process and system changes will need to be made for accounting for these transactions from current practice (including for example, how an assessment of transfer of risk and rewards will be measured and documented).

Create an assessment model that incorporates the full cost benefit analysis of undertaking securitization transactions even if they don't meet the de- recognition norms as a funding alternative to raising deposits.

Consolidation of entities

Under IFRS, consolidation is not driven purely by the ownership structure of an entity. Instead the focus is more on the power to control an entity to obtain economic benefits - this power to control could be expressed as ownership of equity securities but is not limited to it. For instance, this will include a consideration of currently exercisable potential voting rights / shares; management and other agreements, de facto control and other arrangements that provide the power to control an entity. IFRS also provides guidance on how consolidation decisions for special purpose entities should be arrived at. In a number of ways, IFRS provides more rigorous consolidation tests and in practice can result in the consolidation of a larger number of entities as compared to Indian GAAP which focuses on a narrower set of tests (majority y of ownership and control over a majority of the composition of the board of directors or similar body).

What should companies focus on to meet this challenge?

Collate and inventories the full set of entities where consolidation assessment need to be made and perform those assessments as early as possible including a consideration of non-shareholding related factors that impact consolidation.

Ensure that common accounting policies are applied across the group

Prepare for the impact of factors arising out of consolidation such as how disclosures at a group level can be collated and populated, chart of accounts, group reporting packages, reporting timelines and consider specifically how inter-company transactions and deferred taxation related aspects will be dealt with.

Concept of a group

The Companies Act (The Act) treats Indian companies as separate legal entities, while IFRS promotes a group concept, where individual legal entities lose their individual relevance to the overall economic entity, the group, except for legal or tax compliance.

The Act does not specifically deal with consolidated accounts or their auditors' reports. Hence the form of accounts adopted by a group can be different from the format specified by the Act for individual companies.

Our tax laws individual entities as separate units for tax and do not asses the group as a single taxable entity. Hence the role of consolidated accounts has no relevance for tax purposes. In many countries like the US, the group could be the primary unit for tax assessment in one legal jurisdiction and the consolidated accounts then become relevant.

Fixed assets

There is a significant distinction between the Act and IFRS for fixed assets - the description of assets itself. The Act defines a class of assets whereas IFRS promotes a concept of components of fixed assets based on their usefulness.

This means that various significant components embedded in an asset having different useful lives will be depreciated separately. It would be appropriate to depreciate the engines and airframe of an aircraft using different lives. Another key difference with the Indian GAAP and the Act is on the definition of cost.

Under IFRS, the fair estimate of the retirement obligation of an asset is discounted to a fair value and recognized as a liability. The corresponding costs are capitalized with the fixed assets. In India, future costs are not allowed to be discounted and capitalized and they are recognized as a liability when they become an obligation.

The Companies Act prohibits depreciation on revaluation of fixed assets to be reflected in the profit and loss account as such depreciation is netted off against the reserve specifically created on revaluation in the balance sheet.

IFRS is based on fair value concepts and where a company revalues its fixed assets to reflect its current value, the depreciation of the revalued assets is routed through the income statement and affects the earnings.

Capital and reserves

If we look at the capital side of the balance sheet, the Companies Act requires capital instruments to be separately disclosed as equity and preference shares and there are separate provisions that govern the issue of these instruments and their relative legal rights. Similarly, convertible debentures or bonds, whether they are in Indian or foreign currency, have specific rules relating to their issue and disclosure in the accounts.

There are also foreign exchange regulations which would also come into play relating to these bonds. IFRS treats debentures, bonds or preference shares that are convertible into equity shares as compound instruments that need to be segregated into a debt and an equity portion based on their relative fair values.

Similarly, a redeemable preference share for cash will normally be a debt. Such re-classification of preference shares to debt or equity or creating equity instruments from bonds or debentures will need sanction of the Companies Act, which lays down rules on how such instruments are to be issued and shown in the accounts.

Mere segregation by using IFRS principles will not comply with the Act, nor will it retain the legal rights and obligations that are associated with these instruments. This leaves a gap between our current laws and IFRS.

Reserves in a balance sheet are a result of past profits following Indian GAAP and are available to shareholders either as dividend or distributed on dissolution. Upon transition to IFRS, an entity will have an increase or deduction of reserve just by the application of the new GAAP. A shareholder could have more distributable reserves or conversely if the reserves get wiped out, it could leave him poorer due to such a change.

How changes in GAAP affect the wealth or earnings of the shareholders will be the cornerstone of decisions.

IFRS and initial public offerings

Some other areas of attention would be the rules relating to initial public offerings. Under the current laws, five years of audited financial accounts under Indian GAAP form the base financial information for an IPO.

When we transition to IFRS in 2011, we are not sure whether all the five years of accounts for a company need to be under IFRS or the law will allow a part thereof, say, three years.

The efforts a company needs to make if they are to re-cast their accounts to IFRS for the past five years will be significant. How the Act and Sebi will define this requirement will be important for companies looking for an IPO in the next few years.

Correction of past errors

Correction of errors under IFRS can be made in the years they pertain to, even if they are audited and adopted by the shareholders. Currently, past errors in India are shown as adjustment relating to previous years in the current year as no changes can be made to the accounts as adopted by shareholders.

Furthermore, no specific disclosure relating to the error is required to be made. If we go the route of IFRS, the restatement of material errors is a feature that Indian companies and their auditors will need to be aware of. Whether or not this triggers a number of lawsuits in the future against the company and their auditors, only time will tell.

These are some of the indicative areas where an amendment to the law needs to be made if we are to converge with IFRS. We have a choice of having specific differences.

CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1 Conclusion

a) Newly framed Indian AS are the converged form of IFRS and ICAI and MAC has accepted most of the provisions of IFRS as it is. The table of difference shows that except few items almost all the provisions are same as IFRS. So it is a good thing about Indian AS that we have not any major changes in India GAAP.

b) There are significant differences between IFRS and Indian-GAAP. In fact, Indian Accounting Standards have not kept pace with changes in IFRS. This is because Indian Standards remain sensitive to local conditions, including the legal and economic environment.

c) No significant differences have been found in profitability of companies as per statistical tools used by researcher. Although differences in actual figures of profits are material and it can affect the decision of any decision maker.

d) We are going to converge our accounts with IFRS with half preparedness and less knowledge that's why the date for transition is again and again shifting forward and it will be harmful to implement IFRS with less knowledge.

e) IFRS could bring in volatility in earnings and that is primarily because of the fair valuation accounting which is being brought into by the IFRS. But over the period both analyst and investors will take that into account. In European Union, IFRS has been accepted as good process and people have appreciated the use of IFRS.

f) IFRS will definitely facilitate various areas such as cross border takeover, share based payments etc.

g) ICAI is the prominent body regarding the adoption of the IFRS. ICAI have performed their duty with full respect and honor. ICAI have performed their duty in a very organized manner. ICAI formed the different task force for smoothly adoption of the IFRS. ICAI has organized different conferences, seminars and workshop for educating and awareness about IFRS to the different stakeholders. It also started the short term courses for fulfilling the demand of the IFRS trained skilled accounting persons. These efforts are valuable for effectively adoption of the IFRS however these are not sufficient for effectively adoption of the IFRS.ICAI being a top accounting regulatory body of India should take initiatives for successful implementation and training process because now it is clear that IFRS are the requirement of time and we are going to adopt these changes so training is compulsory for all.

h) Indian AS framed by ICAI and MAC are revised form of IFRS which are made with regulatory requirements required by various regulatory bodies.

5.2 Recommendations

Recommendation to Governments:

a) Government should set some rules and regulations for early and successful implementations of IFRS in country because deferment of convergence date will hurt the reputation of Indian accounting process because convergence is not a national matter it is an international matter. Many mergers and acquisition are only depending on international reporting. And if we delay the period then international mergers and acquisitions can get stuck. Internationally our reputation will also affect due to postponement of date for convergence.

b) Government should bring all the regulatory bodies who affects the accounting process in India at single platform to sort out all the problems which they will face on convergence. This is required because if afterward some discrepancies will found or any conflict will arise between two laws then it will be tough to make amendments. So at the time of making regulations it is necessary to bring all the bodies under a single roof.

c) Government should set rules regarding Fair Valuation Accounting which is an important challenge in convergence process. Government should clearly mention the rules of fair valuation in easy and simple form so that laymen can also understand the fair valuation rules. Fair valuation can affect the financial reports vary highly.

d) Government should make some certified courses for fair valuers who will help in determining the fair valuation process because this area can become an apple of discord in future. Fair values can make financial position stronger or weaker. Government should start some certificates for fair valuation. Only those who have certificate for fair valuation should be allowed to become fair valuers. Government should also decide responsibilities and liabilities of fair valuers.

e) Government should make certain Authorities and determine responsibilities for monitoring and easeful implementation. Without proper control an authority will not properly perform so government should step forward for successful implementation and make proper authorities and delegate responsibility to officers of that authority.

f) Government should provide helpline desk for guidance for successful implementation. In initial stage government should perform as helping hand for

corporate. If corporate feels any problem, then government should provide help to corporate.

g) Government should make some changes in syllabus of accountancy in various boards and universities for giving knowledge about new regulations of IFRS because the youth is the ultimate group who will become the future accounting professionals.

Recommendation to ICAI:

a) To give knowledge about IFRS to existing accounting professional and chartered accountants ICAI should implement a compulsory short duration certificate course for all existing chartered accountants and accounting professionals.

b) ICAI should make compulsory certificate course for members of ICAI to give knowledge of IFRS.

c) Some simplified literature should be provided for all the common users of accounting such as investors, bankers and analysts etc. so that they can also understand the changes.

d) ICAI should increase their role in the IASB by holding the important position in the IASB Foundation monitoring board. So that emerging issues in accounting of India can also be merged in accounts.

e) ICAI should continuously co-operation with the other regulatory bodies like a RBI, SEBI, IRDA, and MCA (Ministry of corporate affairs) for effectively convergence of the IFRS.

f) ICAI should conduct more and more conferences, seminars, workshop, and short term programs for awareness to different users about the IFRS.

Recommendation to Companies

a) Companies should start early so that they will get significant advantage that they are better suited to confront the numerous of tactical and strategic decisions (e.g. impact on existing operations and information systems, impact on other technical or strategic initiatives currently under way at your bank) that would need to be made as the project progresses.

b) Make effective plan for convergence successfully

   a. Preliminary impact assessment
   b. Design and planning
   c. Testing and problem solution
   d. Implementation

c) Involve the following staff on priority basis for successful convergence:

   a. Steering committee
   b. Information technology department
   c. Divisional business head
   d. Human resources.

d) Use external advisors for successful implementation and impact assessment.

5.3 Limitations

Sufficient dedicated internal staff

The single biggest differentiator of successful and less successful conversion projects is the presence or absence of full-time internal staff that are dedicated to the project, particularly in the project management arena. You cannot successfully manage a large project with part-time staff. Within the organization there has to be a core team who do nothing but focus on the day-to-day progress of the IFRS implement action project. We find that part-time resources inevitably get lost to their day jobs and this has critical implications for the overall momentum of the project.

Failure to spend sufficient time and energy on 'impact assessment'

Believe that the initial 'impact assessment' is by far the most critical phase of the project. It is essential that banks plan for this phase and allow sufficient time to ensure that the gap analysis is conducted on a line-by-line basis through the income statement and balance sheet. The gap analysis feeds the systems changes, the training program and the accounting policies – only realizing that elements of this have been missed later in the conversion process, leads to expensive unwinding of activities.

Failure to train staff to a sufficient standard

Many organizations that we have encountered underestimated the level of investment required in training their finance community. A comprehensive training strategy and program is a complex area and needs to be carefully considered. Training should be tailored to the needs of the organization with delivery in a range of different ways to various stakeholders with different needs and requirements.

The **RBI also prescribes accounting requirements for banks**, such as accounting for derivatives or provision for non-performing assets, and these requirements of the RBI are currently at variance with the IFRS.

5.4 Scope of the Study

As stated earlier, this research involves a comparative study of standard setters, standard setting process, accounting standards and disclosure compliances under the selected accounting standards. This research studies Indian accounting standards 1, 3, 20 and 25 as applied or used by Indian Information Technology (IT) Companies. These accounting standards are compared and contrasted with US-GAAP and IFRS.

Reasons for Selecting These Accounting Standards

Direct Impact on Financial Statements

The selected accounting standards affect financial reporting directly by having effect on the disclosures in the financial statements. AS-1 prescribes which accounting policies should be disclosed, AS-3 mandates preparation of cash flow statement for listed companies, AS-20 prescribes presentation of Earnings Per Share on the face of the income statement and AS-25 regulates preparation of Interim Financial Reports. These standards have a direct impact on preparation and presentation of financial statements, hence they are selected for the study.

Directly Linked to Objectives of Financial Statements

ICAI Conceptual Framework states that the objective of financial statements are to provide information about financial position, performance and cash flows of an enterprise.

Study of AS- 1, 3 and 20 help in analyzing annual financial statements and study of AS-25 helps in analyzing the interim financial statements, the recognition, measurement and presentation prescriptions used therein Earnings Per Share is the most important figure to measure performance of an organization Cash Flow Statement measures whether the profit earned is liquid or not, whether organization IS solvent or not Because of AS-1 all organizations disclose accounting policies used m preparation of financial statements A study of these policies enables the analysts and the investors to know whether increase or decrease in profits over the years is due to changes in any accounting policies or not Thus, selected standards are directly linked to basic objectives of financial statements Better compliance with these accounting standards will mean improvement in financial reporting, which is the objective of this study.

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