# UNIT 1
# INTERNATIONAL FINANCIAL REPORTING STANDARDS

**Meaning**

The term "International Financial Reporting Standards" includes IFRS, IAS and interpretations originated by the IFRIC or the former Standing Interpretations Committee (SIC).

**Process of setting IFRS**

From 1973 to 2001, the body in charge of setting the international standards was the International Accounting Standards Committee (IASC). The principal aim of IASC was to encourage national accounting standard setters around the world to improve and harmonize national accounting standards.

IASC issued 41 numbered standards, known as International Accounting Standards (IAS), as well as a framework for the preparation and presentation of financial statements. While some of the standards issued by the IASC have been withdrawn, many are still in force. In addition, the interpretations issued by the Standing Interpretations Committee (SIC) of IASC, are still in force.

In 2001, to strengthen the independence, legitimacy and quality of the international accounting-standard-setting process, the IASC Board was broad based and replaced by the International Accounting Standards Board (IASB) as the body in charge of setting the international standards.

It was decided by IASB that all effective IAS issued by the IASC as well as the interpretations issued by the SIC are adopted as its own standards. Those IAS continue to be in force to the extent they are not amended or withdrawn by the IASB. New standards issued by IASB would have prefix of "IFRS" and new interpretations would be issued by the International Financial Reporting Interpretation Committee (IFRIC).

**Merits of IFRS**

1. IFRS brings improvement in comparability of financial information and financial performance with global peers and industry standards. This will result in more transparent financial reporting of a company's activities which will benefit investors, customers and other key stakeholders in India and overseas.

2. The adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements.

3. IFRS provide better access to the capital raised from global capital markets since IFRS are now accepted as a financial reporting framework for

companies seeking to raise funds from most capital markets across the globe. Thus, IFRS increase the efficiencies of global capital management.

4. IFRS minimize the obstacles faced by Multi-national Corporations by reducing the risk associated with dual filings of accounts. A recent decision by the US Securities and Exchange Commission (SEC) permits foreign companies listed in the US to present financial statements in accordance with IFRS. This means that such companies will not be required to prepare separate financial statements under Generally Accepted Accounting Principles in the US (US GAAP). Therefore, Indian companies listed in the US would benefit from having to prepare only a single set of IFRS compliant financial statements, and the consequent saving in financial and compliance costs.

5. The impact of globalization causes spectacular changes in the development of Multi-national Corporations in India. This has created the need for uniform accounting practices which are more accurate, transparent and which satisfy the needs of the users. Implementation of uniform accounting practices i.e., IFRS will provide much better quality information.

6. Uniform accounting standards (IFRS) enable investors to understand better the investment opportunities as against multiple sets of national accounting standard.

7. With the help of IFRS, investors can increase the ability to secure cross border listing.

**Limitations of IFRS**

1. The perceived benefits from IFRS' adoption are based on the experience of IFRS compliant countries in a period of mild economic conditions. Any decline in market confidence in India and overseas coupled with tougher economic conditions may present significant challenges to Indian companies.

2. IFRS requires application of fair value principles in certain situations and this would result in significant differences in financial information currently presented, especially in relation to financial instruments and business combinations. Given the current economic scenario, this could result in significant volatility in reported earnings and key performance measures like EPS and P/E ratios. Indian companies will have to build awareness amongst investors and analysts to explain the reasons for this volatility in order to improve understanding, and increase transparency and reliability of their financial statements.

3. This situation is worsened by the lack of availability of professionals with adequate valuation skills, to assist Indian corporate in arriving at reliable fair value estimates. This is a significant resource constraint that could impact

comparability of financial statements and render some of the benefits of IFRS' adoption ineffective.

4. Although IFRS are principles-based standards, they offer certain accounting policy choices to preparers of financial statements. For example, the use of a cost-based model or a revaluation model in accounting for investment properties. This could reduce consistency and comparability of financial information to a certain extent and therefore reduce some of the benefits from IFRS' adoption.

5. IFRS are formulated by the International Accounting Standards Board (IASB) which is an international standard body. However, the responsibility for enforcement and providing guidance on implementation vests with local government and accounting and regulatory bodies, such as the ICAI in India. Consequently, there may be differences in interpretation or practical application of IFRS provisions, which could further reduce consistency in financial reporting and comparability with global peers. The ICAI will have to make adequate investments and build infrastructure to ensure compliance with IFRS.

**Practical challenges in implementing IFRS**

1. There is a need for a change in several laws and regulations governing financial accounting and reporting in India. In addition to accounting standards, there are legal and regulatory requirements that determine the manner in which financial information is reported or presented in the financial statements. For example, the Companies Act determines the classification and accounting treatment for redeemable preference shares as equity instruments of a company, whereas these may be considered to be a financial liability under IFRS. The Companies Act also prescribes the format for presentation of financial statements for Indian companies, whereas the presentation requirements are significantly different under IFRS. Similarly, the Reserve Bank of India regulates the financial reporting for banks and other financial institutions, including the presentation format and accounting treatment for certain types of transactions. In the absence of adequate clarity and assurance that Indian laws and regulations will be amended to conform to IFRS, the conversion process may not gain momentum.

2. There is a lack of adequate professionals with practical IFRS conversion experience and therefore many companies will have to rely on external advisers and their auditors. This is magnified by a lack of preparedness amongst Indian corporate as this project may be viewed simply as a project management or an accounting issue which can be left to the finance function and auditors. However, it should be noted that IFRS conversion will involve a fundamental change to an entity's financial reporting systems and processes. It will require a detailed knowledge of the standards and the ability to consider their impact on business transactions and performance measures.

3. Another potential pitfall is viewing IFRS accounting rules as similar to Generally Accepted Accounting Principles in India (Indian GAAP), since Indian accounting standards have been formulated on the basis of principles in IFRS. However, this view disregards significant differences between Indian GAAP and IFRS as well as differences in practical implementation and interpretation of similar standards. Further, certain Indian standards offer accounting policy choices which are not available under IFRS, for example, use of pooling of interests method in accounting for business combinations.

4. Convergence is not just a one-time technical step but will impose practical challenges of significant business and regulatory matters like structuring of ESOP schemes, training of employees, tax planning, modification of IT system, compliance with debt covenants.

5. Educating investors to understand the changed financial reporting under IFRS is challenging due to differences in various conceptual, practical, legal and implementation methods.

6. The regulatory and legal requirements in India will pose a challenge unless the same is been addressed by respective regulatory. For example the present direct tax laws do not address any tax implications likely to arise from IFRS transitions.

7. Complexities in the introduction of concepts such as present value and fair value measurement, recognition and the extent of disclosure required under IFRS are other challenges. Examples:
   - Treatment of expenses like premium payable on redemption of debentures, discount allowed on issue of debentures, underwriting commission paid on issue of debentures etc are different. This would bring a change in the income statement leading to enormous confusion and complexities.
   - Financial statements are more complex under IFRS and thereby would pose a challenge in making useful decision.

**Ind AS – The Indianised version of IFRS**

**Meaning of convergence with IFRS**

In general terms, convergence with IFRS means to achieve harmony with IFRS. In precise terms convergence can be considered as "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRS". Thus, 'convergence with IFRS' means adoption of IFRS with certain exceptions, wherever necessary.

**Need for convergence with IFRS**

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

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

**Benefits of achieving convergence with IFRS**

There are many beneficiaries of convergence with IFRS such as the economy, investors, industry and accounting professionals.

*Economy*

As the markets expand globally, the need for convergence also increases. The convergence benefits the economy by increasing growth of its international business. It facilitates maintenance of orderly and efficient capital markets and also helps to increase the capital formation and thereby economic growth. It encourages international investing and thereby leads to more foreign capital flows to the country.

*Investors*

A strong case for convergence can be made from the viewpoint of the investors who wish to invest outside their own country. Investors want the information that is more relevant, reliable, timely and comparable across the jurisdictions. Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national accounting standards. Investors' confidence would be strong if accounting standards used are globally accepted. Convergence with IFRS contributes to investors' understanding and confidence in high quality financial statements.

*Industry*

A major force in the movement towards convergence has been the interest of the industry. The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. With the diversity in accounting standards from country to country, enterprises which operate in different countries face a multitude of accounting requirements prevailing in the countries. The burden of financial reporting is lessened with convergence of accounting standards because it simplifies the process of preparing the individual and group financial statements and thereby reduces the costs of preparing the financial statements using different sets of accounting standards.

*Accounting professionals*
Convergence with IFRS also benefits the accounting professionals in a way that they are able to sell their services as experts in different parts of the world. It offers them more opportunities in any part of the world if same accounting practices prevail throughout the world. They are able to quote IFRS to clients to give them backing for recommending certain ways of reporting. Also, their mobility to work in different parts of the world increases.

**Relevance/Applicability of Ind AS (Converged IFRS)**
The Ministry of Corporate Affairs (MCA) notified the Companies (Indian Accounting Standards) Rules, 2015 (the 'Rules') on $16^{th}$ February, 2015. The Rules specify the Indian Accounting Standards (Ind AS) applicable to certain class of companies and set out the dates of applicability as follows:

1) *Voluntary adoption*
   Companies may voluntarily adopt Ind AS for financial statements for accounting periods beginning on or after 1 April, 2015, with the comparatives for the periods ending 31 March, 2015 or thereafter. Once a company opts to follow the Ind AS, it will be required to follow the same for all the subsequent financial statements.
2) *Mandatory adoption*
   The following companies will have to adopt Ind AS for financial statements from the accounting periods beginning on or after 1 April, 2016:
   - Companies whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India (listed companies) and having net worth of Rs. 500 crores or more.
   - Unlisted companies having a net worth of Rs. 500 crores or more.
   - Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.

   Comparatives for these financial statements will be periods ending 31 March, 2016 or thereafter.

   The following companies will have to adopt Ind AS for financial statements from the accounting periods beginning on or after 1 April, 2017:
   - Listed companies having net worth of less than Rs. 500 crore.
   - Unlisted companies having net worth of Rs. 250 crore or more but less than Rs. 500 crore.
   - Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.

   Comparatives for these financial statements will be periods ending 31 March, 2017 or thereafter.

The above mentioned roadmap for adoption will not be applicable to:

- Companies whose securities are listed or in the process of listing on SME exchanges (Exchanges meant for small and medium-sized enterprises).
- Companies not covered by the roadmap in the 'Mandatory adoption' categories mentioned above.
- Insurance companies, banking companies and non-banking finance companies.

In pursuance to the budget announcement by the Union Finance Minister Shri Arun Jaitley, after consultations with the Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA) and Pension Fund Regulatory and Development Authority (PFRDA), the roadmap for implementation of Ind AS converged with IFRS for Scheduled Commercial Banks (excluding Regional Rural Banks), Insurers/Insurance Companies and Non-Banking Finance Companies (NBFCs) for accounting periods beginning from 1 April, 2018 onwards, with comparatives for the periods ending 31 March, 2018 has been drawn up.

**List of IFRS 1 – 15**

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|---|---|---|---|---|---|
| Ind AS | 101 | (IFRS | 1) | : | First Time Adoption of Indian Accounting Standards |
| Ind AS | 102 | (IFRS | 2) | : | Share Based Payments |
| Ind AS | 103 | (IFRS | 3) | : | Business Combinations |
| Ind AS | 104 | (IFRS | 4) | : | Insurance Contracts |
| Ind AS | 105 | (IFRS | 5) | : | Non-Current Assets Held for Sale & Discontinued Operations |
| Ind AS | 106 | (IFRS | 6) | : | Exploration and Evaluation of Mineral Resources |
| Ind AS | 107 | (IFRS | 7) | : | Financial Instruments: Disclosures |
| Ind AS | 108 | (IFRS | 8) | : | Operating Segments |
| Ind AS | 109 | (IFRS | 9) | : | Financial Instruments |
| Ind AS | 110 | (IFRS | 10) | : | Consolidated Financial Statements |
| Ind AS | 111 | (IFRS | 11) | : | Joint Agreements |
| Ind AS | 112 | (IFRS | 12) | : | Disclosure of Interests in Other Entities |
| Ind AS | 113 | (IFRS | 13) | : | Fair Value Measurement |
| Ind AS | 114 | (IFRS | 14) | : | Regulatory Deferral Accounts |
| Ind AS | 115 | (IFRS | 15) | : | Revenue from Contracts with Customers |
| Ind AS | 115 | (IFRS | 15) | : | Impact on Various Sectors |
| Ind AS | 115 | (IFRS | 15) | : | Accounting for Construction and Real Estate |

**List of International Accounting Standards (IAS) issued by IASB**

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| Ind AS | 1 | (IAS | 1) | : | Presentation of Financial Statements |
| Ind AS | 2 | (IAS | 2) | : | Inventories |
| Ind AS | 7 | (IAS | 7) | : | Statement of Cash Flows |
| Ind AS | 8 | (IAS | 8) | : | Accounting Policies, Changes in Accounting Estimates & Errors |
| Ind AS | 10 | (IAS | 10) | : | Events after the Reporting Period |

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| Ind AS | 11 | (IAS | 11) | : | Construction Contracts |
| Ind AS | 12 | (IAS | 12) | : | Income Taxes |
| Ind AS | 16 | (IAS | 16) | : | Property, Plant & Equipment |
| Ind AS | 17 | (IAS | 17) | : | Leases |
| Ind AS | 18 | (IAS | 18) | : | Revenue |
| Ind AS | 19 | (IAS | 19) | : | Employee Benefits |
| Ind AS | 20 | (IAS | 20) | : | Government Grants & Government Assistance |
| Ind AS | 21 | (IAS | 21) | : | The Effects of Changes in Foreign Exchange Rates |
| Ind AS | 23 | (IAS | 23) | : | Borrowing Costs |
| Ind AS | 24 | (IAS | 24) | : | Related Parties |
| Ind AS | 27 | (IAS | 27) | : | Consolidated and Separate Financial Statements |
| Ind AS | 28 | (IAS | 28) | : | Investments in Associates |
| Ind AS | 29 | (IAS | 29) | : | Financial Reporting in Hyperinflationary Economics |
| Ind AS | 31 | (IAS | 31) | : | Interests in Joint Ventures |
| Ind AS | 32 | (IAS | 32) | : | Financial Instruments: Presentation |
| Ind AS | 33 | (IAS | 33) | : | Earnings Per Share |
| Ind AS | 34 | (IAS | 34) | : | Interim Financial Reporting |
| Ind AS | 36 | (IAS | 36) | : | Impairment of Assets |
| Ind AS | 37 | (IAS | 37) | : | Provisions, Contingent Liabilities and Contingent Assets |
| Ind AS | 38 | (IAS | 38) | : | Intangible Assets |
| Ind AS | 39 | (IAS | 39) | : | Financial Instruments: Recognition and Measurement |
| Ind AS | 40 | (IAS | 40) | : | Investment Property |
| Ind AS | 41 | (IAS | 41) | : | Agriculture |