

Step up to IFRS

Ernst & Young guide on first-time
adoption of IFRS in India



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of IFRS in India**

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This publication does not attempt to capture all of the differences between Indian GAAP and IFRS or impact on transition to IFRS, that exist or that may be material to a particular entity's financial statements. Our focus is on differences or impacts that are commonly found in practice. The existence of any differences – and their materiality to an entity's financial statements – depends on a variety of specific factors including, among others: the nature of the entity, an entity's interpretation of the more general IFRS principles, industry practices and accounting policy elections required under either Indian GAAP or IFRS. Accordingly, we recommend that readers seek appropriate advice regarding any specific issues that they encounter. This publication should not be relied on as a substitute for reading IFRS. Before reaching any conclusion as to how your specific company may be affected by a change to IFRS, you should consider your specific facts and circumstances and then consult with Ernst & Young or other professional advisors familiar with your particular factual situation for advice.

This publication is based on pronouncements under IFRS issued by IASB and Indian accounting standards notified under the Companies Act 1956, and other pronouncements issued by ICAI up to 1 January 2009, irrespective of their dates of applicability. The ICAI has issued certain standards which are applicable from dates beyond 2009 and have not been notified under the Companies Act 1956 till date. For example, ICAI has issued AS 30, AS 31 and AS 32 on *Financial Instruments: Recognition and Measurement*, *Financial Instruments: Presentation* and *Financial Instruments: Disclosures*, respectively, which are recommendatory for accounting periods commencing on or after 1 April 2009 and mandatory for accounting period commencing on or after 1 April 2011. These standards have not been notified under the Companies Act 1956 as at 1 January 2009. The publication is without considering the impact of these Standards. Similarly, limited revisions consequent to these standards have also not been considered in the publication. Exposure Drafts of new/revised standards issued by IASB/ASB of ICAI have not been considered in the publication, though at appropriate places they have been referred to.

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Preface

International accounting standards have come a long way since Henry Benson led the way to the creation, first, of the Accountants International Study Group in 1967 and, thereafter, of the International Accounting Standards Committee in 1973. Perhaps most remarkable is the pace at which the globalization of accounting standards has moved: from the position only seven years ago where numerous disparate national standards existed, to the position today where IFRS has established itself as the globally accepted passport to capital raising in the world's capital markets.

This represents a considerable achievement by all concerned: the European Union, whose leaders had the vision to set the agenda for a common financial reporting regime across the EU; the former Board of the IASC, who undertook the core standards programme that laid the groundwork for global acceptance of international standards, the many countries throughout the world whose standard setters have contributed to the work of the IASC and the International Accounting Standards Board (IASB), the members of the IASB, who have worked assiduously over the past seven years under the unstinting

leadership of Sir David Tweedie; and the large number of governments that have recognized the value of a common financial reporting regime, and have adopted IFRS.

2007 has also seen the significant decision by the US Securities and Exchange Commission to accept from foreign private issuers financial statements prepared in accordance with IFRS as published by the IASB without reconciliation to US GAAP.

The requirement for public interest entities in India to comply with IFRS from 1 April 2011 as announced by the Institute of Chartered Accountants of India and Ministry of Corporate Affairs is in line with the global momentum towards convergence and high quality financial reporting.

Significant benefits can be derived from converging to IFRS. These include enhanced comparability and reporting transparency. Migration to IFRS will lower the cost of raising capital, as it will eliminate multiple reporting and reduce the risk premium built in by investors who are not conversant with Indian GAAP, unlike IFRS.

Conversion to IFRS is more than a mere technical exercise. The consequences are far wider than financial reporting issues, and extend to various significant business and regulatory matters including compliance with debt covenants, structuring of ESOP schemes, training of employees, modification of IT systems and tax planning.

For the first IFRS-compliant financial statements it is a requirement that the comparatives should also comply with IFRS. The consequence of this is that impacted Indian entities will need to start preparing IFRS compliant accounts from the period commencing 1 April 2010 and preferably much earlier. Thus, a great deal of preparation will be necessary long before the adoption date. A carefully considered strategy with support from the leadership and strong teamwork will be necessary to successfully migrate to the new system. For many entities, financial statements and ratios may change dramatically. This will affect the perception of analysts, bankers and investors. A proper communication strategy could turn this event to your advantage.

The purpose of this book is to answer questions such as:

- ▶ How will IFRS impact the financial statements of businesses and what would be the conversion efforts?
- ▶ What challenges, other than converting the financial statements, will the entity face?
- ▶ What approach or strategy should be followed in transiting to IFRS?
- ▶ How to convert Indian GAAP balance sheet to IFRS balance sheet on first time adoption?
- ▶ What are the key differences between IFRS and Indian GAAP?

The next few years will be exciting, but challenging at the same time. We, at Ernst & Young, are committed to help you migrate to IFRS as smoothly as possible, and look forward to teaming with you on this landmark event both for Corporate India and for your entity.

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An aerial, high-angle photograph of a city street intersection. The image is heavily pixelated, giving it a low-resolution, digital-art appearance. A multi-lane road runs diagonally from the top left towards the bottom right. Several cars are visible on the road, including a white car in the upper left, a dark car in the center, and a red car in the lower right. The surrounding area includes sidewalks, crosswalks, and parts of buildings with windows. The overall color palette is dominated by the tan and grey tones of the pavement and buildings.

Overview of IFRS

1

Overview of IFRS

What is IFRS?

International Financial Reporting Standards (IFRS) have recently emerged as the numero-uno accounting framework, with widespread global acceptance. The IASB, a private sector body, develops and approves IFRS. The IASB replaced the IASC in 2001. The IASC issued IAS from 1973 to 2000. Since then, the IASB has replaced some IAS with new IFRS and has adopted or proposed new IFRS on topics for which there was no previous IAS. Through committees, both, the IASC and the IASB have issued Interpretations of Standards.

The term IFRS has both, a narrow and a broad meaning. Narrowly, IFRS refers to the new numbered series of pronouncements that the IASB is issuing, as distinct from the IAS series issued by its predecessor. More broadly, IFRS refers to the entire body of IASB pronouncements, including standards and interpretations approved by the IASB, IFRIC, IASC and SIC. Currently, 29 IAS and 8 IFRS are effective. In addition, 11 SICs and 16 IFRICs provide guidance on interpretation issues arising from IAS and IFRS (see Appendix for a detailed listing of IFRS issued to date). In this publication, the term 'IFRS' has been used in the broader context.

IFRS is principle based, drafted lucidly and is easy to understand and apply. However, the application of IFRS requires an increased use of fair values for measurement of assets and liabilities. The focus of IFRS is on getting the balance sheet right, and hence, can bring significant volatility to the income statement.

IFRS – A truly global accounting standard

The year 2000 was significant for IAS, now known as IFRS. The International Organization of Securities Commission formally accepted the IAS core standards as a basis for cross-border listing globally. In June 2000, the European Commission passed a requirement for all listed companies in the European Union to prepare their CFS using IFRS (for financial years beginning 2005). Since 2005, the acceptability of IFRS has increased tremendously.

There are now more than 100 countries across the world where IFRS is either required or permitted. This figure does not include countries such as India, which do not follow IFRS but whose national GAAP is inspired by IFRS. The table below provides a snapshot of IFRS acceptability globally.

Domestic listed entities	Number of countries
IFRS required for all domestic listed companies	85
IFRS permitted for domestic listed companies	24
IFRS required for some domestic listed companies	4
IFRS <i>not</i> permitted for domestic listed companies	34
Total	147

Considering that more than 100 out of 147 countries require or permit IFRS, this should not leave any doubt that IFRS is now numero-uno. This status has been unequivocally accepted by the SEC

as well. The SEC has allowed the use of IFRS without reconciliation to US GAAP in the financial reports filed by foreign private issuers, thereby, giving foreign private issuers a choice between IFRS and US GAAP. Recently, the SEC has also issued for public comment, its long awaited proposed 'roadmap' related to the eventual use of IFRS by the US entities. Within this roadmap, the SEC is proposing that the US issuers begin reporting under IFRS from 2014 (actually 2012 if requirement for three year comparable are considered), with full conversion to occur by 2016 depending on size of the entity. This is a milestone proposal that will bring almost the entire world on one single, uniform accounting platform, i.e., IFRS.

IFRS and India

The issue of convergence with IFRS has gained significant momentum in India. At present, the ASB of the ICAI formulates Accounting Standards based on IFRS, however, these standards remain sensitive to local conditions, including the legal and economic environment. Accordingly, the Accounting Standards issued by the ICAI depart from the corresponding IFRS in order to ensure consistency with the legal, regulatory and economic environments of India.

At a meeting held in May 2006, the Council of ICAI expressed the view that IFRS may be adopted in full at a future date, at least for listed and large entities. The ASB, at a meeting held in August 2006, considered the matter and supported the council's view that there would be several advantages of converging with IFRS. Keeping in mind the extent of differences between IFRS and Indian Accounting Standards, as well as the fact, that convergence with IFRS

would be an important policy decision, the ASB decided to form an IFRS Task Force. The objectives of the Task Force were to explore:

- ▶ The approach for achieving convergence with IFRS, and
- ▶ Laying down a road map for achieving convergence with IFRS with a view to make India IFRS-compliant.

Based on the recommendation of the IFRS Task Force, the Council of ICAI, at its 269th meeting, decided to converge with IFRS, for accounting periods commencing on or after 1 April 2011. IFRS will be adopted for listed and other public interest entities such as banks, insurance companies and large-sized organizations.

With an objective to ensure smooth transition to IFRS from 1 April 2011, ICAI is taking up the matter of convergence with IFRS with NACAS and other regulators including RBI, IRDA and SEBI. The NACAS has been established by the Ministry of Corporate Affairs, Government of India. ICAI is taking various other steps as well to ensure that IFRS is effectively adopted from 1 April 2011.

These include:

- ▶ Formulation of work-plan, and
- ▶ Conducting training programmes for members of ICAI and others concerned to prepare them to implement IFRS.
- ▶ ICAI will also discuss, with the IASB those areas, where changes in certain IFRS may be required, to reflect conditions specific to India and areas of conceptual differences.

In May 2008, the MCA issued a press release in which it committed to IFRS convergence by 1 April 2011.

Recognizing the convergence efforts of ICAI and MCA, the European Union has recently allowed entities to use Indian

GAAP for listing on a European securities market without reconciliation through to 2011, and if the convergence plan is achieved, to continue to do so after 2011.

Benefits of adopting IFRS for Indian companies

The decision to converge with IFRS is a milestone decision and is likely to provide significant benefits to Indian corporates.

Improved access to international capital markets

Many Indian entities are expanding or making significant acquisitions in the global arena, for which large amounts of capital is required. The majority of stock exchanges require financial information prepared under IFRS. Migration to IFRS will enable Indian entities to have access to international capital markets, removing the risk premium that is added to those reporting under Indian GAAP.

Lower cost of capital

Migration to IFRS will lower the cost of raising funds, as it will eliminate the need for preparing a dual set of financial statements. It will also reduce accountants' fees, abolish risk premiums and will enable access to all major capital markets as IFRS is globally acceptable.

Enable benchmarking with global peers and improve brand value

Adoption of IFRS will enable companies to gain a broader and deeper understanding of the entity's relative standing by looking beyond country and regional milestones. Further, adoption of IFRS will facilitate companies to set targets and milestones based on global business environment, rather than merely local ones.

Escape multiple reporting

Convergence to IFRS, by all group entities, will enable company managements to view all components of the group on one financial reporting platform. This will eliminate the need for multiple reports and significant adjustment for preparing consolidated financial statements or filing financial statements in different stock exchanges.

Reflects true value of acquisitions

In Indian GAAP, business combinations, with few exceptions, are recorded at carrying values rather than fair values of net assets acquired. Purchase consideration paid for intangible assets not recorded in the acquirer's books is usually not reflected separately in the financial statements; instead the amount gets added to goodwill. Hence, the true value of the business combination is not reflected in the financial statements. IFRS will overcome this flaw, as it mandates accounting for net assets taken over in a business combination at fair value. It also requires recognition of intangible assets, even if they have not been recorded in the acquiree's financial statements.

New opportunities

Benefits from the adoption of IFRS will not be restricted to Indian corporates. In fact, it will open up a host of opportunities in the services sector. With a wide pool of accounting professionals, India can emerge as an accounting services hub for the global community. As IFRS is fair value focused, it will provide significant opportunities to professionals including, accountants, valuers and actuaries, which in-turn, will boost the growth prospects for the BPO/KPO segment in India.

IFRS challenges

Shortage of resources

With the convergence to IFRS, implementation of SOX, strengthening of corporate governance norms, increasing financial regulations and global economic growth, accountants are most sought after globally. Accounting resources is a major challenge. India, with a population of more than 1 billion, has only approximately 145,000 Chartered Accountants, which is far below its requirement.

Training

If IFRS has to be uniformly understood and consistently applied, training needs of all stakeholders, including CFOs, auditors, audit committees, teachers, students, analysts, regulators and tax authorities need to be addressed. It is imperative that IFRS is introduced as a full subject in universities and in the Chartered Accountancy syllabus.

Information systems

Financial accounting and reporting systems must be able to produce robust and consistent data for reporting financial information. The systems must also be capable of capturing new information for required disclosures, such as segment information, fair values of financial instruments and related party transactions. As financial accounting and reporting systems are modified and strengthened to deliver information in accordance with IFRS, entities need to enhance their IT security in order to minimize the risk of business interruption, in particular to address the risk of fraud, cyber terrorism and data corruption.

Taxes

IFRS convergence will have a significant impact on financial statements and consequently tax liabilities. Tax authorities should ensure that there is clarity on the tax treatment of items arising from convergence to IFRS. For example, will government authorities tax unrealized gains arising out of the accounting required by the standards on financial instruments? From an entity's point of view, a thorough review of existing tax planning strategies is essential to test their alignment with changes created by IFRS. Tax, other regulatory issues and the risks involved will have to be considered by the entities.

Communication

IFRS may significantly change reported earnings and various performance indicators. Managing market expectations and educating analysts will therefore be critical. A company's management must understand the differences in the way the entity's performance will be viewed, both internally and in the market place and agree on key messages to be delivered to investors and other stakeholders. Reported profits may be different from perceived commercial performance due to the increased use of fair values, and the restriction on existing practices such as hedge accounting. Consequently, the indicators for assessing both business and executive performance, will need to be revisited.

Management compensation and debt covenants

The amount of compensation calculated and paid under performance-based executive, and employee compensation

plans may be materially different under IFRS, as the entity's financial results may be considerably different. Significant changes to the plan may be required to reward an activity that contributes to an entity's success, within the new regime. Re-negotiating contracts that referenced reported accounting amounts, such as, bank covenants or FCCB conversion trigger, may be required on convergence to IFRS.

Distributable profits

IFRS is fair value driven, which often results in unrealized gains and losses. Whether this can be considered for the purpose of computing distributable profits, will have to be debated, in order to ensure that distribution of unrealized profits will not eventually lead to reduction of share capital.

Impact of key differences

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Impact of key differences

Presentation of financial statements

Key differences

1. IAS 1 (Revised 2007) *Presentation of Financial Statements* (IAS 1-R) (effective from annual accounting periods beginning on or after 1 January 2009) is significantly different from the corresponding AS 1. While IAS 1-R sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content, Indian GAAP offers no standard outlining overall requirements for presentation of financial statements. In India, for various entities, the statutes governing the respective entities lay down formats of financial statements. For example, in the case of companies, format and disclosure requirements are set out under Schedule VI to the Companies Act, 1956. For entities such as partnership firms, the statute governing those entities does not lay down any specific format of financial statements.
2. IAS 1-R recognizes the true and fair override provisions. The true and fair override concept is generally not permitted under Indian GAAP. While Clause 49 of the Listing Agreement contains provisions relating to the true and fair override, no practical guidance is available.
3. IAS 1-R requires the presentation of a statement of comprehensive income as part of the financial statements. This statement presents all items of income and expense recognized in profit or loss, together with all other items of recognized income and expense. Entities may either present all items together in a single statement or present two linked statements:
 - i. Displaying the items of income and expense recognized in profit or loss (the income statement), and
 - ii. Statement beginning with profit or loss and displaying all the items included in 'other comprehensive income' (the statement of comprehensive income).The concept of 'other comprehensive income' does not prevail under Indian GAAP, however, information relating to movement in reserves, etc., is generally presented in the caption reserves and surplus in the balance sheet.
4. IAS 1-R requires presentation of all transactions with equity holders in their capacity as equity-holders in the SOCIE. The SOCIE is considered to be an integral part of the financial statements. The concept of a SOCIE does not prevail under Indian GAAP, however, information relating to appropriation of profits, movement in capital and reserves, etc., is presented on the face of the profit and loss account and in the captions share capital and reserves and surplus in the balance sheet.
5. IAS 1-R requires disclosure of:
 - ▶ Critical judgements made by management in applying accounting policies,

- ▶ Key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, and
- ▶ Information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

There are no such disclosures required under Indian GAAP.

6. IAS 1-R prohibits any item to be presented as an extraordinary item, either on the face of the income statement or in the notes, while *AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*, in Indian GAAP, specifically requires disclosure of certain items as extraordinary items.
7. IAS 1-R requires a statement of financial position (balance sheet) as at the beginning of the earliest comparative period, where an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements, to be included in a complete set of financial statements. *AS 5* requires the impact of material changes in accounting policies to be shown in the financial statements. There is no requirement to present an additional balance sheet.
8. IAS 1-R requires dividends recognized as distributions to owners and related amounts per share to be presented in the statement of changes in equity or in the notes. The presentation of such disclosures in the statement of comprehensive income is not permitted. Under Indian GAAP,

a proposed dividend is shown as appropriation of profit in the profit and loss account.

Impact on financial reporting

IAS 1-R essentially sets out overall requirements for presentation of financial statements. For balance sheets, it requires a clean segregation of current and non-current items for assets and liabilities. In the profit and loss account presentation of expenses by function or by nature is allowable. Therefore, IAS 1-R significantly impacts the presentation of financial statements. These impacts are covered under the following broad parameters:

▶ Enhanced transparency and accountability

The disclosure of information required by IAS 1-R, with reference to critical judgements made by management in applying accounting policies and to key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, would not only bring greater transparency in the financial statements, but it would also put additional onus on entities to ensure that estimates and judgements made are justifiable, since, they are publicly accountable for them.

Application of IAS 1-R would require entities to present the total amount of recognized gains or losses for a period, comprising profit or loss for the period and amounts recognized directly in reserves in the statement of comprehensive income. Transactions with equity holders or 'owners' of the entity, in their capacity as such, are presented separately in SOCIE. These amounts are not

available separately in Indian GAAP financial statements.

► **Better presentation of financial position**

Under IAS 1-R, each entity should present its balance sheet using current and non-current assets and liabilities classifications on the face of the balance sheet, except, when a presentation based on liquidity provides information that is reliable and more relevant. As per IAS 1-R, whichever method of presentation is adopted, for each asset and liability item that combines amounts expected to be recovered or settled, both, before and after 12 months from the balance sheet date, an entity shall disclose two amounts separately. For various items, there is no similar requirement under Indian GAAP. For example, under Schedule VI, companies are not required to disclose the amount payable within one year with respect to secured loans.

► **Legal implications**

Unless Indian laws are amended to comply with IFRS, entities would not be able to make an unreserved and explicit statement of compliance with IFRS, as required to be made under IAS 1.

Impact on organization and its processes

Till now, we have discussed the impact of IFRS convergence on financial reporting. However, the impact on an organization implementing IFRS may be very different, from what can be understood only by solely analyzing the impact on financial reporting.

Although, IAS 1-R would be unlikely to have any bottom line impact on entities, they would be required to review and modify, if necessary, their organization and processes to ensure that information to comply with all disclosure requirements of IAS 1-R is collected. It may be noted that because of the current/non-current classification, some of the gearing ratios may change or become more transparent.

Many entities, particularly those not subject to any externally imposed capital requirements, may not have well documented and formally established objectives, policies and processes for managing capital. To comply with the IAS 1-R requirement for making disclosures regarding capital, such entities would need to formalize and document their objectives, policies and processes for managing capital. This would involve personnel, not only from the entity's accounts department, but also those from other functions, such as finance and treasury. Similarly, the disclosure of current and non-current portions of assets and liabilities in the balance sheet would also require the involvement of finance and treasury functions.

Though not prohibited, most entities do not use functional classification to present their expenses, as this would result in extra efforts, due to the Schedule VI requirement that information be given based on the nature of expense. Some software companies and a few other entities provide information according to the function of expense on the face of profit and loss account. They also present complete information as to nature of the expense in the notes, in order to comply with the requirements of Schedule VI. If entities want to follow functional classification under IFRS, the successful

establishment of such a mechanism would require changes in the accounting system and codification structure.

The above discussion is based on existing Schedule VI and AS 1. The MCA has exposed a draft of revised Schedule VI. Our analysis above would change significantly if the proposed changes were currently effective. The ICAI is also in process of revising AS 1.

Business combinations

Key differences

1. IFRS 3 (Revised) *Business Combinations* (effective for business combinations for which acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009) applies to most business combinations, including amalgamations (where the acquiree loses its existence) and acquisitions (where the acquiree continues its existence). Under Indian GAAP, there is no comprehensive standard dealing with all business combinations. AS 14 *Accounting for Amalgamations* applies only to amalgamations, i.e., when acquiree loses its existence and AS 10 *Accounting for Fixed Assets* applies when a business is acquired on a lump-sum basis by another entity. AS 21 *Consolidated Financial Statements*, AS 23 *Accounting for Investments in Associates in Consolidated Financial Statements* and AS 27 *Financial Reporting of Interests in Joint Ventures* apply to subsidiaries, associates and joint ventures, respectively.
2. IFRS 3-R requires all business combinations (excluding common control transactions) within its scope to be accounted under the purchase method, prohibiting merger accounting. Indian GAAP permits both the purchase method and the Pooling of Interest method in the case of amalgamation. The Pooling of Interest method is allowed only if the amalgamation satisfies certain specified conditions.
3. IFRS 3-R requires the net assets taken over, including contingent liabilities and intangible assets, to be recorded at fair value, unlike Indian GAAP, which requires, in the case of subsidiaries, associates and joint ventures, the recording of net assets at carrying value. Contingent liabilities of acquiree are not recorded as liabilities under Indian GAAP.
4. IFRS 3-R prohibits amortization of goodwill arising on business combinations and requires it to be tested for impairment annually. Indian GAAP requires amortization of goodwill in the case of amalgamations. With reference to goodwill arising on acquisition through equity, no guidance is provided in Indian GAAP.
5. IFRS 3-R requires negative goodwill to be credited to profit and loss account, whereas this is credited to the capital reserve under Indian GAAP.
6. Under IFRS 3-R, acquisition accounting is based on substance. Reverse acquisition is accounted assuming the legal acquirer is the acquiree. In Indian GAAP, acquisition accounting is based on form. Indian GAAP does not deal with reverse acquisitions.
7. IFRS 3-R requires that contingent consideration in a business combination be measured at fair value at the date of acquisition, and that

this is recognized in the computation of goodwill/negative goodwill. Subsequent changes in the value of contingent consideration depend on, whether they are equity instruments, assets or liabilities. If they are assets or liabilities, subsequent changes are, generally, recognized in profit or loss for the period. Under Indian GAAP, AS 14 requires that, where the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment is included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment is recognized as soon as the amount is determinable. No guidance is available for contingent consideration arising under other types of business combinations.

8. IFRS 3-R specifically deals with accounting for pre-existing relationships between acquirer and acquiree and for re-acquired rights by the acquirer in a business combination. Indian GAAP does not provide guidance for such situations.
9. IFRS 3-R provides an option to measure any non-controlling (minority) interest in an acquiree at its fair value or at the non-controlling interest's proportionate share of the acquiree's net identifiable assets. Under Indian GAAP, AS 21 does not provide the first option and it requires minority interest in a subsidiary to be measured at the proportionate share of net assets at book value.
10. IFRS 3-R requires that, in a business combination achieved in stages, the acquirer remeasures its previously

held equity interest in the acquiree at its acquisition date fair value and that it recognizes the resulting gain or loss, if any, in profit or loss. There is no such requirement under Indian GAAP. Under AS 21, if two or more investments are made in a subsidiary over a period of time, the equity of the subsidiary at the date of investment is generally determined on a step-by-step basis.

The changes brought in by IFRS 3-R are going to affect all stages of the acquisition process, from planning to the presentation of the post deal results. The implications primarily involve providing greater transparency and insight into what has been acquired, and allowing the market to evaluate the management's explanations of the rationale behind a transaction. The key impact of IFRS 3-R is summarized below.

Impact on financial reporting

► True value of acquisition will be reflected

Following an acquisition, financial statements will look very different. Assets and liabilities will be recognized at fair value. Contingent liabilities and intangible assets which are not recorded in the acquiree's balance sheet will be appearing in the acquirer's balance sheet. In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition date fair value. The acquirer shall also have an option to measure non-controlling interest at fair value. These changes in the recognition of net assets and the measurement of previously held equity interests and non-controlling interests will significantly change

the value of goodwill recorded in the financial statements. Goodwill reflected in the financial statements will project actual premium paid by an entity for the acquisition.

► **Greater transparency**

Significant new disclosures are required regarding the cost of the acquisition, the values of the main classes of assets and liabilities and the justification for the amount allocated to goodwill. All stakeholders will be able to evaluate actual worth of an acquisition and its impact on the future cash flow of the entity.

► **Significant impact on post acquisition profits**

Under Indian GAAP, net assets taken over are normally recorded at book value, and hence, the charges to the profit and loss account for amortization and depreciation expenses are based on carrying value. However, net assets taken over will be recorded at fair value under IFRS 3-R. This results in a charge to profit and loss account for amortization and depreciation based on fair value, which is the true price paid by acquirer for those assets. Goodwill is not required to be amortized but is required to be tested annually for impairment under IFRS 3-R. Negative goodwill is required to be credited to profit and loss account under IFRS 3-R. In a business combination achieved in stages, the previously held equity interest in the acquiree is measured at its acquisition-date fair value and the resulting gain or loss, if any, is recognized in the profit and loss account. These items increase volatility in the income statement.

► **Accounting for business combination vis-à-vis High Court order**

In India, 'law overrides Accounting Standards' is an accepted principle. Hence, accounting is based on the treatment prescribed by the High Court in its approval, even though it may not be in accordance with Accounting Standards. However, IFRS does not recognize the principle of a legal override. Thus, once IFRS is adopted, accounting will need to be based on principles prescribed in IFRS 3-R. To achieve this, entities will need to ensure that schemes filed with the High Court do not prescribe any treatment or that the treatment prescribed is in accordance with IFRS.

Impact on organization and its processes

► **Use of experts**

The acquisition process should become more rigorous, from planning to execution. More thorough evaluation of targets and structuring of deals will be required in order to withstand greater market scrutiny. Expert valuation assistance may be needed to establish values for items such as new intangible assets and contingent liabilities.

► **Purchase price allocation**

Under Indian GAAP, no emphasis was given to purchase price allocation as net assets were generally recorded based on the carrying value in the acquiree's balance sheet. IFRS 3-R places significant importance to the purchase price allocation process. All the identifiable assets of the acquired business must be recorded at their fair values. Many intangible assets that would previously have been subsumed within goodwill must be separately identified and valued.

Explicit guidance is provided for the recognition of such intangible assets. Contingent liabilities are also required to be fair valued and recognized in the acquirer's balance sheet. The valuation of such assets and liabilities is a complex process and would require specialist skills.

► **Deal structures may change**

Under Indian GAAP, entities were inclined to give consideration in equity shares to satisfy conditions of merger accounting. The end of merger accounting for all acquisitions, under the scope of IFRS 3-R, removes this constraint on the structure of deal considerations. Presently, it is possible for entities to buy companies which do not violate merger conditions so that the pooling method can be applied. Under IFRS 3-R, these opportunities will no longer be available.

3. Under IAS 27-R, consolidation is required for all subsidiaries, whereas, there are two exemptions from consolidation provided under Indian GAAP.
4. The definition of control is different under IFRS as compared to Indian GAAP.
5. Potential voting rights, which are currently exercisable, are considered for determination of control under IFRS. Indian GAAP is silent on whether potential voting rights are to be considered for control. However, under AS 23, potential voting rights are not considered for determining significant influence in the case of an associate. Thus, an analogy can be drawn in the case of a subsidiary as well.
6. For cross-holdings between an associate and an investor, IFRS requires the reciprocal interest to be accounted for at fair value and deducted from equity. There is no guidance under Indian GAAP for cross-holdings.
7. Both, IFRS and Indian GAAP require use of uniform accounting policies for preparation of CFS. However, Indian GAAP provides an exemption on the grounds of impracticality.
8. IFRS allows a three-month time gap between financial statements of a parent or investor and its subsidiary, associate or jointly controlled entity. Indian GAAP allows a six-month time gap for subsidiaries and jointly controlled entities. For associates, there is no time gap prescribed.
9. IFRS requires consolidation of SPEs, whereas, Indian GAAP does not provide any specific guidance on this subject.

Group accounts

Key differences

1. Under IAS 27 (Amended) *Consolidated and Separate Financial Statements* (IAS 27-R), the preparation of group accounts is mandatory, subject to a few exemptions, whereas, preparation of CFS is required only for listed entities under Indian GAAP.
2. Under IAS 27-R, the application of equity method or proportionate consolidation to associates/joint ventures is mandatory, subject to a few exceptions, even if an entity does not have any subsidiaries. Under Indian GAAP, application of the equity method or proportionate consolidation is required only when the entity has subsidiaries and prepares CFS.

10. Under IFRS changes in ownership interests of a subsidiary (that do not result in the loss of control) are accounted for as an equity transaction and have no impact on goodwill or the income statement. No guidance is given in Indian GAAP for changes in ownership interest of a subsidiary that do not result in loss of control.
11. IFRS requires losses incurred by the subsidiary to be allocated between the controlling (parent) and non-controlling interests, even if the losses exceed the non-controlling equity investment in the subsidiary. Under Indian GAAP, excess losses attributable to minority shareholders over the minority interest are adjusted against the majority interest unless the minority has a binding obligation to, and is able to, make good the losses.

Impact on financial reporting

Preparation of CFS

Indian GAAP does not require preparation of CFS for unlisted entities. If IFRS is adopted by such entities, they will have to prepare their group accounts. Even for listed entities, under Indian GAAP there is no guidance on consolidation of SPEs, and hence, many are not being consolidated. Under IFRS, SPEs which satisfy certain criteria need to be consolidated. Unlike Indian GAAP, the consolidation of associates and joint ventures will be required even if the entity does not have any subsidiary in the financial statements prepared under IFRS.

Adoption of IFRS does not always result in consolidation, but may result in de-consolidation of certain subsidiaries in some cases. Under Indian GAAP, two groups can consolidate the same

entity, i.e., one group consolidates as it holds majority ownership stake, whereas, another group consolidates as it controls the board of directors. Under IFRS, control can be held only by one entity, and it is unlikely that two entities would consolidate the same company.

Uniform accounting policies

Indian GAAP provides an exemption from the use of uniform accounting policies for the consolidation of subsidiaries, associates and joint ventures on the grounds of impracticality. IFRS does not provide such an exemption and mandates the use of uniform accounting policies for subsidiaries, associates and joint ventures. This is likely to pose significant challenges, especially, in the case of associates where the entity does not have a control over the associate. All entities will have to gear their systems or develop systems like preparation of group accounting manuals to ensure compliance with this requirement. On adoption of IFRS, many group entities will have to change their accounting policies to bring them in line with the parent entity.

Financial year-ends of all components in the group

Indian GAAP allows a maximum time gap of six months between financial statements of parent and subsidiary, and that of venturer and joint venture. There is no time limit prescribed between financial statements of investor and associate. IFRS allows a maximum time gap of three months for subsidiaries, associates and joint ventures. On adoption of IFRS, many entities may be compelled to change the year-ends of their group entities to comply with this requirement to avoid reporting results at multiple dates.

Impact on organization and its processes

Use of group accounts by various stakeholders

Under Indian GAAP, the preparation of CFS is required only by listed entities. Once IFRS is adopted, the preparation of CFS will be required for all entities. Benchmarking by analysts and other stakeholders will move from entity centric to group centric information. Management of the holding entity will be accountable, not only for the performance of the holding company, but also for the performance of all group entities. Consolidation of previously unconsolidated entities may adversely affect key ratios and performance indicators such as risk-based capital ratios of a financial institution.

Coordination with management of associates and joint ventures

Under IFRS, there is no exemption from the requirement of uniform accounting policies. Also, the time gap between financial statements of an investor and of an associate can be maximum three months. Hence, an entity needs to initiate dialogue with the management of the associate and joint venture to obtain information of the requisite data as per the group accounting policies for the purpose of consolidation.

Updation of group structures

Adoption of IFRS may result in consolidation of certain entities such as SPEs and de-consolidation of certain other entities. The adoption of IFRS will also require potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, to be considered when assessing, whether another entity is a

subsidiary, associate or joint venture of the entity. This will require updating the organization structure maintained by the entity. Many unlisted entities, who are not required to prepare CFS, might not have prepared a comprehensive group structure. They will have to initiate this exercise for identifying all components in the group.

Financial instruments

Key differences

IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement*, and IFRS 7 *Financial Instruments: Disclosures* deal with presentation, recognition and measurement and disclosure aspects of financial instruments, in a comprehensive manner. In India, ICAI has issued AS 30, *Financial Instruments: Recognition and Measurement*, AS 31, *Financial Instruments: Presentation* and AS 32 *Financial Instruments: Disclosures*, which are based on IAS 39, IAS 32 and IFRS 7, respectively, and are mandatory from 1 April 2011. However, these have not yet been adopted under the Companies Accounting Standard Rules. Pending the application of these AS, the pronouncements which deal with certain types of financial instruments are AS 13, *Accounting for Investments*, *Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options*, *Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds*, *Guidance Note on Accounting for Securitisation* and ICAI Announcement on *Accounting for Derivatives*.

1. IAS 32 requires the issuer of a financial instrument to classify the instrument as a liability or equity on initial recognition, in accordance with its substance and the definitions of these terms. The application of this principle requires certain instruments which have the form of equity to be classified as liability. For example, under IAS 32, mandatorily redeemable preference shares on which a fixed dividend is payable are treated as a liability. Under Indian GAAP, classification is normally based on form rather than substance.
 2. IAS 32 requires compound financial instruments, such as convertible bonds, to be split into liability and equity components and each component is recorded separately. Under Indian GAAP, no split accounting is done and financial instruments are classified as either a liability or equity, depending on their primary nature. For example, a convertible debenture is generally treated as liability.
 3. Under IAS 39, all financial assets are classified into four categories, namely, FVPL, AFS, HTM, and L&R. Subsequent to initial recognition, FVPL assets are valued at fair value with gain or loss being recognized in profit or loss. AFS assets are valued at fair value with gain or loss being recognized in equity, which is recycled into profit or loss, either on impairment or on derecognition of those assets. HTM and L&R assets are valued at amortized cost using the effective interest rate. Under Indian GAAP, long term investments are recorded at cost less "other than temporary" diminution in value of investments. Current investments are recorded at lower of cost or market price. L&R are carried at actual cost and interest thereon is recognized at contractual rate, if any.
 4. Under IAS 39, all financial liabilities are classified into two categories, namely, FVPL and other financial liabilities. Initial measurement of all financial liabilities is at fair value. Subsequent to initial recognition, FVPL liabilities are measured at fair values with gain or loss being recognized in income statement. Other financial liabilities are measured at amortized cost using effective interest rates at each balance sheet date.
 5. IAS 39 defines a derivative as a financial instruments or other contract having the following three characteristics:
 - i. Its value changes in response to the change in a specified interest rate, financial instrument price, etc.
 - ii. It requires no or smaller initial net investment.
 - iii. It is settled at a future date. As per IAS 39, all derivatives, except those used for hedge purposes, are measured at fair value and any gains/losses are recognized in profit or loss.
- In India, AS 11 *The Effects of Changes in Foreign Exchange Rates* currently deals with foreign currency forward exchange contracts (except for those entered into to hedge a firm commitment or highly probable forecast transaction). Accounting prescribed under AS 11 for such forward contracts is based on whether the contract is for hedge or speculation purposes. For derivatives not covered under AS 11, the ICAI

Announcement on *Accounting for Derivatives* requires a mark-to-market loss to be provided for open derivative contracts as at the balance sheet date. Mark-to-market gains generally remain outside the balance sheet.

6. IAS 39 deals with various aspects of hedge accounting in a comprehensive manner. It defines three types of hedging relationships, comprising, fair value hedges, cash flow hedges and hedges of net investments in a foreign operation. It also lays down conditions which need to be fulfilled to apply hedge accounting. In India, AS 11 currently deals with forward exchange contracts for hedging foreign currency exposures (except for those arising from firm commitments or highly probable forecast transactions). There is no standard which deals with other types of hedge.
7. IAS 39 requirements on derecognition of financial assets are different to those contained in the *Guidance Note on Accounting for Securitisation*. Further, under Indian GAAP there is no methodology for determining impairment of financial assets. IAS 39 includes detailed provisions for determining impairment of financial assets.
8. IFRS 7 requires entities to provide comprehensive disclosures in their financial statements that enable users to evaluate:
 - ▶ The significance of financial instruments for its financial position and performance, and
 - ▶ The nature and extent of risks arising from financial instruments, and how the entity manages those risks.

The disclosures required under IFRS 7 include quantitative, as well as, qualitative information. Under Indian GAAP, ICAI has issued an Announcement on *Disclosure regarding Derivative Instruments*, which requires certain minimum disclosures to be made concerning financial instruments.

Impact on financial reporting

Recognition and measurement

IAS 39 requires balance sheet recognition for all financial instruments (including derivatives), and makes greater use of fair values than under Indian GAAP. All financial assets and financial liabilities are initially recognized (in the balance sheet) at fair value. In the case of FVPL assets, liabilities and derivatives (other than those used for hedging), subsequent changes in fair value are recognized in profit or loss. The use of fair values sometimes causes volatility in the income statement or equity. To comply with the IAS 39 requirement to measure all derivatives at fair value, entities have to make use of valuation tools.

Impairment

IAS 39 requires a provision for impairment to be recognized as soon as there is a risk that the initial value of an asset may not be recovered. The measurement of impairment takes into account the time value of money. Thus, under IFRS, a change in the timing of cash flows may cause impairment, even if the entity does not expect any default on restructured terms. IAS 39 prohibits reversal of impairment on AFS equity instruments and unquoted equity instruments carried at cost. Thus, under IFRS, an impairment of the above equity instruments would be final and the entity would never be allowed to reverse the loss.

Debt

Debt and equity classifications are substantially changed, as a result of several provisions in IAS 32 and IAS 39. Some of the instruments, such as redeemable preference shares, are classified as equity, based on their form under Indian GAAP. This may contain liabilities upon conversion to IFRS. Similarly, to convert to IFRS, the compound instruments which are classified as debt or equity depending on their primary nature need to be split into debt and equity and each portion treated separately.

Derecognition

Because of the very strict criteria for derecognizing financial assets in IAS 39, some financial asset disposal transactions (particularly the sale of trade receivables) may be reclassified as guaranteed loans. This risk is greater since, SPEs involved in such transactions must generally be consolidated by the vendor entity in accordance with strict criteria of SIC 12 *Consolidation – Special Purpose Entities*. The IFRS derecognition criteria are based on the substance of the transaction, and are generally more restrictive than the approach applied under the *Guidance Note on Accounting for Securitisation*.

Comprehensive disclosures

IFRS 7 requires very comprehensive disclosures regarding financial instruments and financial risks to which an entity is exposed, as well as, the policies for managing such risks. Comprehensive information on the fair value of financial instruments would enhance the transparency and accountability of financial statements.

Impact on organization and its processes

The implementation of IAS 39 and IAS 32 will have a significant impact on all banks and on many industrial and commercial entities. In particular, entities with central treasury functions will have to review their operational processes and consider implications for their current hedge accounting policies. In addition to accountants, operational personnel from various departments must be involved in implementing IAS 32 and IAS 39, including the following:

- ▶ Treasury teams (front office, back office, and middle office),
- ▶ Sales representatives in charge of negotiating contracts,
- ▶ Purchasing personnel, and
- ▶ Legal staff.

For example, identifying derivatives would be an entity-wide process under IAS 39. Embedded derivatives are also considered as derivatives and must be recognized separately from their host contracts (debts or sales contracts). In addition, certain contracts, which were not classified previously as derivatives, may qualify as such and will be required to be measured at fair value (resulting in an impact on profit or loss).

Therefore, the first phase of IAS 39 implementation will include identification of derivatives, documentation of hedges, and requires the involvement of:

- ▶ **The treasury department:** for analyzing all financial contracts, particularly debt contracts,
- ▶ **Sales representatives:** for identifying any embedded derivatives in the form of indexation to a financial instrument price, interest rate or any other variable without a close link with the host contract,

- ▶ **Purchasing department personnel:** for performing similar analyzes on supply contracts, including any indexing provisions in commodity contracts, and
- ▶ **Operational personnel:** for documenting hedges.

Income taxes

Key differences

- ▶ AS 22 *Accounting for Taxes on Income* is based on the income statement liability method, which focuses on timing differences, whereas, IAS 12 *Income Taxes* is based on the balance sheet liability method which focuses on temporary differences.
- ▶ IAS 12 requires the recognition of deferred taxes in the case of business combination. Under IFRS, the cost of a business combination is allocated to the identifiable assets acquired and liabilities assumed by reference to their fair values. However, if no equivalent adjustment is allowed for tax purposes, it would give rise to a temporary difference. Under Indian GAAP, business combinations (other than amalgamation) will not give rise to a deferred tax adjustment.
- ▶ Where an entity has a history of tax losses, under IFRS the entity recognizes a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available. Under Indian GAAP, if the entity has carried forward tax losses or unabsorbed depreciation, all deferred tax assets are recognized only to the extent that there is virtual certainty supported by

convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realized. IAS 12 does not lay down any requirement for consideration of virtual certainty in such cases.

Impact on financial reporting

- ▶ **Deferred tax accounting for the group**
Under IFRS, temporary differences arise to the extent that the subsidiary, associate or joint venture has not distributed its profits to the parent or investor, which is normally the case. IAS 12 requires deferred tax to be recognized for this, except in specified circumstances. IAS 12 also requires deferred tax to be recognized on temporary differences that arise from the elimination of profits and losses resulting from intra-group transactions. As a result, deferred tax for the group under IFRS can be significantly different from that under Indian GAAP, depending on the undistributed profits of the subsidiaries, associates or joint ventures and the effect of elimination of profits and losses resulting from intra-group transactions. IFRS requires recognition of deferred tax on revaluation of assets. This, however, is not required under Indian GAAP.
- ▶ **Acquisitions**
Deferred tax on acquired assets, liabilities and contingent liabilities is considered an acquired asset or liability. Goodwill under IFRS is determined accordingly. Reversal of deferred tax asset/liability in future years affects the tax expense or income of those years. Therefore, the

effect of acquisition deferred taxes on future financial statements will differ significantly under IFRS and Indian GAAP. This factor will influence the acquisition transaction.

► **Entities in tax losses**

Due to the strict principle under Indian GAAP of virtual certainty, only in very rare cases can entities recognize deferred tax assets, where they have carried forward losses and unabsorbed depreciation. The 'convincing evidence' principle under IFRS, which is less stringent compared to Indian GAAP 'virtual certainty' principle, allows the entity to recognize tax income on carried forward tax losses and unabsorbed depreciation as well.

Impact on organization and its processes

IAS 12 implementation requires accounting personnel to work effectively with the tax department to:

1. Monitor and calculate tax bases of assets and liabilities,
2. Monitor tax losses and tax credits of all components in the group,
3. Assess recoverability of deferred tax assets,
4. Determine possible offsets between deferred tax assets and liabilities,
5. Monitor changes in tax rates and collect applicable tax rates to determine the amount of deferred tax in the event of asset disposal,
6. Understand implications of double tax treaty, where there are foreign operations, and
7. Prepare more detailed disclosures – tax reconciliation.

Tax teams should be involved, both at the group and subsidiary level. If no tax

specialists are available at the subsidiary level, tools (e.g., accounting and tax manuals, including checklists that enable group entities to accurately determine tax bases) and appropriate training should be provided to ensure quality reporting. The group needs to do a thorough review of existing tax planning strategies to test alignment with any organizational changes created by IFRS conversion.

Employee benefits and share-based payments

Key differences

1. IAS 19 *Employee Benefits* provides options to recognize actuarial gains and losses immediately in the statement of comprehensive income either as a component of income statement or other comprehensive income. Alternatively, an entity may apply the corridor approach, under which an entity recognizes a portion of its actuarial gains and losses as income or expense if the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of:
 - 10% of the present value of the defined benefit obligation at that date (before deducting plan assets), and
 - 10% of the fair value of any plan assets at that date.

Any actuarial gains and losses above the 10% corridor can be amortized over the remaining service period of employees or on an accelerated basis. Indian GAAP requires all actuarial gains and losses to be recognized immediately in the profit and loss account.

2. Under IFRS, the liability for termination benefits has to be recognized based on constructive obligation, Indian GAAP requires it to be recognized based on legal obligation.
3. In IFRS, there is no concept of deferral for termination benefits. Under Indian GAAP, for VRS expenditure incurred on or before 31 March 2009, the entity may choose to follow the accounting policy of deferring such expenditure over its pay-back period. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1 April 2010 (sunset date).
4. Under IFRS, employee share-based payments should be accounted for using the fair value method. In contrast, Indian GAAP permits an option of using either intrinsic value method or fair value method.
5. IFRS provides detailed guidance for accounting for group and treasury share transactions. No such guidance is provided in Indian GAAP.

Impact on financial reporting

► **Reduce volatility in income statement on account of actuarial differences**

Actuarial gains and losses arise due to changes in actuarial assumptions, such as in respect to the discount rate, increase in salary, employee turnover, mortality rate, etc. Under the corridor approach of IFRS, it is permissible to defer the actuarial gains or losses under certain circumstances. This flexibility is not provided under Indian GAAP. This approach, purely from a fair value and asset or liability definition perspective, is superior

to IFRS but puts Indian entities at a disadvantage as compared to their global counterparts. On adoption of IFRS, an entity can choose to reduce volatility in their income statement arising on account of actuarial differences.

► **Timing of recognition of termination benefits**

Under IFRS, termination benefits are required to be provided when the scheme is announced and the management is demonstrably committed to it. Under Indian GAAP, termination benefits are required to be provided for, based on legal liability (when employee signs up for the VRS) rather than constructive liability. This is a timing issue for creating a provision. Under IFRS, an entity cannot spread the impact of providing termination benefit to more than one accounting period as deferral is not permitted. Under Indian GAAP, the VRS expenditure prior to 31 March 2009 could be deferred.

► **True value of ESOP**

Indian GAAP permits entities to account for ESOPs, either through fair value method or intrinsic value method though disclosure is required to be made of the impact on profit or loss of applying the fair value method. It is observed that most Indian entities prefer to adopt the intrinsic value method. The drawback of the intrinsic value method is that it does not factor option and time value when determining compensation cost. Under IFRS, the accounting for ESOPs will have to be remeasured using fair value method, which may result in increased charges for ESOPs for many

entities and will have a significant impact on key indicators like EPS.

► **Accounting for share-based payments to non-employees**

In recent times, it is observed that many entities are entering into partnership agreements with their vendors so as to provide them with opportunities of sharing profits of a particular venture by offering them share-based payments. This mode of payment is considered as an incentive tool intended to encourage vendors to complete efficient and quality work. Under Indian GAAP, AS 10 requires a fixed asset acquired in exchange for shares to be recorded at its fair market value or the fair market value of the shares issued, whichever is more clearly evident. For other goods and services, there is no guidance for recognizing the cost of providing such benefits to the vendors in lieu of goods or services received. Different accounting policies are being followed by Indian entities which ranges from no-charge to accounting, as per principles of IFRS 2 *Share-based Payment*. On adoption of IFRS, an entity will have to account for such benefits under fair value method laid down in IFRS 2.

► **Accounting for group ESOP Plans**

In India, the practice is that a subsidiary normally does not account for ESOPs issued to its employees by its parent entity, contending that clear-cut guidance is not available and it does not have any settlement obligation. Under IFRS, such ESOPs will have to be accounted as per principles laid down in IFRIC 11 *IFRS 2 Group and Treasury Share transactions*, i.e., either as equity settled or as cash settled plan,

depending on whether the parent or subsidiary is obligated to provide stock options to the employees. As per IFRIC 11, all entities whose employees are being provided ESOP benefits by its parent or other group entities will have to account for the charge in their income statement, which will reflect the true compensation cost of receiving employee benefits.

Impact on organization and its processes

IAS 19 and IFRS 2 are likely to have a major impact on many organizations. Additional liabilities arising from adoption of IFRS 2 will negatively impact financial results and ratios. In some situations, the ability to pay dividends may be affected and there may also be implications from restrictive covenants in existing debt/equity agreements or lease contracts. As a result, many entities should carry out a comprehensive review of their rewards and recognition mechanisms in order to ensure that these continue to support business strategies in a cost effective manner. Not only cash cost, but accounting cost also needs to be considered, and the impact on key stakeholders (senior management, employees, potential recruits, trade unions, pension trustees and rating agencies) needs to be understood. While IFRS 2 may have a negative effect, IAS 19 may have the opposite effect, since actuarial losses are allowed to be deferred.

Senior management, finance, operational and human resource personnel will need to work closely with each other, their actuaries and their external advisors to ensure a full understanding of the accounting and business impact of

alternative employee benefits and of emerging best practices in an IFRS environment.

Impairment of assets

Key differences

- ▶ Under Indian GAAP the recoverable amount of intangible assets which are not yet available for use, or those that are amortized over a period exceeding ten years from the date when the asset is available for use needs to be estimated at least at the end of each financial year. Under IFRS, an annual impairment test is required for intangible assets with an indefinite useful life or an intangible asset not yet available for use. This test can be performed at any time during the year, provided it is performed at the same time every year.
- ▶ AS 28 *Impairment of Assets* employs 'bottom-up/top-down' approach for goodwill allocation for impairment testing. This requires goodwill to be allocated to a CGU or smallest group of CGUs to which goodwill (or portion thereof) can be allocated on a reasonable and consistent basis. In contrast, IAS 36 *Impairment of Assets* requires goodwill to be allocated to each of the acquirer's CGUs which are expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated should:
 - ▶ Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes, and

- ▶ Not be larger than an operating segment.
- ▶ IFRS requires an annual impairment test for goodwill acquired in a business combination.
- ▶ Once an impairment loss is recognized for goodwill, it cannot be reversed subsequently under IFRS. In Indian GAAP, the impairment loss on goodwill is reversed in a subsequent period when the impairment loss was caused by a specific external event of an exceptional nature, that is not expected to recur and subsequent external events have occurred that reverse the effect of that event.

Impact on financial reporting

- ▶ **Income statement volatility due to impairment of specified intangible assets and goodwill**
Indian GAAP does not allow intangible assets to be assigned an indefinite useful life. Therefore, all intangible assets are amortized over time. Since IFRS permits certain intangibles to be assigned an indefinite useful life with no amortization, it creates volatility in the income statement when impairment is recognized for such intangible assets. Due to the requirement under IFRS for annual impairment testing of goodwill, impairment testing is unavoidable for CFS when such financial statements include goodwill, which is the case for most groups.
- ▶ **Goodwill once impaired is impaired forever under IFRS**
IAS 36 prohibits reversal of impairment losses on goodwill in subsequent periods. In Indian GAAP, entities have the possibility of reversing such loss of goodwill.

Impact on organization and its processes

The identification of Cash Generating Units (CGUs) for impairment testing purposes requires the participation of operational staff, in addition to accounting and finance staff. Personnel from strategy and planning, mergers and acquisitions, and management and operations are likely to play an important role in identifying CGUs, allocation and tracking of goodwill arising on acquisition to various CGUs, and in preparing cash flow projections used for calculating recoverable amounts. The future cash flows are estimated for the asset in its current condition under both the frameworks. Typically, an entity's budgets will include cash inflows and outflows related to restructuring planned in the coming years. Such cash flows need to be excluded for impairment testing. As a result, the entity will need to adjust its budgets to enable them to be used for impairment tests.

Future impairment on newly acquired businesses may invite negative publicity and class action from investors. The threat of impairment will also mean that a company will be extremely cautious in its merger and acquisition strategies. In many situations, the entity would probably refrain from those acquisitions where the threat perception of impairment is greater.

Property, plant and equipment, intangible assets, investment property and leases

Key differences

1. IAS 16 *Property, Plant and Equipment* mandates component accounting, whereas, AS 10 recommends, but does not require, component accounting.

2. IFRS requires depreciation to be based on the useful economic life of an asset. In Indian GAAP, depreciation is based on higher of useful life or Schedule XIV rates.
3. Major repairs and overhaul expenditure are capitalized under IFRS as replacement costs, if they satisfy the recognition criteria, whereas, in most cases, Indian GAAP requires these to be charged off to the profit and loss account as incurred.
4. IFRS requires estimates of useful lives and residual values to be reviewed at least at each financial year-end. In Indian GAAP, there is no need for an annual review of estimates of useful lives and residual values.
5. Both IFRS and Indian GAAP permit the revaluation model for subsequent measurement. If an asset is revalued, IFRS mandates revaluation to be done for the entire class of property, plant and equipment to which that asset belongs, and the revaluation to be updated periodically. In Indian GAAP, revaluation is not required for all the assets of the given class, it is sufficient that the selection of the assets to be revalued is made on systematic basis, e.g., an entity may revalue a class of assets of one unit and ignore the same class of assets at other location. Also, there is no need to update revaluation regularly under Indian GAAP.
6. Under IFRS, depreciation on the revaluation portion cannot be recouped out of revaluation reserve, and will have to be charged to the income statement over the useful life of the asset, whereas, Indian GAAP permits depreciation on revaluation portion to be recouped out of

revaluation reserve to the income statement.

7. IFRS provides detailed rules for the classification of an asset as an investment property and allows subsequent measurement of investment property at cost or at fair value. Indian GAAP requires investment property to be recognized at cost less other than temporary diminutions in value.
8. Under IFRS, intangible assets can have indefinite useful life. Such assets are required to be tested for impairment and are not amortized. Under Indian GAAP, there is no concept of indefinite useful life.
9. Under IFRS, the revaluation model is allowed for accounting of an intangible asset provided an active market exists, whereas, Indian GAAP does not permit use of the revaluation model for intangible assets.
10. IFRS requires land leases to be normally classified as an operating lease unless title passes to the lessee at the end of the lease term. Under Indian GAAP, no accounting standard deals with land leases. As per a recent EAC opinion, long-term lease of lands should be treated as finance lease.
11. IFRS requires an entity to determine whether an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments, is a lease. Under IFRIC 4, *Determining whether an Arrangement contains a Lease*, such determination shall be based on the substance of the arrangement, e.g., power purchase agreements and outsourcing contracts may have the substance of

lease. Indian GAAP does not provide any guidance for such arrangements.

Impact on financial reporting

Under IAS 16, a component of an item of property, plant and equipment with a cost that is significant in relation to total cost of an item shall be separately depreciated. Hence, entities need to bifurcate the cost of an asset into significant parts if their useful life is different and depreciate them separately. This requirement will require entities to restructure their fixed asset register and recompute depreciation. Also, the requirement of estimating residual value is likely to change depreciation of many assets as Indian entities normally presume 5% of the value of assets as their residual value, rather than making any estimate of the residual value.

► Revaluation of fixed assets

Indian entities, which have selectively revalued fixed assets or intend to revalue the fixed assets, will have to determine whether they want to continue with the revaluation model or not. This decision is crucial for an entity, as to continue with the revaluation model:

- They will have to adopt the revaluation model for the entire class of assets which cannot be restricted to some selective location,
- Update such revaluation on regular basis, and
- Take a depreciation charge in the income statement based on revalued amounts.

► Investment property

In IFRS, Indian entities will have an additional option of reflecting their investment property at fair value and recognizing any resulting gain

or loss in the profit or loss for the period. If an entity decides to adopt the fair value model for its investment property, it is not required to charge any depreciation on it. Detailed guidance is provided in IAS 40 *Investment Property* for classification of an asset as an investment property, which may result in some reclassifications into or out of the investment property category.

► **Intangible assets**

Unlike Indian GAAP, amortization will not be required under IFRS for an intangible asset for which there is no foreseeable limit on the period over which the asset is expected to generate net cash inflow for the entity. However, annual impairment testing will be required for such an asset. This can create volatility in profit or loss. Also, the entity will be able to reflect intangible assets at their fair value, provided, there is an active market for them. This will help the entity project the real value of their intangible assets in the balance sheet to their stakeholders.

► **Service contracts**

Under IFRS, services contracts, such as power purchase contracts, waste management contracts and outsourcing contracts may have to be accounted for as leases, if the use of the specific asset is essential to the operations and satisfies certain conditions. In such cases, the lease is analyzed in light of IAS 17 *Leases* to determine its classification. Such contracts are presently not assessed for identifying leases under Indian GAAP, though there is no restriction on doing so. This can have a substantial impact, as the

service provider might be required to derecognize the asset from its books if it satisfies the finance lease classification.

Impact on organization and its processes

Several provisions of IAS 16, IAS 40 and IAS 17 require entities to transfer responsibilities, previously assumed by the finance function, to operational personnel for the purpose of:

1. Validating costs of parts of property, plant and equipment items (including determining cost of directly attributable costs)
2. Defining the relevant components
3. Identifying investment properties
4. Validating depreciation periods and methods for items of property, plant and equipment
5. Regularly reviewing the depreciation periods and methods, residual values and valuation of unused property, plant and equipment
6. Reviewing various arrangements to identify lease arrangement

The maintenance of a fixed asset register would be a cumbersome exercise since this will now have to be more granular to include components and major repairs that are capitalized. It would be difficult, if not impossible, to maintain them manually and hence, appropriate ERP packages need to be implemented or the existing ones need to be modified to capture such information.

One of the methods permitted for accounting of investment property is the fair valuation method. If such a method is followed by a company, then it needs to institute an appropriate mechanism of valuing such investment properties on a regular basis as well as an internal

control mechanism to ensure that such a valuation is robust and reliable.

The purchase department needs to be trained in order to identify leases in a service contract. This would ensure that service contracts which are in substance leases are properly accounted for as leases in accordance with IFRIC 4.

Related party disclosures

Related party transactions cover transactions with certain defined parties, regardless of whether any price is charged or not. It is common for every entity to enter into transactions with related parties. Therefore, the differences between Indian GAAP and IFRS will impact many entities.

Key differences

1. AS 18 *Related Party Disclosures* defines related party as “parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions”. While defining related party under IAS 24 *Related Party Disclosures*, the words used are “financial and operating decisions.” Therefore, it appears that AS 18 definition is more stringent in this regard.
2. AS 18 does not include post-employment benefit plans as related parties, whereas, these are covered under IAS 24.
3. IAS 24 includes close members of families of key management personnel as related parties. It also includes close members of the families of persons who exercise control or significant influence over related parties. AS 18 includes only relatives of key management personnel as related parties.
4. AS 18 has defined relatives by specifying certain relationships in the definition. The IAS 24 definition is broader and principle based, which defines close member of the family as those who may be expected to influence, or be influenced by, that individual in their dealings with the entity.
5. IAS 24 includes executive as well as non-executive directors in the definition of key management personnel, whereas, AS 18 and ASI 21 *Non-Executive Directors on the Board – whether related parties* excludes non-executive directors from the definition of key management personnel.
6. The definition of control given in IAS 24 is principle based. It states that control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. It does not define ways in which the control can be demonstrated. AS 18 provides different ways of control as definition of control, such as ownership of voting power, control of composition of board of directors or substantial interest in voting power and the power to direct the financial and/or operating policies. Therefore, it is interpreted in a restrictive manner.
7. While discussing the term ‘significant influence’, AS 18 states that holding 20% or more of the voting power of the entity is presumed to result in significant influence. IAS 24 does not give any percentage to interpret significant influence and is based on the substance.

8. Disclosures required in the two frameworks differ to a certain extent. IAS 24 requires that, when neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so is required to be disclosed. IFRS also requires disclosure of terms and conditions of outstanding balances, including, whether they are secured and the nature of the consideration to be provided in settlement, details of any guarantees given or received. Indian GAAP mandates certain disclosures which are not required under IFRS, such as, the name of the transacting related party and amount written back in the period in respect of debts due from or to related parties. Indian GAAP permits disclosure of volume of transactions and outstanding items to be given either in amounts or as an appropriate proportion. IFRS requires amounts to be disclosed for these items.
9. AS 18 provides exemptions for transactions with the related parties where reporting of such disclosures would conflict with the reporting entity's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority. IAS 24 does not contain any such exemption.
10. IAS 24 provides that an entity discloses that the terms of related party transactions are equivalent to those that prevail in arm's length transactions only if such terms can be substantiated. AS 18 does not contain such requirement.
11. IAS 24 requires disclosure of the key management personnel's compensation in total and for certain specified categories, such as short-term employee benefits and post-employment benefits. AS 18 does not have such requirement.

Impact on financial reporting

► Scope of applicability of IAS 24

IAS 24 disclosures will apply to the following transactions if the entities adopt IFRS:

- Transactions among state controlled entities, and
- Transactions with non-executive directors.

IAS 24 does not grant exemptions of non-disclosure of related party transaction on the basis of conflict of duty of confidentiality. Thus, banking organizations will be required to disclose all related party transactions.

► Identifying related parties

Related parties identified under Indian GAAP may not provide the correct list of related parties under IFRS and the entities would be required to reassess the list for the following:

- Parties exercising significant influence need to be reassessed to determine whether they influence both financial and operating decisions,
- Post-employment benefit plans need to be added to related party list,
- All relatives of key management personnel, who may not be close members of his family and therefore not a related party under IAS 24 and vice-versa, and

- ▶ Non-executive directors, who need to be considered as related parties under IAS 24.

If additional parties are covered in related parties, additional information for transactions with those parties needs to be compiled and disclosed.

- ▶ **Transactions with special purpose entities (SPEs)**

Since the definition of 'control' in AS 18 is restricted to three conditions given therein, SPEs may not be caught in the net. IAS 24 definition is based on substance. Therefore, it is likely that transactions with SPEs fall under the scope of IAS 24.

Impact on organization and its processes

Under IFRS all entities, including non-corporate entities, will be required to disclose related party relationships and transactions. In order to comply with disclosure requirements under IFRS, many entities will need to strengthen/change their reporting processes and information technology systems.

Segment reporting

The IASB has recently issued IFRS 8 *Operating Segments* which supersedes IAS 14 *Segment Reporting*. IFRS 8 is applicable for accounting periods on or after 1 January 2009. Early application is permitted. The following discussion regarding segment reporting is based on IFRS 8.

Key differences

1. IFRS 8 adopts management reporting approach to identify operating segments. It is likely that in many cases, the structure of operating segments will be the same under

IFRS 8 as under AS 17 *Segment Reporting*. This is because AS 17, like IFRS 8, considers reporting segments as the organizational units for which information is reported to key management personnel for the purpose of performance assessment and future resource allocation. When an entity's internal structure and management reporting system is not based on either product lines or geography, AS 17 requires the entity to choose one as its primary segment reporting format. IFRS 8, however, does not impose this requirement to report segment information on a product or geographical basis and in some cases this may result in different segments being reported under IFRS 8 as compared with AS 17.

2. An entity is first required to identify all operating segments that meet the definition in IFRS 8. Once all operating segments have been identified, the entity must determine which of these operating segments are reportable. If a segment is reportable, then, it must be separately disclosed. This approach is the same as that required by AS 17, except that it does not require the entity to determine a 'primary' and 'secondary' basis of segment reporting.
3. IFRS 8 requires that the amount of each segment item reported is the measure reported to the CODM in internal management reports, even if this information is not prepared in accordance with the IFRS accounting policies of the entity. This may result in differences between the amounts reported in segment information and those reported in the entity's primary financial statements. In contrast, AS 17 requires the segment

information to be prepared in conformity with the entity's accounting policies for preparing its financial statements.

4. Unlike AS 17, IFRS 8 does not define terms such as 'segment revenue', 'segment profit or loss', 'segment assets' and 'segment liabilities'. As a result, diversity of reporting practices will increase.
5. As IFRS 8 does not define segments as either business or geographical segments and does not require measurement of segment amounts based on an entity's IFRS accounting policies, an entity must disclose how it determined its reportable operating segments, alongwith the basis on which the disclosed amounts have been measured. These disclosures include reconciliations of the total key segment amounts to the corresponding entity amounts reported in IFRS financial statements.
6. A measure of profit or loss and assets for each segment must be disclosed. Additional line items, such as interest revenue and interest expense, are required to be disclosed if they are provided to the CODM (or included in the measure of segment profit or loss reviewed by the CODM). AS 17, in contrast, specifies the items that must be disclosed for each reportable segment.
7. Under IFRS, disclosures are required when an entity receives more than 10% of its revenue from a single customer. In such instances, an entity must disclose this fact, the total amount of revenue earned from each such customer and the name of the operating segment that reports the revenue. This is not required by AS 17.

Impact on financial reporting

► **Change in segment reporting approach**

On adoption of IFRS 8, the identification of an entity's segments may change from the position under AS 17. IFRS 8 requires operating segments to be identified on the basis of internal reports on components of the entity that are regularly reviewed by the CODM, in order to allocate resources to the segment, and to assess its performance. AS 17 requires an entity to identify two sets of segments, business and geographical, using a risk-and-reward approach, with the entity's 'system of internal financial reporting to key management personnel' serving only as the starting point for the identification of such segments.

► **Goodwill impairment**

IAS 36 requires goodwill to be allocated to each CGU or to groups of CGUs. The relevant CGU or group of CGUs must represent the lowest level within the entity at which the goodwill is monitored for internal management purposes, and may not be larger than an operating segment. If different segments are reported under IFRS 8, than were reported under AS 17, it follows that there will be differences between the CGUs that make up an IFRS 8 segment and those that made up an AS 17 segment. As a result, the CGUs supporting goodwill may no longer be in the same segment under IFRS 8 as under AS 17. It may, therefore, be necessary to reallocate goodwill associated with CGUs that are affected by the change from AS 17 to IFRS 8. It is possible that this reallocation of goodwill could 'expose'

CGUs for which the carrying amount, including the allocated goodwill, exceeds the recoverable amount, thereby giving rise to an impairment loss.

► **Customer concentration**

On adoption of IFRS, entities will be required to furnish a disclosure of customer concentration, which will enable investors to assess risk faced by a company. The company will have to compile information of revenue generated by each customer to furnish disclosures required by IFRS 8.

Impact on organization and its processes

► **Reconciliation of management information system with financial statement**

IFRS 8 requires segment reporting to be made based on information furnished to the chief decision makers. If the policies followed for computing information for management information system does not match with those used in the financial statements, an entity will need to furnish reconciliation. Hence, entities need to devise or upgrade systems to prepare reconciliation between the MIS and the accounting system.

► **Identification of CODM**

Reporting under IFRS 8 is based on information furnished to the CODM. The term CODM defines a function rather than an individual with a specific title. The function of the CODM is to allocate resources and assess operating results of the segments of an entity. The CODM could either be an individual, such as the chief executive officer, the

chief operating officer, a group of executives like the board of directors or a management committee. Entities should review their management structure to identify the CODM.

Revenue recognition

Key differences

- IAS 18 *Revenue*, unlike its Indian counterpart AS 9 *Revenue Recognition*, requires revenue to be measured at the fair value of the consideration received or receivable.
- For recognition of revenue from sale of goods, IAS 18 also prescribes the condition that the costs incurred or to be incurred in respect of the transaction can be measured reliably. This condition is not there in AS 9.
- For recognition of revenue from rendering of services, IAS 18 states that when the outcome of a transaction can be estimated reliably, revenue associated with the transaction shall be recognized by reference to the stage of completion of the transaction at the balance sheet date. Under Indian GAAP, AS 9 provides an option to use either the proportionate completion method or the completed service contract method for recognizing revenue from service transactions.
- IAS 18 requires interest to be recognized using the effective interest method as outlined in IAS 39. AS 9 requires interest to be recognized on a time proportion basis, taking into account the amount outstanding and the rate applicable.

Impact on financial reporting

► **Contracts with multiple elements or barter – fair value concept**

AS 9 states that revenue is measured by the charge made to customers or clients for goods supplied and services rendered and by the charges and rewards arising from the use of resources by them. In the absence of a fair value concept, it sometimes becomes difficult to determine the revenue in a contract that contains multiple elements such as sale of goods and rendering of services. For example, in case of franchise agreements IAS 18 provides guidance on allocation of revenue between supply of tangible items and the franchisee fee. Under Indian GAAP, an EAC opinion deals with accounting in the case of multiple element contracts in a limited way. Unlike IFRS, Indian GAAP does not deal with barter sales.

► **Management's judgement to determine revenue from sale of goods**

IAS 18 prescribes five conditions, all of which should be fulfilled for recognizing revenue. Apart from transfer of significant risks and rewards of ownership as required in Indian GAAP, IFRS also requires fulfilment of the following conditions:

- The seller does not retain continuing managerial involvement and effective control over the goods sold
- The amount can be reliably measured
- There is probability that the economic benefits associated with the transaction will flow to the seller

- Costs incurred in respect of the transaction can be reliably measured

As a result, the management has to use judgement to determine if, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue under IFRS.

► **Reduced volatility of revenue recognition for rendering of services**

Since IFRS requires the recognition of revenue arising from rendering of services only on the basis of stage of completion, entities who defer revenue based on the completed service contract method under Indian GAAP, will have a significant impact on their income statement. The volatility of income statement of such entities will be smoothened by the application of IFRS and the profit or loss for the period will better represent the efforts put in by entities during the period.

Impact on organization and its processes

Though the revenue recognition principles under Indian GAAP and IFRS may not be significantly different, one has to take a close look at practices that have emerged over time. These practices may not be in accordance with international norms. A case in point is the accounting for real estate sales. The IASB believes that many of the real estate sales by developers should be recognized based on product completion (this was later confirmed in IFRIC 15 *Agreements for the Construction of Real Estate*), whereas in India, the percentage of completion method is followed. Such issues could have a significant impact on how an organization sells or how the contracts and payments are structured.

Unlike Indian GAAP, IFRS provides detailed guidance on identification of the transaction. Under IFRS, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Therefore, strategies developed by the marketing department which combine various components in a single transaction, would need to consider its impact on revenue recognition.

Impact on key industries

3



Impact on key industries

Here we take a look at the key impact of IFRS on some critical industries. In some cases there may be no difference between IFRS and Indian GAAP. However, in practice, the manner in which the standard is understood and implemented in India may be quite different when compared to the global practice. In this section, we not only discuss GAAP differences by industry, but also certain areas where we believe that global practices may not be consistent. Analysis presented in this section does not consider the impact of AS 30, AS 31 and AS 32 issued by the ICAI, which are mandatorily applicable only from accounting period commencing on or after 1 April 2011.

Telecom

The Telecom industry poses significant accounting challenges due to complexities in the schemes offered to customers, distribution arrangements, infrastructure sharing arrangements entered by telecom players, etc. Neither Indian GAAP nor IFRS provide any industry specific guidance. This section identifies a few areas where accounting treatment under IFRS will be different from accounting under Indian GAAP or industry practice in India, along with some other practical issues.

Key impact areas

Bundled multiple service offerings

Telecom entities provide package offers comprising handset, prepaid minutes, messages, discounts, special offers and other incentives. The decision to

account for a transaction in its entirety or individual components can have a significant impact on the results. For example, separating handset sales from connection revenues may result in increased revenues upfront for the sale of handsets. Indian GAAP does not currently provide any specific guidance on revenue recognition for multiple element contracts and hence, inconsistent practices are followed by various telecom entities. IAS 18 requires, in certain circumstances, to apply the recognition criteria to separately identifiable components of a single transaction in order to reflect the substance of the transaction. The recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. The key issue which all telecom entities will have to face on adoption of IFRS is whether the components of a single transaction can be technically and commercially separated, and if so, whether the fair values can be reliably determined to recognize revenue. As no specific guidance is available under IFRS, many entities could well use the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to consider any relevant US GAAP requirement for determining the fair value of separate components. However, care should be exercised to ensure that the principles applied are not in conflict with IFRS.

Accounting for Indefeasible Right to Use (IRU)

In the Telecom industry, entities often buy and sell capacity of each other's networks, often referred to as an IRU. The main issue involved here is on revenue recognition – can revenue be recognized upfront (as an asset sale) or should revenue be recognized over the IRU term as a provision of service? If it is considered that an IRU arrangement contains a lease then the appropriate treatment under IFRS would be determined by IAS 17 *Leases*. IFRIC 4 provides more guidance on this subject. If the IRU is not a lease, it will have to be ascertained whether the arrangement constitutes sale of goods or rendering of services. The accounting consequences for sale of goods and rendering of services would be significantly different.

Under Indian GAAP no guidance is available on the identification of leases contained in arrangements or transactions which are not structured as a lease. Thus, lease elements contained in an IRU may not be captured by AS 19 *Leases*, which governs lease accounting in India. The accounting for IRUs under Indian GAAP is significantly different to that required under IFRS.

Revenue from interconnect and content revenue agreements – gross or net

Both, fixed line and mobile operators, may enter into a number of interconnect agreements with other carriers. Industry practice under Indian GAAP and IFRS is to account for revenue and costs from such transactions on gross basis as the carriers are exposed to the gross risks of the transaction. Interconnect agreements usually allow carriers to settle the amount on a net basis, which does not normally change the appropriateness of

recognizing the transaction gross, even if periodic cash settlements may be made on a net basis.

It is common for telecommunications operators to enter into arrangements with third party content providers to offer a range of services to their subscribers (e.g., ringtones, games and traffic updates), with charges based either on duration or on quantity. Often, the operator collects all of the content revenue from the subscriber and is required to remit the content revenue to the supplier net of a percentage retained as commission. If the operator is acting as the principal in the relationship with the subscriber, the revenue should be recognized on a gross basis, with the amount remitted to the supplier being accounted for as a cost of sale. However, if the operator is acting as an agent for the supplier in its relationship with the subscriber, only the net amount of commission retained should be recognized as revenue.

Close attention needs to be paid to the details of each such arrangement since that may have an impact on the accounting.

Asset retirement obligations AROs

In the construction of networks, mobile and fixed line operators often build assets on leased land or premises where an obligation exists (e.g., under the lease agreement) to reinstate the land or premises at the end of the agreed term. Provision for such costs is required under IFRS, where they are referred to as AROs. The obligation is accounted for by including the present value of the estimated cost of dismantling and removing the asset as part of the cost of the asset and setting up a provision for an equivalent amount. The discounting of

provisions is unwound over the relevant period and is accounted for as an interest expense. Under Indian GAAP, AS 29 *Provisions, Contingent Liabilities and Contingent Assets* requires a provision to be created at the undiscounted amount of an ARO at the time of setting up the assets.

The challenge in providing for AROs is that often it may not be evident from the contractual terms that an obligation exists. The contract may be unclear or silent on restoration requirements at the end of the contracted period. There might not be express legislation which requires companies to carry out restoration work. In such cases, entities need to make their 'best estimate' based on past experience. Many times entities contend that restoration work as per legislation/contractual arrangement is not enforced and hence no cost is incurred by them. For instance, obligations with respect to cables laid in international waters on the seabed or on coastal 'landing stations' may be unclear and inconsistently enforced. Some consider that removing the original cables may cause more environmental damage than leaving them intact. The question that then arises is: should the obligation not be valued at all, on the grounds that it may not crystallize?

Another complexity in ARO provisions under IFRS is the assumption of tenor of lease. Many telecom companies enter into agreements to lease land or property to erect cell sites. These leases can vary in length and may contain an option to extend the lease. In these circumstances, issues arise in calculating the present value of an ARO. Should the obligation be based on the original length of the lease or the extended period?

In practice an estimate needs to be made of what is perceived to be the most likely economic life of the asset taking into account all the above variables. For example, if there is no certainty of renewing the lease term of a particular site, dismantling and removal costs should be based on the assumption that removal will be required at the end of the initial lease term.

Fixed assets

Typically, this industry faces poor ROI, which drives a rigorous investment approach. Investors focus more on the balance sheet, about 60% of which is made up of fixed assets. Therefore, losing market reputation and rating is unaffordable. Compliance with IFRS increases the complexity of verifying and accounting for fixed assets for most, though not all, telecom entities. National regulators also focus on these accounting practices.

In 2005, when many global entities adopted IFRS, Ernst & Young conducted a global online study of major Telecom industry players to find out how the new environment was affecting them and the management of fixed assets. Various entities from around the world participated in this study by providing their time and input. Ernst & Young developed and disseminated an online survey on changing reporting and regulatory requirements. The entities represented had more than USD309 billion in combined annual revenues and more than USD298 billion in combined total fixed assets. Until this study was made, there had been a limited analysis of this topic.

The study brought out the following points:

1. Increasing customer demands for new communication products and services are pressuring telecom entities to update existing networks or deploy new ones
2. Many telecom entities are yet to recognize the need to proactively manage potential changes to their fixed asset accounting practices and how this impacts their competitive position
3. Matching operational realities to changing business and customer demands and complying with IFRS are critical to success in the telecommunications marketplace
4. The financial health of the industry was stabilizing, opening the path to renewed profitability and growth, however, the transition to IFRS may create earnings volatility
5. The entities that succeed in a dynamic environment will be those that can adapt to IFRS quickly while proactively managing their asset bases
6. The pressure to update or replace network assets increases the risk of traditional assets being impaired. In the study referred above, 62% respondents believed that their current IT systems, accounting processes and fixed asset designs were suitable for IFRS adoption

In the case of Telecom entities, IFRS reporting requirements will have the greatest potential impact on the management of their fixed asset accounting, including component accounting, the estimation of useful lives, residual values, impairment, etc.

Other issues

Under both IFRS and Indian GAAP, start up costs cannot be capitalized. Another interesting issue is the straight-lining of operating lease rentals. As per an EAC opinion, straight-lining is required. IFRS also requires straight-lining. Accounting for various incentive schemes is another area where practices may not be consistent.

Banking

The industry most affected by the adoption of IFRS in India is the banking industry. Banking is a highly regulated industry in India and, like other entities, banks are also required to comply with the accounting standards issued by the ICAI, to the extent applicable to the banking industry. In addition, the regulator, viz., RBI also prescribes certain mandatory accounting principles to be followed by banks (e.g., investments are accounted as per RBI guidelines instead of AS 13). The aim of IFRS is to present fairly the position, performance and cash flows of an entity. The RBI, however, sets prudential norms for banks and so the requirements of the RBI are not fully in compliance with IFRS. Additionally, banks have other extensive regulation to deal with such as Basel II capital requirements.

Key impact areas

Income recognition

In Indian GAAP, in accordance with the RBI regulations, interest income is recognized in profit or loss on an accrual basis, except in the case of NPAs. Any associated fees, such as loan processing fees are recognized upfront when those are received. IAS 39 requires that income on loans be recorded on an effective interest-rate basis. This spreads the

interest and any associated fees, unless they can clearly be demonstrated to relate to the delivery of a separate service, over the life of the loans. Therefore, for example, when there is moratorium period or interest ballooning in the loan terms, interest will be measured differently under IFRS and Indian GAAP.

In case of HTM assets, IAS 39 requires carrying value to be measured after initial recognition at amortized cost. This results in a premium/discount being recognized on effective interest rate basis. Under Indian GAAP, in accordance with the RBI regulations, for HTM assets acquired at a discount with coupon interest, banks recognize interest income based on the coupon without considering the amortization of the discount. It results in a gain being recognized at the time of maturity when the entire discount gets realized. However, for zero coupon assets and treasury bills, the discount is amortized to bring carrying value of the discounted instrument to par value on maturity.

Under Indian GAAP, in accordance with the RBI regulations, banks recognize interest income on NPAs only when income is actually received. Under IFRS, once a financial asset or group of financial assets has been written down as a result of an impairment loss, interest income is, thereafter, recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Identification of impaired loan

The RBI has prescribed the guidelines for identification of impaired loans. An asset is a NPA in respect of which interest/ installment has remained unpaid for more than ninety days. Under IFRS, a financial asset or a group of financial assets is

impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather, the combined effect of several events may have caused the impairment. Credit losses expected as a result of future events, are not recognized even if very likely, because the IFRS model is based on an 'incurred loss' approach.

Impairment provision

In India, the impaired assets (NPAs) are classified into three categories:

1. Sub-standard assets,
2. Doubtful assets, and
3. Loss assets as per the time buckets prescribed by RBI.

The impairment provision is made on the basis of the above three categories prescribed by RBI at the prescribed minimum percentage of the asset value. Under IFRS, if there is objective evidence that an impairment loss on L&R or HTM investments carried at amortized cost has occurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Under IFRS, the formula prescribed by the RBI will not be acceptable since there are significant differences between IFRS loan loss provision and RBI loan loss provision.

When a provision is created for the portfolio of standard assets, the loss is

computed, based on the RBI guidelines under Indian GAAP as a certain percentage of carrying values. However, under IFRS, these general provisions are not allowed but there is a requirement to hold a provision for any Incurred But Not Reported (IBNR) losses. An IBNR loss can occur when assessing assets collectively for impairment and it is known that a loss event would have occurred as at a reporting date, but this loss event has not manifested itself as objective evidence of impairment. This IBNR provision is computed on a similar basis as explained in the preceding paragraph, i.e., based on the present value of the estimated future cash flows rather than provision being made at a predetermined percentage.

Hedge accounting

Accounting for hedges in the two frameworks is different. There are three types of hedges under IFRS, being cash flows hedges, fair value hedges and hedges of net investments in foreign operations. The treatment of the three types of hedges is different. For a fair value hedge, both the hedging instrument and the hedged item are accounted at fair value in the profit and loss, resulting in, the net ineffectiveness impacting profit or loss. For a cash flow or hedge of net investments in foreign operations, only the hedging instrument is held at fair value, with the effective portion being accounted for in equity and the ineffective portion being accounted for in the profit and loss account. In Indian GAAP, it is accounted in the profit and loss.

Under IFRS, hedge accounting is allowed as an option to replicate the economic purpose of the hedging relationship. However, IAS 39 imposes a considerable documentary and procedural burden. Unless such documentation is maintained, banks cannot follow hedge accounting.

Under Indian GAAP, banks can classify the instruments for hedging the risk of hedged item so that hedge accounting can be applied on those instruments. Hedges are not required to be classified as fair value hedge, cash flow hedge or hedge of net investment in foreign operation. Hedging instruments are accounted for on accrual basis and not marked to market unless the underlying is also marked to market. Banks are provided freedom to assess the effectiveness based on their internal policy, such as duration coverage, marked to market etc.

Embedded derivatives

Identification of embedded derivatives is a very onerous area in the case of banks. Typical embedded derivatives that could be found in many banking arrangements are convertibility options, prepayment options, interest caps and floors, foreign exchange derivatives, etc. Indian GAAP does not provide any guidance on this. Under IFRS, an embedded derivative is separated from the risk of the host contract and accounted for as a derivative if the economic characteristics and the risk of the embedded derivative are not closely related to the economic characteristics and the host contract, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative and the hybrid instrument is not measured at fair value with changes in fair value recognized in profit or loss.

Accounting for financial assets

The RBI guidelines require investments, HFT investments and derivatives to be marked to market. Net depreciation is charged to the profit and loss account and net appreciation is not recognized except to the extent of depreciation already provided. This measurement can

be made on a category basis. If an HFT investment is not sold in ninety days, then it is required to be transferred to AFS category.

Under IFRS, IAS 39 prescribes principles for accounting for financial assets.

All financial assets other than those categorized as at FVPL are required to be initially recognized at fair value plus directly attributable transaction costs. FVPL assets (HFT assets fall in this category) are initially recognized at fair value. Subsequent measurement of the financial asset depends on the categorization given. AFS and FVPL, including all derivatives are carried at fair value in the balance sheet. Fair value movements of FVPL investments are charged/credited to the income statement. Fair value movements of AFS investments are booked in equity. These are computed on asset by asset basis.

Under Indian GAAP, investments that a bank intends (whether or not it has an ability) to hold till maturity are classified under HTM category. A bank can transfer securities between the AFS, HFT and HTM categories.

Classifying an investment as HTM is very restrictive under IFRS. A bank cannot classify any financial assets as HTM if it has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of HTM investments before maturity, except in very limited circumstances. Consequently, the HTM category is used only sparingly.

Loan commitments to provide loan at a below-market interest rate and financial guarantees

The RBI has not prescribed any guidelines for accounting of loan commitments and loan commitments are not disclosed as

off balance sheet items in the financial statements. Under IFRS, a commitment to provide a loan at a below-market interest rate is initially recognized at fair value, and subsequently measured at the higher of:

- ▶ The amount that would be recognized in accordance with IAS 37, and
- ▶ The amount initially recognized less, cumulative amortization recognized in accordance with IAS 18, as appropriate.

Under IFRS, financial guarantees provided will be measured at fair value at the time of initial recognition. The commission charged for issuing the guarantee will be the fair value in most cases. The financial guarantee will be subsequently measured at the higher of :

- ▶ The amount that would be recognized in accordance with IAS 37, and
- ▶ The amount initially recognized less, cumulative amortization recognized in accordance with IAS 18, as appropriate.

Under Indian GAAP, the commission received on financial guarantees is accounted upfront, on time proportion basis or in some cases on receipt basis. Financial guarantees are disclosed as contingent liability. If financial guarantee is invoked then banks provide for the liability with corresponding recognition of advance to customer.

Priority sector loans and restricted assets

IFRS requires financial assets to be recognized initially at fair value. Fair value is "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction". Due to directed lending regulations, in many cases, banks are often compelled to give

loans to priority sectors which are not at fair value. It is not clear whether fair value in regards to priority sector lending should be evaluated based on the overall market, or specifically in regards to the priority sector lending market. If the fair value is determined based on the overall market then there may be a considerable amount of Day 1 loss to be recognized.

Disclosures

IFRS 7 requires comprehensive disclosures regarding financial instruments with a view to communicate the significance of financial instruments to an entity's financial position, performance and cash flows, the risks associated with those financial instruments and how an entity manages those risks. These disclosures particularly impact entities such as banks whose financial statements comprise primarily financial assets and liabilities. Key disclosures required under IFRS 7 include:

1. Enhanced balance sheet and income statement disclosures 'by category' of instrument (e.g., whether the instrument is available-for-sale or held-to-maturity).
2. For each class of financial assets and financial liabilities, a comparison of fair values with carrying amounts.
3. Methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.
4. Exposure to financial risks (primarily market risk, credit risk and liquidity risk) and how these are managed.

These disclosures will be achieved through a mixture of qualitative and quantitative requirements.

5. Quantitative analysis of sensitivity to each type of market risk (interest rates, foreign exchange rates, equity prices, etc.), showing how profit or loss and equity would be affected by a reasonably possible range of increases and decreases in each of the market rates (e.g., the impact of a +/-5% change in the GBP/Euro exchange rate).
6. The processes that the company uses to manage and measure risk. At present under RBI regulations, the risk management disclosures are mainly for derivative instruments.

One of the biggest practical challenges in implementing IFRS 7 will be the collection of the information requiring disclosure. However, before a bank can get to this point, it is necessary to determine precisely what information is required. One of the best ways to start may be to take each IFRS 7 requirement in turn so as to determine whether it is already being disclosed or is at least already internally available. The difficulties of gathering the information for disclosure should not be underestimated, particularly as such information is often not held directly in the accounting records but instead must be sourced from other areas.

Other contentious issues

When banks adopted IFRS in Europe in 2005, they were particularly affected by IAS 32 and IAS 39. Many of the changes required by IAS 32 and IAS 39 entail developing processes to churn out vast amounts of data. IAS 32 requires recording derivative transactions gross and does not allow netting them off, even with the same counterparty trading under

a master netting agreement, unless they are intended to be settled net. Another issue not specific to banks, but impacting on adoption of IFRS, is the classification between liabilities and equity of various sources of funds.

Venture capital funds (VCFs)

Under Indian GAAP, there is no specific accounting standard dealing with accounting for VCF. AS 13, *Accounting for Investments*, specifically excludes VCF from its scope. *The Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996*, which apply only to listed ventures, also do not contain any specific requirement for accounting by VCFs. The following are key areas where the accounting treatment under IFRS may be significantly different to that under Indian GAAP or industry practice in India.

Key impact areas

Carrying value of investments

Under Indian GAAP, in the absence of any specific treatment laid down in the accounting standards, general industry practice is to measure investments in VCC at fair value. Unrealized gains and temporary losses arising on restatement of such investments are accounted in Unrealized Investment Reserve. Such gains and losses are recognized in the profit or loss on actual realization. Losses, other than those that are temporary, are recognized in the profit or loss immediately.

Under the IFRS, classification of investments required by IAS 39 will result in investments being classified as one of the four categories of financial assets, namely FVPL, AFS, L&R and HTM. Entities have an option to designate financial assets and liabilities at fair value and

account the changes in fair value in profit or loss if certain criteria are met. VCF entities meet the criteria that a group of financial assets, financial liabilities or both that are managed with performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel. Accordingly, a VCF may designate their financial assets as FVPL. If a VCF entity does not choose to classify its investment in a VCC as FVPL, these would be classified as AFS investments. Investments held by a VCF entity for trading purposes will be classified as FVPL.

Consolidation of subsidiaries

Under Indian GAAP, there is no requirement to prepare CFS for unlisted VCFs. Industry practice is generally not to prepare the CFS. Under IFRS, preparation of CFS is generally required except in certain limited cases where specified criteria are met. IAS 27-R provides that a subsidiary is not excluded from consolidation simply because the investor is a venture capital organization or a similar entity. It also provides that a subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other entities within the group. Thus, under IFRS, a VCF entity which has any subsidiary would be required to prepare CFS and consolidate all its subsidiaries.

Investments in associates and interests in joint ventures

IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* do not apply to investments/interests held by mutual funds, unit trusts and similar entities including investment-linked insurance

funds that upon initial recognition are designated as FVPL or are classified as HFT and accounted for in accordance with IAS 39. When such investments are accounted for under IAS 39, IAS 32 and IFRS 7 are also applicable to them. Under Indian GAAP, there is no such scope exclusion under AS 23 and AS 27. Thus, a VCF entity, which prepares CFS, would be required to account for its investments in associates and joint ventures in accordance with AS 23 and AS 27 respectively.

Embedded derivative/equity kicker

Instruments involving embedded derivatives, e.g., warrants with an option of conversion to shares, convertible debts/preference shares, zero coupon bonds, are common feature in a VCF. Such instruments provide the holder an option of conversion into equity instruments at a future date and carry no interest or interest at a rate which is lower than the market rate. In the absence of any specific requirements/guidance on the matter, under Indian GAAP, VCFs are not accounting for such options separately. VCFs recognize interest on the instruments at actual/stated rate, if any.

Under IFRS, the conversion option in a host instrument normally meets the definition of an embedded derivative. IAS 39 requires embedded derivative to be separated from the host contract and treated separately, if certain conditions are met and the combined instrument is not treated as FVPL. Implementation Guidance to IAS 39 also provides that VCF entities may be providing subordinated loans on a condition that if and when the borrower lists its shares on a stock exchange, it would be entitled to receive shares of the borrowing entity free of charge or at a very low price (an 'equity

kicker') in addition to interest and repayment of principal. As a result of the equity kicker feature, the interest on the subordinated loan is lower than it would otherwise be. Under IAS 39, the equity kicker feature meets the definition of an embedded derivative even though it is contingent upon the future listing of the borrower. With regard to such embedded derivatives, if the VCF does not treat the entire instrument (i.e., combined instrument including embedded derivative) as FVPL; it should separate embedded derivative from the host loan agreement and treat the two separately.

Mutual funds

Key impact areas

Carrying value of investments

Under IFRS, entities have an option to designate financial assets and liabilities at fair value and account the changes in fair value of these in profit or loss when certain criteria are met.

Mutual funds meet the criteria that a group of financial assets, financial liabilities or both that are managed with performance evaluated on a fair value basis in accordance with a documented risk management or investment strategy and information about the group is provided internally on that basis to the entity's key management personnel. Accordingly, mutual funds may designate their financial assets at fair value through profit or loss.

Under Indian GAAP, the accounting policies for mutual funds are governed by SEBI regulations. These require all investments to be carried at mark-to-market value in the balance sheet. *The Guidance Note on Accounting for Investments in the Financial Statements*

of *Mutual Funds* issued by the ICAI, in the context of the regulations, require that any diminution in value (unrealized loss) to be routed through the Revenue Account and any increase in value of investment (unrealized gain) is recognized directly in reserves. The Guidance Note also requires any such appreciation recorded at the balance sheet date to be reversed on the next day.

In the case of asset management companies, classification of investments as required by IAS 39 will result in investments being classified as any of the four categories of financial assets. These include FVPL, AFS, L&R and HTM. The first two categories require carrying value to be determined based on fair value, whereas, carrying value is based on amortized cost in the later two. Apart from AFS, all other categories have an impact on profit or loss for the period. Movements in fair values of AFS category are recognized in equity.

In India, asset management companies carry investments at the cost or market value, whichever is lower when the investment is classified as a current investment. Long term investments are carried at cost less diminution in value, which is other than temporary.

Consolidation of subsidiaries

Under Indian GAAP, there is no requirement to prepare CFS for unlisted mutual funds. Industry practice is generally not to prepare the CFS. Under IFRS, preparation of CFS is generally required except in certain limited cases where specified criteria are met. IAS 27-R provides that a subsidiary is not excluded from consolidation simply because the investor is a mutual fund organization or a similar entity. It also provides that a subsidiary is not excluded from

consolidation because its business activities are dissimilar from those of the other entities within the group. Thus, under IFRS, a mutual fund which has any subsidiary would be required to prepare CFS and consolidate all its subsidiaries.

Technology

Due to the nature of technology entities, significant accounting challenges arise in the areas of software revenue recognition, accounting for intangible assets and ESOPs. Also, the technology companies in India are more exposed than others to foreign currency variations as they generate significant revenues from export of services. In this section, we have discussed a few of the challenges that arise in these areas due to the conversion to IFRS.

Key impact areas

Multiple element contracts

There are a number of issues relating to the timing of revenue recognition in the software services industry. One of the more complex issues which the industry continues to grapple with is the accounting for multiple element contracts, such as when a composite contract is entered into for the sale of licenses, implementation fees and maintenance services at a lump-sum price. There is no specific guidance available in AS 9 on accounting for such contracts. Industry practice (other than companies that are globally listed and also draw their accounts under International GAAP) is to account for revenue for such contracts based on values specified in the contract. When values stated in the contract do not prima-facie appear to be fair, no adjustment is carried out. Moreover, multiple element contracts that provide

for free 'version upgrades' and other 'free' add on software/hardware are generally treated as having no effect on revenue, and are not fair valued and recognized separately over the period of the contract. Recently, the Research Committee of ICAI has recently issued an Exposure Draft of the proposed Monograph on *Revenue Recognition for Arrangements with Multiple Deliverables*. The proposed Monograph is an adaptation of *EITF 00-21: Revenue Arrangements with Multiple Deliverables* under US GAAP and purports to establish criteria to determine:

- ▶ Whether multiple deliverables in an arrangement qualifies as a separate unit of accounting, and
- ▶ How the arrangement consideration should be measured and allocated to separate units of accounting.

Since US GAAP follows a rule-based approach, as opposed to the principle-based approach under IFRS, the application of the Monograph based on US GAAP requirements will significantly reduce the scope of judgement by the preparers and limit flexibility available to them under IFRS. In addition, some of these requirements may be contradictory to IFRS. IAS 18 provides limited guidance with respect to multiple element contracts. The recognition criteria in this standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognized as revenue over the period during which the service is performed. Clearly, this is of little

help in addressing the complex revenue recognition issues that characterize the multiple element contracts, such as how to allocate consideration among various components. IASB has issued IFRIC 13 *Customer Loyalty Programmes* which deals with allocating part of the consideration received or receivable from the sales transaction to the award credits. Under IFRIC 13, the consideration allocated to the award credits shall be measured by reference to their fair value, i.e., the amount for which the award credits could be sold separately. The basis for conclusions to IFRIC 13 provides that the interpretation does not specify, whether the amount allocated to the award credits should be:

- ▶ Equal to their fair value (irrespective of the fair values of the other components), or
- ▶ A proportion of the total consideration based on the fair value of the award credits relative to the fair values of the other components of the sale.

This is because IAS 18 does not specify which of these methods should be applied, or in what circumstances. The selection of one or other method is, therefore, left to management's judgement.

Share-based payments

Following the global trend, the IT sector in India also makes extensive use of ESOP schemes for attracting and retaining employees. Under Indian GAAP, share-based payments are accounted as per the guidelines issued by SEBI (for listed companies) and the *Guidance Note on Accounting for Employee Share-based Payments*, both of which permit the use of the intrinsic value method as an alternate to the fair value method. However, a majority of the entities in India presently

follow the intrinsic value method. On transition to IFRS, share-based payments would need to be accounted using the fair value method. This is likely to reduce profits of various technology entities that may be compelled to reconsider share-based payment schemes.

Many global entities across the world have set up subsidiaries in India. Normally, the global parent provides ESOP benefits to the employees of its Indian subsidiary. The Indian subsidiary generally does not account for any compensation cost in their Indian GAAP financial statements for the ESOP granted by the parent entity on the basis that they do not have a settlement obligation and clear guidance is not available in this context. This approach is not permissible in IFRS. IFRIC 11 requires the subsidiary to measure the services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions with a corresponding increase recognized in equity as a contribution from the parent.

Another significant aspect in the case of technology entities is share-based payments made to non-employees. For example, shares granted to a customer for committing a certain volume of business or an option granted to certain service providers in return for their services. Currently, guidance is only available under Indian GAAP for accounting for share-based payments made to employees and for acquisition of fixed assets (covered under AS 10) and not for other goods and services, thereby, resulting in disparate practices followed by various technology entities. Whilst we believe that such arrangements under Indian GAAP need expensing, it is absolutely clear under IFRS that such share-based payments are required to be accounted for based on the fair value method.

Outsourcing contracts

Technology entities enter outsourcing arrangements for programming support, data storage, network support etc. Such arrangements are normally structured as service contracts and revenue is accounted as and when such services are rendered based on terms of the contract. Indian GAAP does not require nor prohibit evaluating such contracts to determine whether, in substance, these are leasing arrangements. However, under IFRS such transactions could fall within the scope of leases in terms of IFRIC 4. IFRIC 4 sets out the criteria for determining whether a transaction is in the nature of a lease or not. This determination is based on the substance of the arrangement and assessment whether the fulfilment of the arrangement is dependent on the use of a specific asset and if the arrangement conveys a right to use the asset. If such arrangement is identified as a leasing arrangement, revenue and asset under consideration will be accounted as per principles of IAS 17.

Hedge accounting

Technology entities usually generate a substantial amount of revenue and incur expenses in foreign currency. Therefore, they are exposed to significant foreign exchange fluctuation risk. To manage the exchange fluctuation risk, technology entities use various risk management products, such as, forward exchange contracts, options and swaps. These products are used to hedge the exchange rate fluctuation on existing assets, liabilities, cash flows arising from future commitments or highly probable forecast transactions. Presently, AS 11 deals with accounting of foreign exchange forward contracts taken to hedge exposure with regards to assets and liabilities on balance sheet and speculative forward contracts.

AS 11 does not require entities to have robust documentation. It should be noted that ICAI has recently approved AS 30 and AS 31 on Financial Instruments which are based on IAS 32 and IAS 39 and contain the same hedging requirements. These standards are mandatorily applicable from accounting periods commencing on or after 1 April 2011. In the meanwhile, the ICAI has issued an Announcement on Accounting for Derivatives which requires provision for mark-to-market losses on outstanding derivative contracts. The announcement was not very clear and gave rise to many interpretative issues. Consequently, the accounting of the announcement has been very disparate. Under IFRS, all derivatives are required to be recognized in the financial statements at fair value. Hedge accounting is permitted only if entities have robust documentation and specified conditions are satisfied. Thus, entities will have to reconsider their hedging strategies and documentation protocols to ensure that they satisfy requirements of IAS 39. Under IFRS, the more exotic a hedge instrument, the less likely it is that hedge accounting would be permitted. For example, a foreign exchange forward contract with barriers or knock-in-knock-out features is unlikely in many situations to qualify for accounting purposes as a hedging instrument.

Accounting for intangibles

Although there are not many 'product' development companies in India, companies that do develop software products either for sale or for their own use often run into the same difficulties as other companies investing in research and development activities in that they are required to write off a significant part of the cost of developing the software as and when the cost is incurred. Moreover,

IAS 38 has the concept of indefinite useful life for such assets which is absent under Indian GAAP. An intangible asset with indefinite useful life, under IFRS, is not amortized but tested for impairment at least annually and when there are indications of impairment. Under Indian GAAP, there would be a constant charge to profit and loss account due to amortization of such intangible asset, whereas, under IFRS, profit and loss account will be subject to volatility due to possible impairment loss in a particular accounting period.

Extractive

Extraction of natural resources are high risk activities as significant investments are made, which may or may not result in the production of commercially viable reserves. Accounting for these activities is complex. Under IFRS, except for accounting treatment of exploration and evaluation expenditure, there is no guidance for extractive industry. Most of the accounting treatment followed in Indian GAAP is based on principles laid down in the *Guidance Note on Accounting for Oil & Gas Producing Activities*. We believe convergence to IFRS will have an impact on the areas mentioned below.

Key impact areas

Accrual for abandonment costs

Most extractive entities have an obligation for abandonment costs relating to their production assets. In accordance with agreements and legislation, the well head, production assets, pipelines and other installations may have to be dismantled. The obligation to decommission the asset normally arises the moment an asset is constructed. Both IFRS and Indian GAAP require provision to be created for abandonment costs net of salvage value.

With respect to oil and gas exploration activities, certain entities assume that in case of onshore activities salvage value would be equal to the cost of dismantling the facilities and carrying out the clean-up and reclamation activities. Consequently, dismantling costs are typically ignored in such cases. In those instances, particularly offshore activities, where dismantling costs are significantly greater than the salvage value, a provision is often recognized for the full eventual liability at the time of installation of the concerned asset. Provision for such abandonment costs are made at current prices. No specific guidance is available under Indian GAAP for subsequent changes in estimation of abandonment cost leading to varied practices followed by various extractive entities in India.

Under IFRS, the provision for abandonment costs needs to be discounted to its present value at the time of initial recognition. The unwinding of discount is recognized as an interest expense over the life of the asset. IFRIC 1 deals with changes in measurement of abandonment costs arising from changes in the estimated timing, or amount of liability or a change in the discount rate. Under the interpretation, the treatment depends upon whether the entity has followed the Cost Model or Revaluation Model for the asset. If the entity has followed the Cost Model, the amount is adjusted to the carrying amount of the asset. If the Revaluation Model is followed, changes in the liability alter the revaluation surplus or deficit previously recognized on that asset.

Method of accounting

There is no specific accounting guidance under IFRS for expenditure incurred for prospecting, acquisition, exploration and development of natural resources, other

than IFRS 6 *Exploration for and Evaluation of Mineral Resources*, which provides some broad guidance on expenditure incurred on exploration and evaluation of mineral resources. Under Indian GAAP, the successful efforts method and the full cost method are two widely used methods for accounting for expenditure on exploration activities. Under the full cost method, all costs incurred in searching for, acquiring and developing the reserves in a large geographic cost centre are capitalized. Cost centres are typically grouped on a country-by-country basis. Although, sometimes countries may be grouped together if the fields have similar or linked economic or geological characteristics. The full cost method permits capitalization of cost even for unsuccessful wells. This is not consistent with the definition of an asset given in the IFRS framework and, therefore, may not be acceptable under IFRS. Recently, the IASB has issued an exposure draft of proposed amendments to IFRS 1. As per the proposed amendment, a first-time adopter using the full cost accounting to account for oil and gas assets under a previous GAAP may elect to measure oil and gas assets at the date of transition to IFRS on the following basis:

- Exploration and evaluation assets at the amount determined under its previous GAAP, and
- Assets in the development or production phases at the amount determined under the entity's previous GAAP. The entity shall allocate this amount to the underlying assets pro rata using reserve volumes or reserve values as of that date.

The entity shall test exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition

to IFRS in accordance with IFRS 6 and IAS 36.

The proposed revision, if accepted, would reduce the impact of IFRS for Indian entities at the date of transition. However, in any case, future capitalization of assets shall be as per IFRS principles.

Exploration and evaluation assets

The *Guidance Note on Accounting for Oil & Gas Producing Activities* issued by ICAI permits capitalization of:

- ▶ Costs of drilling and equipping exploratory and appraisal wells, and
- ▶ Costs of drilling exploratory-type stratigraphic test wells under the successful efforts method.

It does not permit capitalization of geological and geophysical costs, costs of carrying and retaining undeveloped properties (such as delay rental) ad valorem taxes on properties, legal costs for title defence, maintenance of land and lease records or annual licence fees for the Petroleum Exploration License. Under the full cost method all exploration costs are treated as capital work-in-progress. Capitalization of exploration cost may differ under IFRS, as IFRS 6 permits capitalization of geological and geophysical costs, provided the entity classifies them as exploration and evaluation assets and applies the policy consistently.

Impairment

Indian GAAP does not provide any specific indicators for assessing the impairment of exploration and evaluation assets. General indicators specified in AS 28 are used for the assessment of impairment for exploration and evaluation assets.

IFRS 6 requires the exploration and evaluation assets to be assessed for

impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. It specifies explicit indicators for impairment testing of exploration and evaluation assets. The following facts and circumstances are specified, which indicate that an entity should test exploration and evaluation assets for impairment:

- ▶ The period for which the entity has the right to explore in the specific area has expired during the accounting period or will expire in the near future and is not expected to be renewed,
- ▶ Substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned,
- ▶ Exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area, and
- ▶ Sufficient data exists to indicate that, although, a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

If the above indicators suggest impairment, measurement is done using the principles specified in IAS 36.

The determination of CGUs also poses a great challenge for extractive companies because of the nature of their activities. For example, an individual asset, such as an oil well, will not be considered a CGU if it is dependent on other assets to generate cash inflows. Some oil and gas

companies identify CGUs on a field-by-field basis. A field approach to CGUs is often taken because all assets within the field usually share common production facilities integral to the operations and cannot be separated, sold or transferred for alternative use. The determination of a CGU may also be impacted by laws and regulations. Allocation of more than one field in one CGU, if applicable should be done cautiously.

Accounting for support equipment and facilities

Support equipment and facilities are defined as equipment and facilities of the nature of service units, camp facilities, godowns (for stores and spares), workshops (for equipment repairs), transport services (trucks and helicopters), catering facilities and drilling and seismic equipment.

As per industry policy, all support assets pertaining to the oil and gas block are capitalized as part of the exploration or development/producing assets and these are then depleted alongwith the development/producing asset block over the useful life of the field in the IFRS financial statements of the oil and gas companies. Under Indian GAAP, the cost of acquiring or constructing support equipment and facilities used in exploration and production activities is normally capitalized in accordance with AS 10. Depreciation on such equipment and facilities is arrived at in accordance with AS 6 *Depreciation Accounting*, and accounted for as exploration cost, development cost or production cost, as may be appropriate.

Pharmaceuticals

Key impact areas

Collaborative arrangements

Pharmaceutical entities often enter into collaborative Research & Development (R&D) arrangements with counterparts that include multiple elements, such as, intellectual property licenses, R&D services, manufacturing services and commercialization activities. The products and services delivered under these arrangements are unique. Therefore, it raises issues of accounting for such transactions. Under IFRS it is necessary to apply the revenue recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. Even then, it poses peculiar problems in some circumstances since the term 'component' is not defined. In such cases, the vendor has various performance obligations imposed by an arrangement. Indian GAAP does not currently provide any guidance on applying revenue recognition criteria to each component.

Acquisitions

Acquiring new businesses for new brands is a common practice in the Pharmaceutical Industry. Indian GAAP does not require fair value accounting for business combinations and hence, the true worth of intangible assets acquired may not be captured in most cases. Under IFRS 3-R, the only method allowed for accounting for business combinations is the purchase method where accounting is based on the fair values of the identifiable assets, liabilities and contingent liabilities. Significant differences in accounting for business combinations result in considerable differences in financial

results in the year of the acquisition, as well as in the years subsequent to such an acquisition.

Intangible assets

In the pharmaceutical industry, companies face challenges in accounting for development expenditure. The issue becomes complex in this industry because some of the development expenditure is incurred internally, whereas, part of it is incurred in external development. The industry capitalizes internal development expenditure incurred after the final scientific approval is obtained. IAS 38 provides criteria that must be met for capitalization of development expenditure. Determining when to start capitalizing internal development expenditure poses the following challenges:

1. **Technical feasibility:** For capitalizing development expenditure on a new molecule, technical feasibility of completing it needs to be proved.
2. **Intention of completion and ability to use/sell:** Intention to complete
3. **Ability to use or sell:** Pharmaceutical companies will have to obtain letters of intentions from other companies who will purchase the new compound once developed.
4. **Generation of probable future economic benefits:** Pharmaceutical companies will continue with development expenditure only when the new molecule has a proven market.
5. **Availability of resources:** This will have to be assessed for each company separately. Within each company, each development project needs to be assessed to test whether this criteria is satisfied when expenditure is capitalized.
6. **Measuring the expenditure:** Accounting systems need to be developed to capture this data correctly.

For example, a leading global pharmaceutical company, in its 2007 annual report, states as follows:

“In accordance with IAS 38 (*Intangible Assets*), internally generated research expenditure is expensed as incurred under Research and development expenses.

Under IAS 38, internally generated development expenses are recognized as an intangible asset if, and only if, all the following six criteria can be demonstrated:

1. The technical feasibility of completing the development project
2. The probability that the project will generate future economic benefits
3. The Group's ability to use the project
4. The probability that the project will generate future economic benefits
5. The availability of adequate technical, financial and other resources to complete the project
6. The ability to measure the development expenditure reliably

Due to risks and uncertainties relating to regulatory approval and to the research and development process, the six criteria for capitalization are considered not to have been met until marketing approval has been obtained from regulatory authorities. Consequently, internally generated development expenses arising before marketing approval has been obtained, mainly the cost of clinical trials, are expensed off as incurred under Research & Development expenses.”

Whilst there is no difference between Indian GAAP and IFRS on the issue of capitalization, it may be noted that any capitalization of R&D cost in IFRS financial statements will be subject to a higher level of scrutiny, both nationally and globally.

Indian pharmaceutical companies are largely in the generics market where the capital cost is not as high as in the development of a new molecule. However, even in the generics space, the costs incurred in developing a test batch, carrying out bio-equivalence tests and the filing fees to be paid are significant expenditures that are subject to the same rigorous tests under AS 26 *Intangible Assets* and IAS 38 *Intangible Assets*.

Amortization of intangible assets

Under Indian GAAP, intangible assets are amortized over their estimated useful lives and there is a rebuttable presumption that the useful life cannot exceed 10 years. Only in cases where there is persuasive evidence that the useful life of intangible asset is a specific period longer than 10 years, is the presumption of 10 years rebutted. IFRS does not set out any such presumption. The entity is required to determine whether the intangible asset has finite or indefinite useful life. In case of finite life intangible assets, the amortization is charged over the estimated useful life of the asset. In case of indefinite life intangible asset, no amortization is charged but tested for impairment at least annually and whenever there is an indication that the intangible asset may be impaired. Therefore, even in the absence of persuasive evidence, under IFRS, an entity can estimate useful life of more than 10 years.

Media and entertainment

The Indian M&E industry has transformed in the last 15 years. The segments within the industry broadly include TV broadcasting, publishing, radio, new media, filmed entertainment, software production, music and events. Considering that M&E sector is service oriented and depends on intellectual property, accounting challenges mainly arise in the areas of revenue recognition and intangible assets. Some significant challenges which M&E entities will face on transition to IFRS are mentioned below.

Key impact areas

Sale of rights on a minimum guarantee basis

Film copyrights are exploited in theatres, either on a commission basis or a minimum guarantee basis. While revenues from commission based arrangements are recognized on receipt of the information from the exhibitors or distributors, the recognition of 'Minimum Guarantee' (MG) poses challenges as the distributor agrees to pay a minimum licence fee and a revenue share over a threshold amount for the right to exploit the film in a specific market for a limited period. Disparate practices are followed by various M&E entities under Indian GAAP – some entities recognize upfront revenue whereas some entities defer recognition of revenue until the commencement of the exploitation period. IAS 18 provides additional guidance on revenue recognition for license fees and royalties. This states that an assignment of rights for a fixed fee or non refundable guarantee under a non cancellable contract which:

- ▶ Permits the licensee to exploit those rights freely, and

- The licensor has no remaining obligations to perform, is, in substance, a sale. On conversion to IFRS, M&E entities will have to assess the terms of the arrangement with the provisions of IAS 18 to evaluate whether upfront revenue can be recognized or not.

Multiple element contracts

A common practice amongst media owners is the bundling and marketing of space across various products/programmes/channels/publications/portals. The accounting of revenues or costs becomes challenging in cases where such space is marketed for a consolidated amount. While AS 9 addresses accounting of revenue on providing space based on the display of the advertisements, it does not specifically address accounting of multiple elements within a consolidated contract. Industry Practice is to account for revenue on such contracts based on values specified in the contract or to apportion the contract values on some suitable basis. When values stated in the contract or revenue are based on apportionment and do not prima-facie appear to be fair, no adjustment is carried out. The Research Committee of ICAI has recently issued an Exposure Draft of the proposed Monograph on *Revenue Recognition for Arrangements with Multiple Deliverables*. The proposed Monograph is an adaptation of *EITF 00-21: Revenue Arrangements with Multiple Deliverables* under US GAAP and purports to establish criteria to determine:

- Whether multiple deliverables in an arrangement qualify as a separate unit of accounting, and
- How the arrangement consideration should be measured and allocated to separate units of accounting.

Since US GAAP follows a rule-based approach, rather than the principle-based

approach under IFRS, the application of the Monograph based on US GAAP requirements will significantly reduce scope of judgement by the preparers and limit flexibility available to them under IFRS. In addition, some of these requirements may be contradictory to IFRS.

IAS 18 provides limited guidance with respect to multiple element contracts. It requires the application of recognition criteria to be applied separately to each transaction. However, in certain circumstances, it mandates the application of recognition criteria to separately identifiable components of a single transaction, in order to reflect the substance of the transaction. The IASB has issued IFRIC 13 dealing with allocating part of the consideration received or receivable from the sales transaction to the award credits. Under IFRIC 13, the consideration allocated to the award credits shall be measured by reference to their fair value, i.e., the amount for which the award credits could be sold separately. The basis for conclusions to IFRIC 13 provides that the interpretation does not specify whether the amount allocated to the award credits should be:

- Equal to their fair value (irrespective of the fair values of the other components), or
- A proportion of the total consideration based on the fair value of the award credits relative to the fair values of the other components of the sale.

This is because IAS 18 does not specify which of these methods should be applied, or in what circumstances. The selection of one or other method is, therefore, left to management's judgement.

Sale of future rights

In certain cases, a producer or a copyright owner licenses rights to a broadcaster for a pre-defined future period before commencement of such a period. The consideration in such cases (i.e. royalty) is received by the producer/copyright owner on entering into the agreement. The issue generally faced is whether such a receipt should be recorded as income on entering the agreement or whether the revenue should be recognized on the commencement of the licence period.

There is no specific guidance for this under Indian GAAP, and hence, disparate practices are followed by various M&E entities – some entities recognize upfront revenue while others defer the recognition of revenue, until commencement of the exploitation period. IFRS also does not have any media specific guidance. However, IAS 18 provides additional guidance on revenue recognition for license fees and royalties which states that an assignment of rights for a fixed fee or non refundable guarantee under a non-cancellable contract which permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. On conversion to IFRS, M&E entities will have to assess the terms of the arrangement with the provisions of IAS 18 to evaluate whether upfront revenue can be recognized or not. However, accounting treatment under US GAAP differs as commencement of the licence period is a significant condition to recognize revenue.

Barter transactions

Media companies enter into transactions wherein services are rendered in exchange of services received. Part consideration could also be settled in cash. Examples of common barter transactions prevalent in the industry include the following:

- ▶ Broadcasters enter into transactions in which they exchange rights to place advertisements on each other's channels
- ▶ Publishers exchange space on each other's media
- ▶ Internet entities enter into barter transactions in which they exchange rights to place advertisements on each other's web sites
- ▶ The media exchange space with service providers such as hotels or travel agencies, in exchange for those services

Under IFRS, revenue from barter transactions is recognized only when goods are sold or services are rendered in an exchange for dissimilar goods or services. In such cases, the revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred. Under Indian GAAP, the only available accounting literature is the *Guidance Note on Accounting for Dot-Com Companies* which has similar fair value requirements to IFRS. The Guidance Note goes on to add that where reliable estimates of fair value are not available it may not be appropriate to record the revenues and the associated costs.

Artist compensation

At times, artists viz. actors, directors, etc. agree to acquire share in the copyrights as full/part consideration of their services which could include distribution rights to a particular market or media. The determination of the compensation

impacts the overall project revenue and cost.

The following two sources of information could be utilized for estimating the artists' compensation:

- ▶ Revenue foregone by the producer for a particular market/media, and
- ▶ Compensation ordinarily charged by the artist, had no distribution rights been awarded to the artist.

From the above, the second option would seem more feasible. However, facts and information surrounding each transaction must be considered before making the estimate.

Amortization of copyrights and production cost

A film copyright owner either develops the copyright or acquires it from a producer. These rights can be exploited in several ways viz. theatrical release, television broadcast, home video, etc., by selling the same to distributors, broadcasters, etc. A producer may sell these rights on the basis of each predefined market/territory or even medium viz. television broadcasting or for a fixed period.

Both IFRS and Indian GAAP do not provide industry-specific guidance. However, the principles of accounting, including amortization of intangibles, are similar in both the GAAPs. The amortization method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. IAS 8 permits reference to the most recent pronouncement of other standard-setting bodies that use a similar conceptual framework, to the extent it does not conflict other standards, interpretations, or the framework of IFRS. US GAAP provides detailed guidance on

amortization of copyrights and production costs of film and prescribes individual film forecast method for the purpose of amortization. However, a key challenge would be to develop robust systems and processes to reliably estimate revenue which can be generated from the films.

Component accounting

The film exhibition business has been transformed in the last five years, with several new players having developed multiplexes on premises obtained on long term non-cancellable lease arrangements. Significant expenditure is incurred for developing such properties including the designing of the property and providing the necessary ambience and comforts to viewers. Normally, such expenditure is capitalized as leasehold improvements under Indian GAAP and subsequent replacements and overhauling are charged off to profit and loss account if they do not increase the originally assessed standard of performance. Under IFRS, property, plant and equipment is to be accounted for on a component basis, whereby each significant component of the leasehold improvement having a different useful life has to be capitalized and depreciated separately. This facilitates appropriate accounting of the periodic replacement or overhauling which is required for assets having a lower useful life, as such costs are capitalized and the written down value of the asset being replaced is decapitalized.

Lease accounting

Multiplexes are generally set up in leased premises wherein the rentals increase over a period of time. Where the lease is an operating lease, it leads to an issue of straight-lining of the lease rentals. As per an EAC opinion straight-lining is required. IFRS also requires straight-lining of leases.

Real estate and infrastructure

In Indian GAAP, ICAI has issued a *Guidance Note on Recognition of Revenue by Real Estate Developers*. Under IFRS, IFRIC has recently issued IFRIC 15. These pronouncements and other practices developed in this industry, over the period, result in significant differences in accounting under the two frameworks. There is no specific guidance for the Infrastructure Industry in Indian GAAP. Under IFRS, IFRIC 12 *Service Concession Arrangements* deals with accounting for infrastructure for public services. Recently, the ICAI has issued Exposure Draft of *Guidance Note on Accounting for Service Concession Arrangements* in line with IFRIC 12. The analysis given below does not consider requirements of the proposed Guidance Note, since, the Exposure Draft has not been issued as final Guidance Note.

Key impact areas

Real estate developers

Under Indian GAAP, in the case of real estate sales, events such as the transfer of legal title to the buyer or giving possession of real estate to the buyer usually provide evidence to the effect that all significant risks and rewards of ownership have been transferred to the buyer. The significant risks and rewards of ownership are also considered to be transferred to the buyer if there is a legally enforceable agreement for sale and:

- ▶ The significant risks (e.g., price risk) related to the real estate have been transferred to the buyer, and
- ▶ The buyer has a legal right to sell or transfer his interest in the property, without any material impediment.

Once the seller has transferred all significant risks and rewards of ownership to the buyer and other conditions for recognition of revenue, namely measurement and collectability, are met, it would be appropriate to recognize revenue at that stage, provided the seller has no further substantial acts to complete under the contract. However, if the seller is obliged to perform any substantial acts after the transfer of all significant risks and rewards of ownership, revenue is recognized on proportionate basis as the acts are performed, i.e., by applying the percentage of completion method in the manner explained in AS 7 *Construction Contracts*.

Under IFRS, IFRIC 15 provides more specific guidance on determining when the agreement would be treated as a construction contract, as rendering of services or as sale of goods. If the agreement is determined to be a sale agreement, the entity recognizes revenue by reference to the stage of completion, using the percentage of completion method, if and only if it transfers control to the buyer, as well as the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. These conditions should be applied to the underlying real estate in its current state, not to the buyer's right to acquire the fully constructed real estate at a later date. On the other hand, if the entity transfers to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (e.g., at completion, upon or after delivery), it should recognize revenue only when all the criteria of IAS 18 are satisfied. When the entity is required to perform further work on real estate already delivered to the buyer, it shall recognize an expense in

accordance with IAS 18. The liability shall be measured in accordance with IAS 37. If the agreement is within the scope of IAS 11 *Construction Contracts* and its outcome can be estimated reliably, the entity shall recognize revenue by reference to the stage of completion of the contract activity in accordance with IAS 11. It appears that the application of IFRIC 15 may give different results vis-à-vis the Guidance Note, particularly, in those agreements which are real estate sales.

Accounting for investment property

IFRS requires the land and/or building held for earning rentals to be classified as an investment property under IAS 40. The entity has an option to measure such property at cost or using fair value model when certain conditions are satisfied. If the fair value model is adopted, then changes in fair value are recognized in the Income Statement and the carrying amount is not depreciated. Recently, the IASB has amended the scope of IAS 40 to allow the same treatment for property being constructed for future use as an investment property. Under Indian GAAP, there is no accounting standard corresponding to IAS 40 dealing with investment property in a comprehensive manner. AS 13, which deals with investment property in a brief manner, requires investment property to be accounted for at cost less other than temporary diminution in value of the property. Further, such property is required to be depreciated over its useful life.

Infrastructure for public use

Under IFRS, the operator cannot recognize infrastructure as its own asset, as the operator does not control the use of public service infrastructure, such as roads, bridges and tunnels, but is merely a

service provider. IFRIC 12 gives guidance on accounting by operators for public-to-private service concession arrangements. It applies to public-to-private service concession arrangements if:

- ▶ The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price, and
- ▶ The grantor controls any significant residual interest in the infrastructure at the end of the term of the arrangement.

Before its issuance, there was widespread concern about the lack of such guidance. In particular, operators wished to know how to account for infrastructure that they either constructed or acquired for the purpose of public-to-private service concession arrangement or were given access to for the purpose of providing public service. Under IFRIC 12, the operator cannot recognize infrastructure as its own asset since it does not control the use of the public service infrastructure. The operator acts as a service provider. Therefore, the operator recognizes the revenue and costs relating to construction or upgrade service in accordance with IAS 11 *Construction Contracts* and revenue in accordance with IAS 18 for services it performs. The consideration received for construction or upgrade services is recognized at its fair value. In India, in the absence of an IFRIC 12 equivalent, infrastructure companies account for the infrastructure as fixed assets rather than as an intangible asset or financial asset. The ICAI has issued an Exposure Draft on *Accounting for Service Concession Arrangements* which is based on IFRIC 12. Once the Guidance Note becomes effective, differences between Indian GAAP and IFRS will cease to exist.

Power

The power industry is a regulated and very capital intensive industry. Critical activities in operational cycle of power entities are fuel sourcing, generation, transmission and distribution, and retail. On transition to IFRS, various issues arise in all phases. Some of the critical issues are addressed in this section.

Key impact areas

Long term fuel purchase

Utility entities usually conclude long term purchase contracts for oil, gas, coal and/or power to be able to meet their contractual obligations to supply to their customers. Generally, these purchase contracts are entered into for the purpose of the receipt of a commodity (oil, gas, coal and/or power) in accordance with an entity's expected purchase, sale or usage requirements and are therefore in the nature of executory contracts. Many times, however, a utility entity may have a practice of net-settling these purchase contracts or similar contracts (in cash, another financial instrument, or by exchanging financial instruments), or they might have a practice of taking delivery of the commodity and selling it within a short period, for the purpose of generating a profit from short-term price fluctuations or broker-dealer's margin. In such cases, the contracts may meet the definition of a derivative. In Indian GAAP, such derivatives are not required to be recognized, though as per an Announcement of the ICAI, mark-to-market losses are required to be provided for. Under IFRS, it will have to be fair valued. Clearly long term fuel purchase contracts that are fair valued may significantly increase income statement volatility.

Fixed assets

Accounting for fixed assets is also an important issue for utility entities as most are capital intensive. An issue that is relevant to almost every entity in this industry is the application of the component approach. To apply the component approach appropriately, an in-depth analysis is required to identify significant components that make up a plant or a grid. These components need to be depreciated over their own useful lives, rather than the life of the asset as a whole. The application of the component approach in this industry is a challenging task as it requires technical knowledge that usually cannot be provided by the accounting department on its own. Experience of IFRS implementation elsewhere in the world indicates that there is considerable disparity in the way in which components were identified for power plants.

Power purchase agreements/ transmission contracts/ capacity contracts

It is a common practice in India for various entities to enter into power purchase agreements to fulfil their energy demand. Also, many utility entities enter into a contractual arrangement conveying the right to use a part of its grid to third parties. Such contracts are normally accounted for as sales/service contracts in Indian GAAP. On transition to IFRS, such an arrangement needs to be analyzed to identify whether it contains a lease. This can have significant implications on the balance sheet of power entities as an asset under consideration may have to be derecognized if the arrangement is assessed as finance lease.

Re-optimization and own use exemption

The planned utilization of a power plant depends on external market factors and internal factors. External market factors which need to be considered for determining generation profiles are the utility entity's expectations of prices (for fuel sourcing, power purchases and sales as well as for emission allowances and power demand). Internal factors, including the power plant's marginal costs of production and power plant technical constraints, such as load capacities, will need to be considered. When actual prices (for fuel, power and/or emission allowances) or demand volumes deviate from previous expectations, a utility entity will need to re-optimize the generation profile (i.e., adjust the utilization) in the short term within the defined technical constraints of generation capacity in order to maximize profits. Consequently, the utility entity may need to enter into financial or derivative contracts simultaneously. For example, to buy power on the wholesale market to meet its obligations to its customers and to adjust the fuel sourcing for the power plant. In Indian GAAP, the accounting standard on financial instruments comes into effect in respect of accounting periods commencing on or after 1 April 2009 and adoption will be recommended for an initial period of two years. This accounting standard will become mandatory in respect of accounting periods commencing on or after 1 April 2011 for all commercial, industrial and business entities except to a small and medium-sized entities. However, as per ICAI announcement mark-to-market losses on derivatives have

to be provided for. Under IFRS, IAS 39 deals with derivatives comprehensively. Under IFRS, these contracts might require derivatives accounting and would usually have a major impact on the income statement. Therefore, utility entities must look carefully at the scope, scale, and structure of its re-optimization activities to ensure that these activities do not have unexpected consequences.

The above are few critical issues, which may arise on transition to IFRS. There are many other issues, such as accounting for emission rights, service concession contracts, tolling rights, accounting for regulatory assets and liabilities, which power entities will have to deal with on transition to IFRS. On transition to IFRS, power entities may also have to deal with the issue of customer contributions, whereby, an entity receives an item of property, plant and equipment or cash it is required to use to construct or acquire an item of property, plant and equipment that must be used to provide access to a supply of goods or services. Currently, no specific guidance is available under both Indian GAAP and IFRS on the matter. However, IFRIC has issued an exposure draft on this issue.

Retail

Even though Indian GAAP is inspired by IFRS, there are significant differences between both the GAAPs. In many instances, existing industry practices do not always coincide with the current IFRS guidance. The consequences of GAAP differences need to be analyzed and appropriately applied for certain retail and consumer specific issues.

Key impact areas

Capitalization of refurbishment cost of existing stores

In Indian GAAP, the cost of construction, painting, installing false ceilings, furnishing etc., of existing stores, is capitalized to the extent that it increases the future economic benefits in excess of the original assessed standard of performance. Thus, if the expenditure incurred was to increase the available space in the store or add a new outlet the same is capitalized, otherwise it is expensed. The cost of overhaul that does not increase the benefit beyond the originally assessed standard of performance is not capitalized. For example, the management may have a policy to replace carpets of a store once every two years to keep it at the required operating standard. Such expenditure under existing AS 10 cannot be capitalized. Under IFRS, retail entities will have to identify cost of carpets as a separate component and capitalize such cost of replacement when incurred. The capitalized cost is amortized over the period when the next replacement is expected.

Accounting for pre-opening cost

Retailers typically spend a huge amount on developing new stores. For example, a store may require three months for developing, during which expenditure on construction, painting, installing false ceilings, furnishing etc. would be incurred. Also, staff costs are incurred since they may have already been hired in anticipation of the opening of the store. The issue arises as to whether such pre-opening costs should be capitalized or expensed off. The cost of construction, painting, installing false ceilings, furnishing, etc. would be

capitalized. However, the cost of the staff is not capitalized as it is not necessary for bringing the asset to its working condition, and hence, should be expensed. Whilst this is true for both IFRS and Indian GAAP, in practice, few companies may have interpreted Indian GAAP as allowing capitalization.

Accounting for leases

Retail entities normally enter into leasing arrangements for their buildings and stores. Even though accounting for leases under Indian GAAP and IFRS is similar, classification of these leases under IAS 17 could be different due to additional guidance provided under IFRS for composite lease, lease contracts embedded in service contracts, embedded derivatives etc.

In many cases, retail entities pay rentals based on revenue or profit generated by them from that outlet or premises. Indian GAAP does not prescribe any specific accounting treatment for derivatives. Under IFRS, such contracts will have to be analyzed to identify any embedded derivatives, which requires separate accounting. Where the embedded derivative exception applies, such features would be accounted as contingent rentals.

Retailers often pay premiums to a previous tenant or to the owner of the premises in order to obtain prime leasehold premises. These payments, commonly known as 'key money', can take several forms, including payment to existing leaseholders to exit the lease or payment of a non-refundable deposit on the commencement of the lease. The accounting treatment will depend on the lease classification. Under Indian GAAP and IFRS, such initial direct costs are capitalized if the lease is classified as finance lease. There is no specific

accounting treatment specified under Indian GAAP for such cost if the lease is classified as operating lease. Under IFRS, such payments may be recognized as a prepayment and amortized over the lease term.

Straight-lining of lease rentals in an operating lease is another issue. Under Indian GAAP, the EAC has opined that straight-lining would be required for all future increases in rent. Under IFRS, SIC 15 *Operating Leases – Incentives* deals with straight-lining in the context of lease incentives by lessor, e.g., in the form of up-front cash payment to the lessee or the reimbursement by the lessor of costs of the lessee (such as relocation costs, leasehold improvements, etc.,) or initial rent-free period. In cases where future increase in rent represents only inflation or future increased cost of working, IFRS requires straight-lining except where there are embedded derivatives in such lease contracts.

Corners in department stores/ concession agreements

Certain retail entities do business on a 'store-in-store' or concessionary basis, where the retail entity allocates a corner for another store and sells the products of that store. The industry practice is to disclose the gross value of sales, including sales made from the store. Critical analysis of the arrangement should be made to determine whether the retail entity is acting as an agent or principal. If retail entities are acting as an agent for the vendor, they should account only for commission as revenue.

Brands

Many retail and consumer entities have intangible assets in brand names that they have built up over the years through acquisitions and mergers. Key points

to consider are the valuation of these intangibles, annual impairment reviews and the allocation of valuation of these assets to business segments. Accounting principles for brands are very similar in Indian GAAP and IFRS except for identification of brands with indefinite life. Indian GAAP does not recognize the concept of indefinite life. IFRS permits entities to estimate that intangible assets can have indefinite lives. Such intangible assets with indefinite useful lives are not amortized but tested for impairment at least annually and whenever there is an indication that the intangible asset may be impaired. Retail entities may review the classification of brands to make the split between finite and indefinite brands, as per guidance given in IAS 38.

Impairment of assets

Every retailer has underperforming assets. The toughest challenges are likely to be for retailers:

- ▶ To set up adequate procedures to identify impairment indicators
- ▶ To establish annual impairment tests on goodwill and intangible assets with an indefinite useful life
- ▶ To define the CGU at which non-current assets and goodwill are regularly tested for impairment

The question that arises is the level of detail required. For example, will retailers need to go down to country, region, store or department level for the identification of CGUs? This is an interesting issue both under Indian GAAP and IFRS.

Customer loyalty programmes

Many retail entities use customer loyalty programmes to build brand loyalty, attract/retain their valuable customers and increase sales volumes. Programmes are generally designed to reward customers for past purchases and to

provide them with incentives to make further purchases. Typically, customers purchase goods or services and earn award credits (e.g., points) that can be used to obtain free or discounted goods and services. The programmes operate in number of ways:

- ▶ Customers may use the award credits as they are granted, or
- ▶ Customers may be required to accumulate a minimum number of award credits before any can be redeemed.

Award credits may be linked to individual purchases, groups of purchases or purchases made over a specified period of time.

No specific guidance is available under Indian GAAP on treatment of such loyalty programmes. Consequently, differing practices have emerged regarding treatment of such programmes. For example, certain entities may be recognizing the cost of supplying the goods or service in the future as an expense at the time of selling the goods, giving rise to a liability. Further, some companies may be recognizing full cost as expense, while other may be following the practice of recognizing only the incremental cost. Entities may also be treating the award credit as a separate component of the sales transaction that requires delivery in the future and deferring the recognition of an element of the consideration.

Till recently, no specific guidance was available on the matter under IFRS either. However, IFRIC has recently issued IFRIC 13 to provide specific guidance on the matter. As per IFRIC 13, award credits offered as part of a sales transaction are accounted for as a separate component of that sales transaction. The granting

of award credits is effectively accounted for as a future delivery of goods or services. Therefore, the fair value of the total consideration received in the initial sales transaction is allocated between the award credits and the sale of the goods or services. The interpretation requires only that the amount allocated to the award credits is measured 'by reference to' their fair value. It does not prescribe an allocation method for multiple component sales. Thus, amount allocated to the award credits to be either:

- ▶ Equal to their fair value, or
- ▶ The proportion of the total consideration that the fair value of the award credits represents of the total fair value.

The entity shall recognize the deferred portion of consideration as revenue only when it has fulfilled its obligations under the programme.

Consumer product and diversified industrial product companies

Key impact areas

Agency agreements with retailers

Consumer product companies are tending to increase their control over the distribution process up to the ultimate point-of-sale. Therefore, many so called 'shop-in-shop' concepts or other controlled retail spaces have been established. As a result, the consumer product companies need to determine whether the revenues generated in these controlled retail spaces with end-customers should be presented either as gross (and the commission fee paid to retailers expensed) or net as the sale price to the retailer.

Both Indian GAAP and IFRS does not provide specific guidance on how to

determine whether or not an agency relationship between a supplier and retailer exists leading to diversity in practice of accounting of revenue from such channel. IASB is in process of removing ambiguity in this area. It has issued an exposure draft containing an amendment to IAS 18 where it has indicated following features which indicate that an entity is acting as a principal:

- ▶ It has primary responsibility for providing the goods or services to the customers or for fulfilling the order
- ▶ It has inventory risk before or after the customer order, during shipping or on return
- ▶ It has discretion in establishing prices
- ▶ It bears the customer's credit risk

Critical analysis of the arrangement will be required to determine whether the consumer product entity is acting as an agent or principal based on above-mentioned factors. If consumer product entities are acting as an agent for the vendor, they should account only for commission as revenue.

Discount, rebates and other sales incentives to retailers

Consumer product companies offer numerous trade discounts, volume rebates and other sales incentives to retailers. These may include different forms, such as, upfront payments, advertising cooperation programmes in conjunction with distributors, promotional coupons, customer loyalty programmes and promotional activities at the point of sale.

Under Indian GAAP, consumer product companies only reduce volume discounts and other trade discounts from revenue. Prompt settlement discounts or cash discounts and other sales incentives like contributions to advertising, promotional

actions invoiced by distributors etc. are generally accounted for as expenses. Under IFRS, in order to comply with IAS 18, revenue should be measured at the fair value of the consideration received or receivable. Consequently, prompt settlement discounts and other sales incentives should be estimated at the time of sale and deducted from revenues.

Advertising costs

Consumer product companies typically spend significant amounts on advertising and promotional activities. In practice, these exist in various forms, including advertising campaigns in print media, TV or radio spots, etc. Both AS 26 and IAS 38 require advertising and promotional expenditure to be expensed off as and when incurred. However, little guidance is available on the notion "... when it is incurred", resulting in companies adopting a range of interpretations.

The IASB recognized that diversity in practice exists for the interpretation of the notion "... as incurred" and addressed the recognition of advertising and promotional expenditures in its Annual Improvement Project 2006-08. For annual periods beginning on or after 1 January 2009, the amended IAS 38 clarifies that advertising and promotional expenditures should be recognized as an expense when the company has right to access the goods or when it receives the services. Paragraph 69a of IAS 38 describes more in detail when advertising and promotional expenditures should be expensed:

.....

“An entity has a right to access goods when it owns them. Similarly, it has right to access goods when they have been constructed by a supplier in accordance with terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver an advertisement to customers”.

.....

This means that expenditures on advertising and promotions should be expensed off immediately and not deferred until they are delivered to customers. Indian companies need to adhere to revised guidelines on timing of expensing off advertising and promotional expenditure on transition to IFRS.

Contract manufacturing

Many consumer and industrial product companies use job-worker or third party manufacturing facilities for their production. Such arrangements are normally structured as service contracts and cost is accounted as and when such services are rendered based on terms of the contract. Indian GAAP does not require nor prohibit evaluating such contracts to determine whether, in substance, these are leasing arrangements. However, under IFRS such transactions could fall within the scope of leases in terms of IFRIC 4. IFRIC 4 sets out the criteria for determining whether a transaction is in the nature of a lease or not. This determination is based on the substance of the arrangement and

assesses whether the fulfilment of the arrangement is dependent on the use of a specific asset and if the arrangement conveys a right to use the asset. If such arrangement is identified as a leasing arrangement, expense and asset under consideration will be accounted as per principles of IAS 17.

Property, plant and equipment

Consumer and industrial product companies are asset-intensive businesses. Property, plant and equipment comprises significant component of assets held by consumer and industrial product companies. Significant differences exist between Indian GAAP and IFRS with respect to accounting for property, plant and equipment which has been discussed in detail in chapter 2. However, the area which is going to pose significant challenge to consumer and industrial product companies is component accounting. Companies will have to closely analyze their overhaul and replacement policy to identify various components. Changes in fixed assets accounting records will also be required to identify/record values of each components based on which depreciation will be provided on an on-going basis under IFRS.

A photograph of two people shaking hands in front of a large window. The person on the left is wearing a light blue button-down shirt, and the person on the right is wearing a dark maroon sweater. The background shows a blurred cityscape through the window panes.

First-time adoption of IFRS

4

First-time adoption of IFRS

ICAI has announced convergence with IFRS for accounting periods commencing on or after 1 April 2011. As per the Announcement, all listed entities, public interest entities, such as banks, insurance entities and large-sized entities shall adopt IFRS. In addition, the Ministry of Corporate Affairs (MCA) recently issued a press release in which the Ministry has committed to IFRS convergence by 1 April 2011.

Most Indian entities are adopting IFRS for the first time. Although, entities often adopt new accounting standards under Indian GAAP, adopting IFRS, an entirely different basis of accounting, poses a distinct set of problems:

- ▶ The sheer magnitude of the effort involved in adopting a large number of new accounting standards,
- ▶ The requirements of individual IFRS differ significantly from those under Indian GAAP, and
- ▶ The large amount of information that needs to be collected, not previously required under Indian GAAP.

After the IASB had been made aware of the considerable practical difficulties surrounding first-time application of IFRS, it published IFRS 1 *First-time Adoption of International Financial Reporting Standards* in order to assist preparers to overcome the practical difficulties in applying IFRS for the first time. IFRS 1 provides the basis on which entities will convert their financial statements to IFRS. It lays down the ground rules and prescribes the accounting policies to be followed in an entity's first set of IFRS financial statements, and in preparation

of its opening IFRS balance sheet, which serves as the starting point for its future accounting under IFRS.

Though IFRS 1 goes some way to reduce the burden of historical accounting information, it does not turn the transition process into a hassle free job. Even under IFRS 1, the transition process remains complex and time-consuming for many entities. It places demands on companies in areas such as staff training, data collection, and new or modified information system requirements. Another challenge relates to the exemptions from IFRS available in preparing the transition date balance sheet. The standard includes both optional and mandatory exceptions and companies are required to make judgments and decisions about which options to apply in their first set of IFRS financial statements. It is essential for everyone involved in the conversion process to understand the issues and to know how these can be resolved.

This chapter explains the application of IFRS 1 in the particular context of Indian entities. Thus, Indian GAAP has been considered to be the previous GAAP for such entities.

First-time adoption

IFRS 1 prescribes the procedures that an entity is required to follow when adopting IFRS for the first time. The underlying principle is that a first-time adopter should prepare financial statements as if it had always applied IFRS, subject to a number of exemptions and exceptions, whereby, a first-time adopter is allowed to deviate

from this general rule. The objective of IFRS 1 is to ensure that an entity's first IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

- a. is transparent for users and comparable over all periods presented,
- b. provides a suitable starting point for accounting under IFRS, and
- c. can be generated at a cost that does not exceed the benefits to users.

Scope of IFRS 1

IFRS 1 is applicable to the first set of annual IFRS financial statements prepared by an entity. The first IFRS financial statements are defined as the first annual financial statements in which an entity adopts IFRS by an 'explicit and unreserved statement' of compliance with IFRS. The decisive factor is whether or not the entity made that explicit and unreserved statement. An entity is not considered to be a first-time adopter if it departed from certain IFRS (whether recognition, measurement or disclosure) in its previous financial statements but still made an explicit and unreserved statement of compliance with IFRS. Accordingly, such an entity is not allowed to apply IFRS 1 in accounting for changes in its accounting policies. Instead, it would need to apply IAS 8 in making any corrections.

IFRS 1 states that an entity's first IFRS financial statements will be subject to IFRS 1, even if it presented its most recent previous financial statements in compliance with IFRS in all respects, except that they did not contain an explicit and unreserved statement.

Below are some examples of situations where an entity's financial statements

under IFRS would be considered as the first IFRS financial statements, and therefore, would be subject to IFRS 1 requirements:

- ▶ An entity presented its most recent previous financial statements:
 - i. Under national requirements that are not consistent with IFRS in all respects,
 - ii. In conformity with IFRS in all respects, except that the financial statements did not contain an explicit and unreserved statement of compliance with IFRS,
 - iii. Containing an explicit statement of compliance with some, but not all, IFRS,
 - iv. Under national requirements inconsistent with IFRS, using some individual IFRS to account for items for which national requirements did not exist, and
 - v. Under national requirements, with a reconciliation of some amounts to the amounts determined under IFRS.
- ▶ An entity prepared financial statements under IFRS for internal use only, without making them available to the entity's owners or any other external users,
- ▶ An entity prepared a reporting package under IFRS for consolidation purposes without preparing a complete set of financial statements as defined in IAS 1-R *Presentation of Financial Statements*, and
- ▶ An entity did not present financial statements for previous periods.

If the most recent previous financial statements of an entity contained an explicit and unreserved statement of compliance with IFRS, then it will not be considered as a first-time adopter.

For example, IFRS 1 does not apply when an entity:

- ▶ Stops presenting financial statements under national requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with IFRS,
- ▶ Presented financial statements under national requirements in the previous year and those financial statements contained an explicit and unreserved statement of compliance with IFRS, or
- ▶ Presented financial statements in the previous year that contained an explicit and unreserved statement of compliance with IFRS, even if the auditors qualified their audit report on those financial statements.

An entity that presents its first IFRS financial statements is a first-time adopter and should apply IFRS 1 in the preparation of those financial statements. It should also apply IFRS 1 in each interim report prepared under IAS 34 *Interim Financial Reporting* for part of a period covered by its first IFRS financial statements. For a company with a 31 March year end, this will mean that if IAS 34 is adopted for quarterly reporting, the first financial information prepared under IFRS will be at 30 June 2011 and the company will need to apply IFRS 1 in the preparation of that quarterly report. Also, comparable quarter, i.e., 30 June 2010 numbers will have to be IFRS compliant.

Example 1: Scope of application of IFRS 1

Entity A applied IFRS in its previous financial statements, but stated that it 'applied IFRS except for SIC-12 - Consolidation - Special Purpose Entities.'

Entity A is a first-time adopter for the current financial statements because its previous financial statements did not contain an unreserved statement of compliance with IFRS. It is irrelevant whether the auditors' report was qualified or not.

Example 2: Scope of application of IFRS 1

Entity B applied IFRS in its previous financial statements and stated that the 'financial statements are prepared in conformity with IFRS.' Despite that statement, B had not applied SIC-12.

Entity B is not a first-time adopter in current financial statements because its previous financial statements contained an unreserved statement of compliance with IFRS. Even if the auditors had qualified their report, the entity would still not be a first-time adopter.

Example 3: Entity applying national GAAP and IFRS

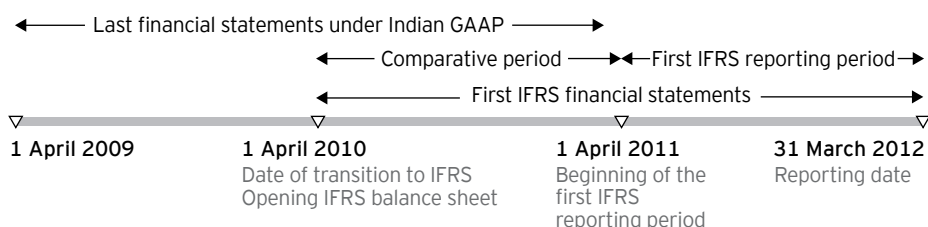
Entity C prepares two sets of financial statements, one set of financial statements based on Indian GAAP and the other set based on IFRS. The IFRS financial statements contained an explicit and unreserved statement of compliance with IFRS, and were made available externally. From 2011 onwards, C stops presenting financial statements based on Indian GAAP.

Entity C is not a first-time adopter in 2011 because it already published financial statements that contained an explicit, and unreserved statement of compliance with IFRS.

First-time adoption timeline/ key dates

Two terms are key to understanding IFRS 1: reporting date and transition date. The reporting date is the end of the latest period covered by financial statements

Therefore, the first set of financial statements shall be for 1 April 2011 to 31 March 2012 with IFRS comparables also provided for 1 April 2010 to 31 March 2011. The opening balance sheet date shall be 1 April 2010.



or by an interim financial report. The transition date is the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements. For an Indian company with a March year-end the first reporting date under IFRS will be 31 March 2012 and transition date will be 1 April 2010.

Opening IFRS balance sheet and accounting policies

IFRS 1 requires an entity to prepare an opening IFRS balance sheet at its transition date (1 April 2010 in the above example). The opening IFRS balance sheet is the starting point for all subsequent accounting under IFRS.

Example 4: Consistent application of accounting policies

Background

The reporting date for entity A's first IFRS financial statements would be 31 March 2012. Entity A has decided to present comparative information in those financial statements for one year only. Therefore, its date of transition to IFRS would be the beginning of business on 1 April 2010. Entity A would present financial statements under Indian GAAP annually to 31 March each year up to, and including 31 March 2011.

Application of requirements

Entity A would be required to apply the IFRS effective for periods ending on 31 March 2012 in:

- Preparing and presenting its opening IFRS balance sheet as at 1 April 2010, and
- Preparing and presenting its balance sheet for 31 March 2012 (including comparative amounts for 31 March 2011), statement of comprehensive income, statement of changes in equity and cash flow statement for the periods then ended and disclosures (including comparative information)

If a new IFRS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements.

A first-time adopter needs to use the same accounting policies in its opening IFRS balance sheet as those used in all periods presented in its first IFRS financial statements. The fundamental principle of IFRS 1 is to require full retrospective application of the standards in force at an entity's reporting date, with limited exceptions.

When selecting accounting policies, a first-time adopter:

- ▶ Needs to apply IFRS effective at the reporting date. It should not apply previous versions of IFRS that were effective at earlier dates.
- ▶ May apply a new IFRS that is not yet mandatory if it permits early application. Transitional provisions in other IFRS do not apply to a first-time adopter's transition to IFRS.
- ▶ Determine which exemptions to use.
- ▶ Take into account the exceptions to retrospective application.

Transition from Indian GAAP to IFRS

In preparing its opening IFRS balance sheet, an entity should:

- ▶ **Not recognize items as assets or liabilities if IFRS does not permit such recognition**
 - ▶ Assets and liabilities recognized under Indian GAAP that do not qualify for recognition under IFRS need to be eliminated from the opening balance sheet. For example, share issue expenses carried forward does not meet the definition of intangible asset under IAS 38. Therefore, it cannot be carried in the IFRS opening balance sheet. Proposed dividends cannot be disclosed as liability in IFRS and this liability should be eliminated in the opening IFRS balance sheet.

▶ Recognize all assets and liabilities whose recognition is required by IFRS

Some of the examples are:

- ▶ All derivative financial assets and liabilities and embedded derivatives need to be recognized in opening IFRS balance sheet. If these are not recorded under Indian GAAP, entities need to bring them on the IFRS balance sheet.
- ▶ IFRS requires restructuring provisions to be recognized based on a constructive obligation, while Indian GAAP permits recognizing such provision only when legal obligation arises. Therefore, if an entity had constructive obligation on the opening balance sheet date, it needs to record the provision in the IFRS balance sheet. If there was no legal obligation by that date, the Indian GAAP balance sheet would not have recorded such provision.
- ▶ IAS 12 is based on the balance sheet liability approach. AS 22 requires deferred taxes to be recognized based on the income statement liability approach. Therefore, temporary differences, for which deferred tax is not recognized under Indian GAAP, need to be identified and deferred tax in respect thereof need to be recognized in the opening balance sheet date.

Entities also need to gather information required to be disclosed in the IFRS balance sheet that is not disclosed in Indian GAAP. For example, Indian GAAP prohibits disclosure of contingent assets, whereas, IFRS require such disclosure. Therefore, entities need to develop their systems to capture such information.

► **Reclassify assets, liabilities and items of equity as per the requirements of IFRS**

Asset and liability classifications under Indian GAAP do not comply with IFRS. Therefore, the assets and liabilities need to be reclassified in order to draw up the opening IFRS balance sheet in accordance with IFRS requirements. Certain common differences are highlighted below:

- In an Indian GAAP balance sheet, liability and equity classification is based on legal form, rather than their substance. For example, all redeemable preference shares are classified as equity. Therefore, items which meet the definition of equity and liability under IFRS need to be identified first and then to be reclassified in the opening IFRS balance sheet.
- There may be acquired intangible assets in the past business combinations, which do not meet the definition of intangible assets under IFRS. These need to be reclassified to goodwill. In addition, intangible assets on acquisitions that were not previously recognized need to be reclassified from goodwill to intangibles in the opening balance sheet.
- IFRS 1 provides an exemption from split accounting of compound financial instruments when certain conditions are satisfied. When this exemption cannot be availed by the entity, compound financial instruments need to be split into equity and liability portions for their appropriate classification. Those items which are liabilities but are classified as equity under

Indian GAAP, such as mandatory redeemable preference shares, need to be reclassified as a liability in the opening balance sheet.

- IAS 27 does not provide any exemption from consolidating subsidiaries. Therefore, if the entity has not prepared CFS under Indian GAAP or has not consolidated any subsidiary in its Indian GAAP CFS, the opening IFRS balance sheet needs to be drawn up to ensure all subsidiaries are recorded in the consolidated opening balance sheet.

► **Measure all assets and liabilities in accordance with IFRS**

- All assets and liabilities need to be measured using IFRS principles. For example, an entity would need to measure investment classified as at fair value through profit or loss at fair value in the opening IFRS balance sheet.

The resulting differences between the carrying values under Indian GAAP and carrying values under IFRS are accounted in the retained earnings in the opening balance sheet.

Optional exemptions from the requirements of certain IFRS

IFRS 1 grants limited optional exemptions from the general requirement of full retrospective application of IFRS where the cost of complying with them would be likely to exceed the benefits to users of financial statements. These exemptions relate to:

1. Use of fair value as deemed cost,
2. Decommissioning liabilities included in the cost of property, plant and equipment,
3. Leases,

4. Service concession arrangements,
5. Borrowing costs,
6. Business combinations,
7. Assets and liabilities of subsidiaries, associates and joint ventures,
8. Investments in subsidiaries, jointly controlled entities and associates in separate financial statements,
9. Cumulative translation differences,
10. Financial instruments,
11. Employee benefits,
12. Share-based payment transactions, and
13. Insurance contracts.

Application of these exemptions is entirely optional, i.e., a first-time adopter can pick and choose the exemptions that it wants to apply. It is important to note that the IASB did not establish a hierarchy of exemptions. Therefore, when an item is covered by more than one exemption, a first-time adopter has a free choice in determining the order in which it applies the exemptions. It is, however, specifically prohibited to apply these exemptions by analogy to other items.

Use of fair value as deemed cost

Items of property, plant and equipment are long-lived which means that accounting records for the period of acquisition may not be available anymore. In certain cases, the required records may have never existed to apply accounting as per IAS 16. Furthermore, even if these items are being carried at depreciated cost, the accounting policy for recognition and depreciation may not have been IFRS compliant. For example, unlike IAS 16, Indian GAAP does not mandate component approach with regard to depreciation and the replacement of parts of items of property, plant and equipment. In such a scenario, full retrospective

restatement as per IFRS may not only be difficult, but would often also involve undue cost and effort.

To deal with practical issues in the retrospective restatement, IFRS 1 permits a first-time adopter to measure individual items of property, plant and equipment at deemed cost at the date of transition to IFRS. The deemed cost that a first-time adopter uses is either:

1. The fair value of the item at the date of transition to IFRS,
2. A revaluation under the Indian GAAP at, or before the date of transition to IFRS, if the revaluation was, at the date of the revaluation, broadly comparable to:
 - Fair value, or
 - Cost or depreciated cost under IFRS, adjusted to reflect, for example, changes in a general or specific price index, or
3. The deemed cost under the Indian GAAP that was established by measuring items at their fair value at one particular date because of an event such as a privatization or initial public offering.

The revaluations referred to in (2) above need only be 'broadly comparable' to fair value or reflect an index applied to a cost that is broadly comparable to cost determined under IFRS. It appears that in the interest of practicality, IFRS 1 allows flexibility in this matter.

If the deemed cost of an asset was determined before the date of transition to IFRS, then deemed cost forms the basis for the cost of the asset under IFRS at the date the valuation was performed and not at the date of transition. Depreciation under IFRS is determined from the date deemed cost is applied up until the date of transition.

In addition to property, plant and equipment, IFRS 1 allows deemed cost exemption to be used for the categories of assets listed below:

- ▶ Investment property, if an entity elects to use the cost model in IAS 40, and
- ▶ Intangible assets that meet recognition criteria in IAS 38 (including reliable measurement of original cost), and the criteria in IAS 38 for revaluation (including the existence of an active market).

A first-time adopter cannot use a deemed cost approach for any other assets or liabilities.

It is important to note that the deemed cost exemption in IFRS 1 does not take classes or categories of assets as its unit of measure, but refers to 'an item of property, plant and equipment'. The same exemption is available for investment property and intangible assets. A first-time adopter can, therefore, apply the deemed cost exemption to only some of its assets.

For example, it could apply the exemption only to:

- ▶ A selection of properties,
- ▶ Part of a factory, or
- ▶ Some of the assets leased under a single finance lease.

Example 5: Fair value as deemed cost

Background

Entity Z is a pharmaceutical company, and its balance sheet contains some property, plant and equipment, purchased patents and borrowings. The property, plant and equipment have been revalued to market value each year in the Indian GAAP financial statements. Entity Z also has some development projects in progress that meet the criteria in paragraph 57 of IAS 38 to be recognized as assets. Entity Z has recognized these costs as an intangible asset under Indian GAAP. Can management apply the fair value as deemed cost exemption to the development projects in progress?

Application of requirements

Management can apply the exemption to use fair value as deemed cost to the property, plant and equipment only. The fair value of these assets calculated in accordance with Indian GAAP can be used as deemed cost in the opening IFRS balance sheet.

The purchased patents and the development projects do not meet the criteria in IAS 38 for the revaluation of intangible assets, since there is no active market. The purchased patents must be restated on the opening IFRS balance sheet to cost, less appropriate amortization. The costs of the development projects in progress should be capitalized from the point that the criteria in IAS 38 were satisfied, but only if management made and documented the assessment of probable future economic benefits at that time.

Decommissioning liabilities included in the cost of property, plant and equipment

Under IAS 16, the cost of an item of property, plant and equipment includes 'the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as

a consequence of having used the item during a particular period'. Under IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle an existing decommissioning, restoration or similar liability, or a change in the discount rate, shall be added to,

Example 6: Decommissioning liability

Background

X Telecom's date of transition to IFRS is 1 January 20x7. It has set up a tower that was completed and ready for use on 1 January 20x2. The facts relevant to tower are summarized below:

Cost	INR1,400
Residual value	INR200
Economic life	20 years
Original estimate of decommissioning cost to be incurred	INR175
Revised estimate at 20x4 of decommissioning cost	INR300
Discount rate applicable (assumed to be constant)	5.65%
Discounted value of original decommissioning liability on 1 January 20x2	INR58
Discounted value of revised 20x4 decommissioning liability on 1 January 20x2	INR100
Discounted value of revised decommissioning liability on 1 January 20x7	INR131

X Telecom is not accounting for decommissioning liability under Indian GAAP.

Application of requirements

Full retrospective application of IFRIC 1 would require X Telecom to go back in time and account for each revision of the decommissioning provision. Keeping in view practical difficulties, IFRS 1 allows the following treatment to be followed:

- ▶ Recognize decommissioning liability based on discounted value of revised liability on 1 January 20x7, i.e., INR131
- ▶ Amount to be added to cost of Tower

Discounted value of revised decommissioning liability on 1 January 20x2	INR100
Accumulated depreciation on the above amount =	INR100 x 5/20 = INR25
Net amount to be capitalized =	INR100 - 25 = INR75
Entry to be passed	
Dr. Tower	INR75
Dr. Retained earning	INR56
Cr. Decommissioning liability	INR131

or deducted from, the cost of the related asset. The adjusted depreciable amount of the asset is depreciated prospectively over its remaining useful life.

For a first-time adopter, retrospective application of these requirements would require an entity to construct historical records of all such adjustments that would have been made in the past, which in many cases, will not be practicable. Therefore, under this optional exemption, an entity may elect, for such liabilities incurred before the date of transition, to:

- ▶ Measure the liability at the date of transition to IFRS in accordance with IAS 37, and
- ▶ Estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period.

In Example 6 above, the underlying fixed asset at opening balance sheet date may have been determined either using or not using the deemed cost exemption. In case where the deemed cost exemption for fixed assets has not been used but the decommissioning provision is not made, the decommissioning liability exemption could be applied. In the context of the above example, the cost of fixed asset will be increased by INR75, decommissioning liability will be recorded at INR131 and consequent effect will be made in retained earnings.

An entity may have used the deemed cost option and on that basis fixed asset may have been fair valued on the opening balance sheet date. In such a case, journal entry explained in the above example would prevail provided the fair valuation

ignores the effect of decommissioning provision. This will ensure that the entity does not end up double counting the decommissioning provision.

Leases

IFRIC 4 requires an assessment of, whether a contract or arrangement contains a lease. The assessment should be carried out at the inception of the contract or arrangement. First-time adopters must apply IFRIC 4, but can elect to make this assessment as of the date of transition based on the facts at that date, rather than at inception of the arrangement.

Example 7: Leases

The owner of a co-generation facility and a natural gas provider entered into a natural gas supply contract. The parties to the contract will need to analyze the arrangement under IFRIC 4 to determine whether the arrangement should be accounted for as a single element – that is, a natural gas supply contract – or whether there is an embedded lease within it. For example, a lease of:

- ▶ The pipeline used to transport the natural gas to the co-generation facility, and/or
- ▶ The underlying land.

Indian GAAP does not provide any guidance on determining, whether an arrangement contains a lease.

Using the lease exemption, companies can choose to perform the embedded lease assessment either at the date of transition or at the arrangement inception date for those contracts.

Service concession arrangements

IFRIC 12 applies to contractual arrangements in which a private sector operator participates in the development, financing, operation, and maintenance of

infrastructure for public sector services. Under IFRIC 12, the operator cannot recognize infrastructure as its own asset, since, it does not control the use of the public service infrastructure. The operator acts as a service provider. Therefore, the operator recognizes the revenue and costs relating to construction or upgrade service in accordance with IAS 11 and revenue in accordance with IAS 18 for services it performs. The consideration received for construction or upgrade services is recognized at its fair value.

A first-time adopter may apply the transitional provision in IFRIC 12. This requires retrospective application, unless, it is, for any particular service arrangement, impracticable for the operator to apply IFRIC 12 retrospectively, at the start of the earliest period presented, in which case it should:

- ▶ Recognize financial and intangible assets that existed at the start of the earliest period presented,
- ▶ Use the previous carrying amounts as the carrying amount at that date (no matter how they were previously classified), and
- ▶ Test the financial and intangible assets recognized at that date for impairment.

Key India considerations

It may be noted that ICAI has recently issued Exposure Draft of *Guidance Note on Accounting for Service Concession Arrangements*. The proposed guidance note is based on IFRIC 12 and is intended to be effective for annual periods beginning on or after 1 April 2009. Once this guidance note becomes effective, this exemption will not be relevant for Indian companies presenting its first IFRS financial statements for the financial year ended 31 March 2012.

Borrowing costs

A first-time adopter may apply IAS 23 *Borrowing Costs* using the following guidelines:

- ▶ If the accounting treatment for capitalized interest required by IAS 23 is different from the company's previous accounting policy, the company should apply IAS 23 to borrowing costs related to qualifying assets capitalized on or after 1 January 2009, or the date of transition to IFRS, if later
- ▶ Alternatively, companies can designate any date before 1 January 2009, and apply the standard to borrowing costs relating to all qualifying assets capitalized on or after that date.

Key India considerations

The IASB has recently issued an amended version of IAS 23 that eliminates the option to expense borrowing costs. The requirements of revised IAS 23 are in line with AS 16 *Borrowing Costs*. Therefore, most Indian companies will not be required to use this exemption.

Business combinations

a. Business combination prior to transition date

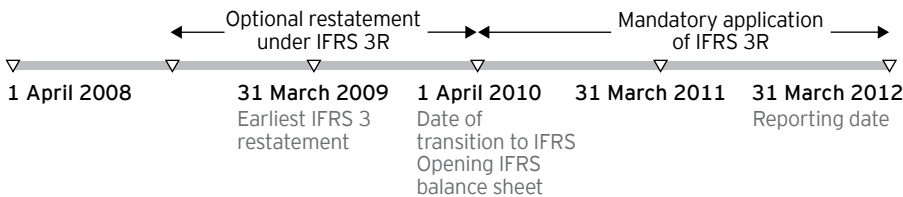
Accounting for business combinations under Indian GAAP is significantly different to that under IFRS. Retrospective application of IFRS 3-R *Business Combinations* may be difficult and in certain cases, impossible for past business combinations. Against this background, besides fair value as deemed cost in case of fixed asset, the business combinations exemption in IFRS 1 is probably the most important exemption, as it provides a first-time adopter an exemption from restating business combinations prior to its date of transition to IFRS, subject to certain requirements. A first-time adopter choosing to apply this exemption is not required to restate business combinations to comply with IFRS 3-R, if control was obtained before the transition date, however, it may choose to restate previous combinations. If a first-time adopter restates any business combination prior to its date of transition to comply with IFRS 3-R, it must restate all business combinations under IFRS 3-R which occur after the date of that combination.

This exemption is available to all transactions that meet the definition of a business combination under IFRS 3-R, irrespective of their classification under Indian GAAP. The exemption also applies to acquisitions of investments in associates and joint ventures. Thus, a

first-time adopter taking advantage of the exemption will not have to revisit past business combinations, acquisitions of associates and joint ventures to establish fair values and amounts of goodwill under IFRS. However, application of the exemption is complex, and certain adjustments to transactions under Indian GAAP may still be required.

When the exemption is applied:

- Classification of the combination as an acquisition, reverse acquisition or a pooling of interests does not change,
- Assets and liabilities acquired or assumed in the business combination are recognized in the acquirer's opening IFRS balance sheet, unless IFRS does not permit recognition,
- For assets and liabilities that are accounted for on a cost basis under IFRS, the carrying amount under Indian GAAP shall be their deemed cost under IFRS at that date. If IFRS require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortization from the date of the business combination, and
- Assets and liabilities that are measured at fair value under IFRS are restated to fair value in the opening IFRS balance sheet, with the offset being recorded in equity (for example, available-for-sale financial assets).



An asset acquired or a liability assumed in a past business combination may not have been recognized under Indian GAAP. However, this does not mean that such items have a deemed cost of zero in the opening IFRS balance sheet. Instead, the acquirer recognizes and measures those items in its opening IFRS balance sheet on the basis that IFRS would require in the balance sheet of the acquiree.

Under IFRS 1, when recognizing an asset or liability associated with a business combination prior to the transition date, the recording of the offsetting debit or credit depends on the nature of the entry. The recognition of most assets or liabilities will result in a corresponding debit or credit in retained earnings. Two adjustments are, however, recorded against goodwill arising from prior business combinations:

- ▶ Goodwill is increased for an intangible asset, recognized under Indian GAAP, that does not qualify for recognition as an asset under IAS 38. Alternatively, goodwill is decreased

for an intangible asset that was subsumed in goodwill under Indian GAAP and qualifies for recognition as a separate intangible asset under IAS 38.

- ▶ Goodwill is impaired at the transition date after applying IAS 36.

b. Previously unconsolidated subsidiaries

Under Indian GAAP, a first-time adopter may not have consolidated a subsidiary acquired in a past business combination. In that case, a first-time adopter applying the business combinations exemption should adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that IFRS would require in the subsidiary's balance sheet. The deemed cost of goodwill equals the difference at the date of transition to IFRS between:

- ▶ The parent's interest in those adjusted carrying amounts, and
- ▶ The cost in the parent's separate financial statements of its investment in the subsidiary.

Example 8: Business combinations

Background

Entity B's first IFRS financial statements have a reporting date of 31 December 20x9 and include comparative information for 20x8 only. On 1 July 20x5, entity B acquired 100% of subsidiary C. Under Indian GAAP, entity B:

- ▶ *Classified the business combination as an acquisition by entity B*
- ▶ *Measured the assets acquired and liabilities assumed at the following amounts under Indian GAAP at 1 January 20x8 (date of transition to IFRS):*
 - ▶ *Property, plant and equipment – INR200 (under Indian GAAP); on 1 July 20x5: INR 250 (under Indian GAAP)*
 - ▶ *AFS Investments – INR100 (Market value: INR300)*
 - ▶ *Pension liability – Nil (IAS 19 net liability: INR30)*
 - ▶ *Unamortized VRS expenses – INR25*
 - ▶ *Goodwill – INR180*

Example 8: Business combinations (cont'd.)

Application of requirements

In its opening (consolidated) IFRS balance sheet, entity B:

- ▶ Classifies the business combination as an acquisition by entity B, even if the business combination would have qualified under IFRS 3R as reverse acquisition by subsidiary C.
- ▶ Does not adjust the accumulated amortization of goodwill under Indian GAAP. Entity B tests the goodwill for impairment under IAS 36 and recognizes any resulting impairment loss.
- ▶ Measures property, plant and equipment which require cost based measurement post acquisition at carrying amount under Indian GAAP immediately after business combination as their deemed cost. The asset will be stated at INR250 on 1 July 20x5. The 1 January 20x8 value will be determined using IFRS accounting from 1 July 20x5 to 31 December 20x7 for fixed assets on the balance of INR250 and the asset will be tested for impairment, if impairment indicators exist on date of transition.
- ▶ Measures AFS Investments at fair value of INR300 and adjusts the corresponding effect in equity as a unrealized gain on investments (INR200).
- ▶ Recognizes a pension liability at INR30 with a corresponding debit/credit to retained earnings.
- ▶ Writes off unamortized VRS expenditure with a corresponding debit/credit to retained earnings.
- ▶ Tests assets for impairment, if there is any indication that identifiable assets are impaired, based on conditions that existed at the date of transition to IFRS.

c. Currency adjustments to goodwill

IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires that any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. For a first-time adopter, it may be impracticable, especially after a corporate restructuring, to determine retrospectively the currency in which goodwill and fair value adjustments should be expressed. Consequently, under IFRS 1, a first-time adopter need not apply this requirement of IAS 21 retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to IFRS. If IAS 21 is not applied retrospectively, a first-time adopter

should treat such fair value adjustments and goodwill as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments are either already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied under Indian GAAP.

Assets and liabilities of subsidiaries, associates and joint ventures

a. Subsidiary becomes a first-time adopter later than its parent

If a subsidiary becomes a first-time adopter later than its parent, it should, in its financial statements, measure its assets and liabilities at either:

- ▶ The carrying amounts that would be included in the parent's consolidated financial statements, based on the

parent's date of transition to IFRS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary, or

- ▶ The carrying amounts required by the rest of IFRS 1, based on the subsidiary's date of transition to IFRS. These carrying amounts could differ from those described above:
 - ▶ When the exemptions in this IFRS result in measurements that depend on the date of transition to IFRS.
 - ▶ When the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in IAS 16, whereas, the group may use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

b. Parent becomes a first-time adopter later than its subsidiary

If an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture), the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary.

c. Adoption of IFRS on different dates in separate and consolidated financial statements

If a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

Investments in subsidiaries, jointly controlled entities and associates in separate financial statements

In its separate financial statements, a first-time adopter can measure investment in subsidiaries, jointly controlled entities and associates at either:

- ▶ Cost determined in accordance with IAS 27-R,
- ▶ Deemed cost, defined as fair value (determined in accordance with IAS 39) at the date of transition to IFRS, or
- ▶ Deemed cost, defined as Indian GAAP carrying amount at the transition date.

Cumulative translation differences

IAS 21 requires, inter alia, the following exchange differences to be recognized in a separate component of equity:

- ▶ Those arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation, and
- ▶ Those arising on certain translations to a different presentation currency and any gains and losses on related hedges.

IAS 21 and IAS 39 also require that, on disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that

foreign operation should be recognized in profit or loss when the gain or loss on disposal is recognized. Full retrospective application of IAS 21 would require a first-time adopter to restate all financial statements of its foreign operations to IFRS from their date of inception or later acquisition onwards, and then to determine the cumulative translation differences arising in relation to each of these foreign operations. The costs of this restatement are likely to exceed the benefits to users of financial statements. For this reason, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to IFRS. If a first-time adopter uses this exemption:

- ▶ The cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRS, and
- ▶ The gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRS and shall include later translation differences.

Financial instruments

a. Designation of previously recognized financial instruments

IAS 39 permits a financial instrument to be designated, on initial recognition, as an available-for-sale financial asset or as a financial asset or financial liability at fair value through profit or loss, subject to the criteria in IAS 39. Despite this requirement in IAS 39, IFRS 1 permits a first-time adopter to designate financial instrument as an available-for-sale financial asset or as a financial asset or financial liability at fair value through profit or loss at the date of transition to IFRS. However, designation of a financial

asset at fair value through profit or loss would be subject to criteria prescribed in IAS 39. For example, if an entity can demonstrate at the date of transition that a portfolio of identified financial instruments was managed together and there was evidence of a recent actual pattern of short-term profit taking, it would be permitted to designate the financial instruments at fair value through profit or loss.

b. Compound financial instruments

IAS 32 requires that compound financial instruments (such as a convertible bond) are split at inception into separate equity and liability components. If the liability component is no longer outstanding, a full retrospective application of IAS 32 would involve identifying two components; one representing the original equity component and the other representing the cumulative interest on the liability component, both of which are accounted for in equity. A first-time adopter does not need to make this allocation if the liability component is no longer outstanding at the date of transition to IFRS. For example, in the case of a convertible bond that has been converted into equity it would not be necessary to make this split.

A first-time adopter applying this exemption can, therefore, avoid the possibly complex allocation process that would be involved. However, if the liability component of the compound instrument is still outstanding at the date of transition to IFRS, then a split will need to be made. In practice, this exemption is of limited value because the number of different compound financial instruments that were outstanding before the date of transition to IFRS is bound to be limited for any given first-time adopter.

c. Fair value measurement of financial assets and financial liabilities at initial recognition

The current version of IAS 39 provides that the best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. Thus, at initial recognition, an entity may recognize a gain or loss on the difference between this fair value measurement and the transaction price (i.e., ‘day one’ gain or loss) only if the measurement of fair value is based entirely on observable market inputs without modification. IFRS 1 allows a first-time adopter to apply these requirements of IAS 39 in any of the following ways:

- ▶ Retrospectively,
- ▶ Prospectively to transactions entered into after 25 October 2002, or
- ▶ Prospectively to transactions entered into after 1 January 2004.

Employee benefits

Under IAS 19, an entity may recognize actuarial gains and losses from defined benefit and similar plans either by applying the ‘corridor approach’ or any other systematic method that results in accelerated recognition. Retrospective application of the corridor approach would require entities to obtain actuarial valuations from a plan’s inception date to compute the proper cumulative unrecognized actuarial gains and losses as of the transition date in accordance with IAS 19. IFRS 1 provides an exemption from IAS 19 by allowing entities to recognize all previously unrecognized actuarial gains and losses from inception of the plans in opening retained earnings. Such actuarial gains and losses are not subsequently recycled through profit and loss. Entities that elect this exemption are still allowed to apply the corridor approach prospectively from the IFRS transition date.

Share-based payment transactions

IFRS 2 applies to accounting for the acquisition of goods or services in equity-settled share-based payment transactions, cash-settled share-based payment transactions and transactions in

Grant date	Option available
On or before 7 November 2002	A first-time adopter is encouraged, but not required, to apply IFRS 2 to equity instruments granted on or before this date. If the entity elects to apply IFRS 2, it may do so only if the entity has publicly disclosed fair value of such equity instruments determined on the measurement date as defined in IFRS 2.
After 7 November 2002, but before the date of transition to IFRS	For vested awards at transition date: A first-time adopter is encouraged but not required to apply IFRS 2. If the entity elects to apply IFRS 2, it may do so only if the entity has publicly disclosed fair value of such equity instruments determined on the measurement date as defined in IFRS 2. For unvested awards at transition date: The entity is required to apply the provisions of IFRS 2.
After the date of transition to IFRS	Apply IFRS 2

which the entity or the counter-party has the option to choose between settlement in cash or equity. The table on previous page summarizes options available to a first-time adopter.

A first-time adopter is encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to IFRS.

Insurance contracts

A first-time adopter may apply the transitional provisions in IFRS 4 *Insurance Contracts*. IFRS 4 limits an insurer to changing its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An insurer shall judge relevance and reliability by the criteria in IAS 8.

Entities that issue insurance contracts need not restate comparatives for IFRS 4. This exemption is available only to entities that have an adoption date before 1 January 2006. Accordingly, it is unlikely that many Indian entities will use this exemption.

Mandatory exceptions to retrospective application of IFRS

IFRS 1 prohibits retrospective application of IFRS in some areas, particularly where retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. These exceptions relate to:

- ▶ Estimates,
- ▶ Non-controlling interests,

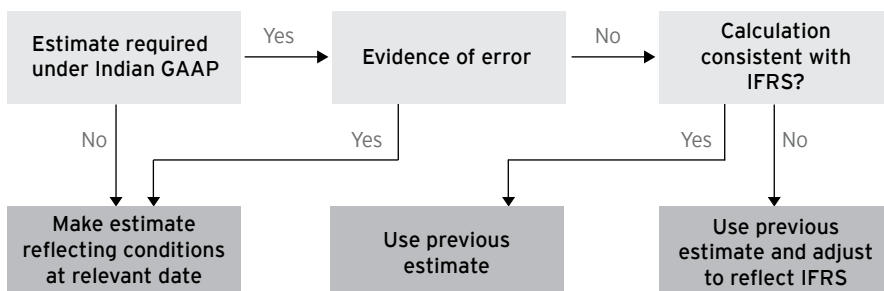
- ▶ Hedge accounting, and
- ▶ Derecognition of financial assets and financial liabilities.

Estimates

IFRS 1 requires the following for estimates made under Indian GAAP:

- ▶ Estimates made at the same date under Indian GAAP should be used for the opening IFRS balance sheet, unless there is objective evidence of an error. For example, a provision for the settlement of litigation made under Indian GAAP would not be revised for the opening IFRS balance sheet because entity subsequently became aware of its outcome.
- ▶ Estimates made under Indian GAAP should be revised, if necessary, to comply with IFRS. Revised estimates should reflect conditions existing at the date of transition. For example, a decommissioning liability which was not discounted under Indian GAAP should be restated to net present value on the opening IFRS balance sheet.
- ▶ At the date of transition, an entity may need to make estimates under IFRS that were not required at that date under Indian GAAP. To achieve consistency with IAS 10, *Events after the Reporting Period*, those estimates under IFRS shall reflect conditions that existed at the date of transition to IFRS. For example, a constructive obligation that was not recognized under Indian GAAP should be included in the opening IFRS balance sheet using the estimates for the expected future cash outflows and discount rates that existed at that time.

The following chart summarizes IFRS 1 requirements relating to estimates:



Non-controlling interest

A first-time adopter shall apply the following requirements of IAS 27R (as amended in 2008) prospectively from the date of transition to IFRS:

- ▶ The requirement that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance,
- ▶ The requirements that changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (i.e., transactions with owners in their capacity as owners), and
- ▶ The requirements for accounting for a loss of control over a subsidiary.

However, if a first-time adopter elects to apply IFRS 3 (as revised in 2008) retrospectively to past business combinations, it also shall apply IAS 27 (as amended in 2008) from the date forward.

Hedge accounting

At the date of transition to IFRS, an entity shall:

- ▶ Measure all derivatives at fair value, and
- ▶ Eliminate all deferred losses and gains

arising on derivatives that may have been reported as assets or liabilities.

An entity shall not reflect, in its opening IFRS balance sheet, a hedging relationship of a type that does not qualify for hedge accounting under IAS 39 (for example, hedging relationships where the hedging instrument is a net written option, where the hedged item is a net position; or where the hedge covers interest risk in a held-to-maturity investment). However, if an entity designated a net position as a hedged item under Indian GAAP, it may designate an individual item within that net position as a hedged item under IFRS, provided that it does so no later than the date of transition to IFRS.

If, before the date of transition to IFRS, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in IAS 39, the entity shall apply IAS 39 requirements to discontinue hedge accounting. Transactions entered into before the date of transition to IFRS shall not be retrospectively designated as hedges.

Derecognition of financial assets and financial liabilities

A first-time adopter should apply the derecognition requirements in IAS 39 prospectively to transactions occurring

on or after 1 January 2004. Therefore, if a first-time adopter derecognized non-derivative financial assets or non-derivative financial liabilities under Indian GAAP as a result of a transaction that occurred before 1 January 2004, it should not recognize those assets and liabilities under IFRS (unless they qualify for recognition as a result of a later transaction or event).

A first-time adopter that wants to apply the derecognition requirements in IAS 39 retrospectively from a date of the entity's choosing, can only do so, provided that the information needed to apply IAS 39 to financial assets and financial liabilities derecognized as a result of past transactions was obtained at the time of initially accounting for those transactions. This will effectively stop most first-time adopters from restating transactions that occurred before 1 January 2004.

Presentation and disclosure

The first IFRS financial statements shall be presented in accordance with the presentation and disclosure requirements in IAS 1R and the other standards and interpretations under IFRS. There are no exemptions from the disclosure requirements of any standards except for certain aspects of IFRS 6, *Exploration for and Evaluation of Mineral Resources*, and IFRS 7. However, because of the effective dates applicable to the exemptions in those standards, it is unlikely that Indian entities will be allowed to use them, so they are not discussed in detail here.

Explanation of transition to IFRS

An entity shall explain how the transition from Indian GAAP to IFRS affected its reported financial position, financial performance and cash flows.

a. Reconciliations

A first-time adopter is required to present:

- ▶ Reconciliations of its equity reported under Indian GAAP to its equity under IFRS at:
 - ▶ The date of transition to IFRS, and
 - ▶ The end of the latest period presented in the entity's most recent annual financial statements under Indian GAAP.
- ▶ A reconciliation to its total comprehensive income under IFRS for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income under Indian GAAP for the same period or, if an entity did not report such a total, profit or loss under Indian GAAP.
- ▶ An explanation of the material adjustments to the cash flow statement, if it presented one under its Indian GAAP.

The reconciliations shall give sufficient detail to enable users to understand the material adjustments to the balance sheet and statement of comprehensive income. If an entity becomes aware of errors made under Indian GAAP, the reconciliations shall distinguish the correction of those errors from changes in accounting policies.

Example 9: Reconciliations to be presented in first IFRS financial statements

Entity E's date of transition to IFRS is 1 January 20x7 and its reporting date is 31 December 20x8. It shall present the primary financial statements and reconciliations in its first IFRS financial statements.

	1 January 20x7	31 December 20x7	31 December 20x8
Balance sheet	Yes	Yes	Yes
Reconciliation of equity	Yes	Yes	
For the period ending			
Total comprehensive income		Yes	Yes
Cash flow statement		Yes	Yes
Statement of changes in equity		Yes	Yes
Reconciliation of total comprehensive income		Yes	
Explanation of material adjustments to cash flow statement		Yes	

b. Interim financial reports

If a first-time adopter presents an interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements, that report should include:

- A reconciliation of its equity under Indian GAAP at the end of that comparable interim period to its equity under IFRS at that date.
- A reconciliation to its total comprehensive income under IFRS for that comparable interim period (current and year-to-date).

The starting point for that reconciliation shall be total comprehensive income under Indian GAAP for that period or, if an entity did not report such a total, profit or loss under Indian GAAP.

- Reconciliations described in (a) above or a cross-reference to another published document that includes these reconciliations.

c. Other disclosures

- If a first-time adopter has recognized or reversed any impairment losses in preparing its opening IFRS balance sheet, the disclosures that IAS 36 would have required if the entity had recognized those impairment losses or reversals in the period beginning with the date of transition to IFRS.

- ▶ If fair value is used as deemed cost, the aggregate fair values and the aggregate adjustment to the previous carrying amounts should be disclosed for each line item.
- ▶ An entity that applies the optional exemption to classify a financial asset or financial liability as at fair value through profit or loss must disclose:
 - ▶ The fair value of the item,
 - ▶ The carrying amount under Indian GAAP, and
 - ▶ The classification under Indian GAAP.



IFRS conversion – Global experience and process

5

IFRS conversion – Global experience and process

Global experience of conversion to IFRS

Currently, there are more than 100 countries across the world wherein entities are required or permitted to speak a common accounting language, viz., IFRS. Come April 2011, India will also join the list of such countries. Adopting IFRS in the financial statements increases comparability of entities within the country as well as with their global counterparts. IFRS is also looked upon as a reliable framework by users of financial statements. It helps entities gain cross-border capital listing and it also helps management, who may be based in another country, to follow uniform systems of reporting across the group in entities with worldwide presence.

Most countries in the EU adopted IFRS for accounting periods beginning on, or after 1 January 2005. Approximately, 8,000 entities listed in the EU are required to follow IFRS in their CFS. All these entities have undergone the conversion exercise from their local GAAP to IFRS. The experience of these entities has been:

- ▶ Certain IFRS requirements are highly complex,
- ▶ Some of the entities did not have the required data to implement IFRS,
- ▶ The accounting staff is not trained enough to implement IFRS, and
- ▶ Regulatory requirements are not in compliance with IFRS.

Issues in implementing IFRS

Some of the issues faced by entities while transiting to IFRS are as follows:

- ▶ Lack of guidance on IFRS conversion,
- ▶ Entity specific issues requiring detailed analysis of facts and circumstances to apply IFRS,
- ▶ Untrained staff,
- ▶ Time spent for converting to IFRS was under budgeted,
- ▶ Collating the data required for conversion,
- ▶ Use of experts for valuations,
- ▶ IFRS application requires management to exercise judgement and make estimations in many areas, since it is a principle based framework and not rule based,
- ▶ Being the initial years, IFRS was interpreted differently by different people,
- ▶ Increased communication was required for keeping analysts and stakeholders informed about the implications of IFRS conversion,
- ▶ In some cases, IFRS dictated business decisions, due to significant accounting impact, and
- ▶ The conversion exercise was handled casually, leading to critical problems as the target date drew closer.

Expected difficulties

When Indian entities adopt IFRS, certain difficulties, set out below, are expected. To overcome these difficulties one needs careful planning and a good advisor. There is sufficient time to overcome these difficulties. However, as the time passes by, the difficulties may become overwhelming.

- ▶ IFRS is significantly different from Indian GAAP in the areas of fixed assets, financial instruments, business combinations, and group accounts. For some entities this may completely wipe out their retained earnings, whereas, for others it may significantly add to the retained earnings.
- ▶ IFRS knowledge, resources and literature is very scarce in the country.
- ▶ Analysts and stakeholders, including regulators, do not understand IFRS financial statements.
- ▶ Difficulties in fair valuation due to:
 - ▶ Very few valuers have the expertise to perform valuations required by IFRS,
 - ▶ Lack of data for the valuers to perform valuation, and
 - ▶ Lack of availability of statistical models.
- ▶ Lack of availability of competitors data.
- ▶ Regulatory requirements may continue to require different accounting treatment as compared to IFRS, such as in the case of tax accounts.

IFRS conversion process

What is an IFRS conversion?

In an IFRS conversion an entity undertakes to change its financial reporting from its current GAAP (Indian GAAP for most Indian entities) to IFRS. Obviously, differences between the Indian GAAP treatment and IFRS would be one of the key inputs to the conversion process in case of Indian entities. These differences may vary significantly from one entity to another depending on the industry and the current accounting policies chosen under Indian GAAP. However, the magnitude of an IFRS conversion project will not depend solely on the magnitude of the GAAP differences, but will be influenced by other factors such as:

- ▶ The quality and flexibility of the existing financial reporting infrastructure,
- ▶ The size and complexity of the organization, and
- ▶ The effect of GAAP changes on the business.

Ultimately, the purpose of an IFRS conversion is to put entities in a position, where they are able to report, unaided and reliably, under IFRS and are able to recognize the IFRS dimension of their actions. However, before the actual start of the conversion project, an initial diagnostic phase should put companies in a position where they are aware of:

- ▶ The differences between IFRS and the entity's current accounting policies,
- ▶ The impacts of the change to IFRS on the financial statements,
- ▶ The impacts of the change to IFRS on tax, business IT and process,

- ▶ The impacts of IFRS on future business decisions, and
- ▶ An understanding of the approach underlying the formulation of IFRS.

Need for conversion methodology

Many entities perceive conversion projects purely as a technical accounting exercise. With a major underlying difference of principle – as embodied in IFRS – this is a grave mistake. IFRS conversions, if not properly planned, are likely to lead to a number of unfortunate results. Common among these are:

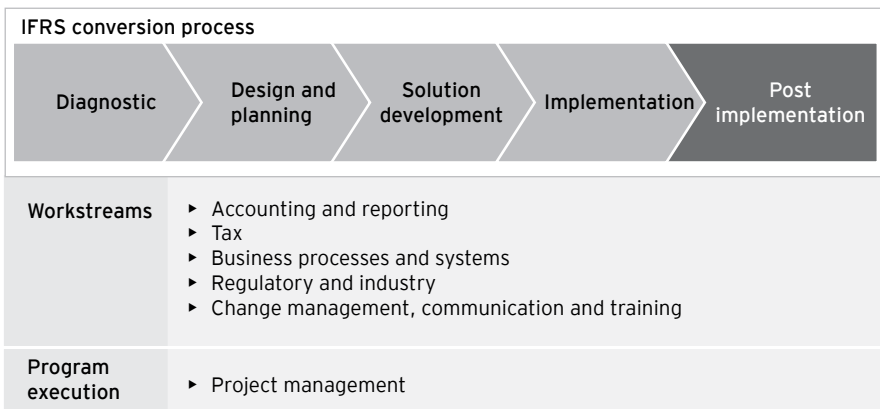
- ▶ Failure to involve all people with the required knowledge, business decisions taken in ignorance of the financial reporting consequences, unreliability and slowness in producing IFRS financial statements, and
- ▶ Gross underestimation of the time required to convert.

Conversion to IFRS will be an exercise in change management. Adopting IFRS may affect many facets of an organization beyond its financial reporting. Every aspect of a company affected by financial information has the potential for change (for example, key performance indicators, employee and executive compensation plans, management's internal reporting, investor relations and analyst information). Both the process and the implications of the conversion can vary widely among companies based on a number of variables, such as levels of expertise, degree of centralization of accounting processes and data collection, and the number of existing accounting methods currently being used. Often, information and data not currently collected and/or warehoused may be needed to produce the required IFRS information.

The conversion to IFRS will entail a business wide change management exercise and should be approached using a structured methodology encompassing the best practices of project management. Such methodology ensures conversion assignments are properly planned and executed. The methodology also ensures that the typical pitfalls for the inexperienced conversion team are avoided by:

- ▶ Promoting the re-use of knowledge,
- ▶ Avoiding costly dead-ends resulting from poor planning and co-ordination,
- ▶ Ensuring efficient use of staff time,
- ▶ Allowing a mix of experienced and less experienced staff, thereby, facilitating knowledge transfer, and
- ▶ Improving the quality of the work.

To take full advantage of the opportunities arising as a result of conversion to IFRS, the conversion methodology needs to be flexible and customized to the needs of an entity. As with any major finance transformation project, the full support of the board and senior management will be critical to the success of the conversion effort. Boards should pay close attention to the details of management's proposed approach to the IFRS conversion to satisfy themselves that it covers all appropriate areas and is based on sound project management principles. While management will be responsible for the conversion execution, boards need to be confident in management's plan, thoroughness and diligence. Management should inform the board and the audit committee on a regular basis as to its plan and progress. As such, audit committees should generally include a standing IFRS agenda update item at their periodic meetings.



The process

A sample methodology for conversion is shown above, which management may consider for IFRS conversion.

The methodology takes, as a starting point, the fact that an IFRS conversion project needs to address more than just accounting issues and that a conversion project is sufficiently complicated to warrant professional project management. It is for these reasons that the methodology comprises five phases, each of which deals with a specific part of the conversion, and that throughout the project it recognizes five different workstreams, each dealing with a specific aspect of the conversion process. This is to facilitate involvement of specialists on need basis. It is, however, important to recognize that the phases can overlap one another and entities need not wait for completion of one phase to end before beginning another. Also, a clear breakdown of all the activities by workstream is not always possible as a mandatory allocation of activities by phase. Thus, this methodology should be tailored according to project specificities, starting point and in place project structure, etc.

Key goals and outputs of each phase

- ▶ **Diagnostic**
This phase involves high level identification of accounting and reporting differences and the consequences to the business, IT, processes and tax. The major outcome management should expect from this phase includes an impact assessment report, which provides implications on above areas. It also entails determining a high-level road map for future phases of the conversion. This phase will also help management to identify potential interdependence between the IFRS conversion project and current or planned organization-wide initiatives (for example, new accounting system implementations such as ERP and finance transformations) and an assessment of, whether the company has adequate resources to complete a conversion.
- ▶ **Design and planning**
This phase involves setting up the project infrastructure, the project management function, including conversion roadmap and change management strategy. The aim of this phase is to set-up a core IFRS team,

framing conversion time-tables and deciding on detailed way-forward. Formation of the project structure, project charter, communication plan, training plan and expanded conversion roadmap are typical outputs from this phase.

► **Solution development**

The objective of this phase is to identify solutions to various issues identified in relation to accounting and reporting, tax, business process and system changes. Typical outputs from this phase comprise of IFRS accounting manuals, group reporting packages, IFRS skeleton accounts, group accounting policies, technical papers on IFRS accounting issues, crystallizing the impact on current and deferred tax, developing solutions for tax functions and identifying processes which need to be re-designed, modified or developed.

► **Implementation**

This phase involves roll out of solutions developed in the previous phase. In this phase the company will conduct a process of dry-run of financial statements to ensure that before the reporting deadline, company is geared up to prepare IFRS financial statements. Post dry-run accounts, the company will roll-out final deliverables, i.e., the opening IFRS balance sheet and the first IFRS financial statements. All business and process solutions developed will also be implemented to facilitate the company transition to the new reporting framework.

► **Post-implementation**

This phase involves an assessment of how various solutions developed work in the implementation phase and the identification of any issues in

the operational model. These issues are tackled in this phase to ensure successful on-going functioning of systems and processes in IFRS reporting regime. On-going update training is also provided, to ensure that company's personnel are updated with latest IFRS developments, and also changes are made in systems and processes. IFRS manuals will also need to be regularly updated for changes in IFRS.

Concluding remarks

Considering comparables, the IFRS conversion date for India is 2010. Experience tells us that major European companies took about eighteen months to two years to convert from national GAAP to IFRS. The right time to start thinking and converting to IFRS is 'NOW'. This process cannot be delayed any further. More importantly, there are no disadvantages to getting a start on the process, but the advantages include:

- Securing the right people, whether by engaging a third party to provide assistance or by hiring them directly,
- Putting fewer burdens on valuable accounting, financial reporting and IT resources as the conversion date nears,
- More time to train employees on IFRS and to have them become comfortable with the standards and interpretations, and
- Discussing the financial reporting effects of conversion to IFRS with analysts to provide them with confidence that this significant undertaking is well in hand.



Detailed comparative statement on Indian GAAP and IFRS

(As on 1 January 2009)

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This comparison does not attempt to capture all of the differences between Indian GAAP and IFRS or impact on transition to IFRS, that exist or that may be material to a particular entity's financial statements. Our focus is on differences or impacts that are commonly found in practice. The existence of any differences – and their materiality to an entity's financial statements – depends on a variety of specific factors including, among others: the nature of the entity, an entity's interpretation of the more general IFRS principles, industry practices and accounting policy elections required under either Indian GAAP or IFRS. Accordingly, we recommend that readers seek appropriate advice regarding any specific issues that they encounter. This publication should not be relied on as a substitute for reading IFRS. Before reaching any conclusion as to how your specific company may be affected by a change to IFRS, you should consider your specific facts and circumstances and then consult with Ernst & Young or other professional advisors familiar with your particular factual situation for advice.

This comparison is based on pronouncements under IFRS issued by IASB and Indian accounting standards notified under the Companies Act 1956, and other pronouncements issued by ICAI up to 1 January 2009, irrespective of their dates of applicability. The ICAI has issued certain standards which are applicable from dates beyond 2009 and have not been notified under the Companies Act 1956 till date. For example, ICAI has issued AS 30, AS 31 and AS 32 on *Financial Instruments: Recognition and Measurement*, *Financial Instruments: Presentation*, and *Financial Instruments: Disclosures*, respectively, which are recommendatory for accounting periods commencing on or after 1 April 2009 and mandatory for accounting period commencing on or after 1 April 2011. These standards have not been notified under the Companies Act 1956 as at 1 January 2009. The comparison given below is without considering the impact of these Standards. Similarly, limited revisions consequent to these standards have also not been considered in the comparison. Exposure Drafts of new/revised standards issued by IASB/ASB of ICAI have not been considered in the comparison, though at appropriate places they have been referred to.

Basic standards



IFRS	Indian GAAP
First-time adoption	
IFRS 1 gives guidance on preparation of the first IFRS financial statements. IFRS 1 grants five mandatory exceptions and limited voluntary exemptions from the full retrospective application.	There is no specific standard. Full retrospective application would be required.
Small and medium sized entities (SMEs)/ Small and medium sized companies (SMCs)	
A separate IFRS for SMEs is under formulation. An exposure draft of the proposed IFRS for SMEs has already been issued.	There is no separate standard for SMEs, however, exemptions/relaxations from the specific requirement of Standards have been provided. For providing exemptions/relaxations, the Companies (Accounting Standards) Rules classify all companies into two categories, namely SMCs and non-SMCs, whereas, the ICAI has classified all non-corporate entities into three levels.
Statement of Cash Flows	
Recently, the ASB of ICAI has issued an Exposure Draft of revised AS 3, <i>Statement of Cash Flows</i> , to bring it in line with IAS 7, except for the removal of certain options. Since, the Exposure Draft has not been issued as final standard till date, the major differences between IAS 7 and the existing AS 3 are listed below.	
Cash and cash equivalents	
Cash comprises not only cash on hand but also demand deposits with banks or other financial institutions. An investment normally qualifies as a cash equivalent only when it has a maturity of three months or less from its acquisition date. Bank borrowings are normally part of financing activities. Nonetheless, bank overdrafts that are repayable on demand and that form an integral part of an entity's cash management are included in cash equivalents.	Indian GAAP is similar to IFRS except that there is no provision in AS 3 for classification of bank overdrafts.

Format and content of cash flow statement	
The cash flow statement may be prepared using either the direct method (cash flows derived from aggregating cash receipts and payments associated with operating activities) or the indirect method (cash flows derived from adjusting net income for transactions of a non-cash nature such as depreciation). The latter is more common in practice. The cash flow should be classified into operating, investing and financing cash flow.	Indian GAAP is similar to IFRS. However, in case of listed entities SEBI requires preparation of cash flow statement using indirect method only.
Cash flow associated with extraordinary items	
Separate disclosure is prohibited. The concept of extraordinary items has been removed from IFRS.	The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.
Disclosure of interest paid and received	
Interest is presented under operating activities in case of financing entities. For other entities, interest paid should be disclosed as operating or financing. Interest received is disclosed as either operating or investing cash flow.	Interest is presented under operating activities in case of financing entities. For other entities, interest paid should be disclosed as financing cash flow and interest received should be disclosed as investing cash flow.
Disclosure of dividend paid	
Operating or financing.	Financing.
Disclosure of dividend received	
Operating in case of financing entities. Operating or investing for other entities.	Operating in case of financing entities. Investing for other entities.
Disclosure of taxes paid	
Operating – unless specific identification with financing or investing activities.	Indian GAAP is similar to IFRS.

Cash paid to manufacture or acquire assets held for rental to others and subsequently held for sale in the ordinary course of business

IAS 7 has recently been amended as part of Annual Improvement Project issued in May 2008. The amendment requires cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale in the ordinary course of business should be presented as part of cash flows from operating activities. Consequently, cash receipts from rent and subsequent sale of such assets should also be shown as part of operating activities.

AS 3 does not specifically deal with such assets. Cash inflows and outflows related to such fixed assets would generally be classified as investment activities.

Consolidated cash flow statement

IAS 7 deals with preparation and presentation of consolidated cash flow statement. Particularly, it provides the following guidances in this regard:

- ▶ The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses, net of cash and cash equivalents acquired or disposed of, is presented as part of investing activities.
- ▶ The effects of 'undistributed profits of associates and non-controlling interests' are adjusted while determining the net cash flow from operating activities using the indirect method.
- ▶ Cash flows of a foreign subsidiary should be translated using the exchange rates at the dates of the cash flows. However, under IAS 7, an entity may use average rate as well if it approximates the actual rate.

Preparation and presentation of consolidated cash flow statement is not specifically addressed in AS 3.

Other disclosures

IAS 7 requires additional disclosure of cash payments by a lessee relating to finance lease under financing activities, additional disclosures in CFS and for acquisition of subsidiaries.

There is no such requirement under AS 3.

Accounting policies, changes in accounting estimates and errors

Change in accounting policies

When an entity changes an accounting policy upon initial application of a Standard or an Interpretation that does not include specific transitional provisions applying to that change, or if it changes an accounting policy voluntarily, it shall apply the change retrospectively. Comparative information is restated, and the amount of the adjustment relating to prior periods is adjusted against the opening balance of retained earnings of the earliest year presented.

Any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from, such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted. There is no specific guidance on how changes in accounting policies are dealt with, except few specific items, like change in the method of depreciation or change arising out of a new standard.

Prior period items

An entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by restating the comparative amounts for the prior period (s) presented in which the error occurred; or if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

These are reported as a prior period adjustment in current year results. Comparatives are not restated.

Definition of prior period items

The definition of prior period items is much broader under IAS 8 as compared to AS 5, since IAS 8 covers all the items in financial statements.

AS 5 covers only items of income and expenses under the definition of prior period items. AS 5 does not include balance sheet misclassification, which do not have an income statement impact.

Change in accounting estimate

Changes in accounting estimates are accounted for prospectively in the income statement when identified. Change in the method of depreciation is regarded as a change in an accounting estimate and hence, the effect is given prospectively.

Indian GAAP is similar to IFRS, except that change in the method of depreciation, which is considered to be change in an accounting policy rather than a change in an accounting estimate.

Absence of standard or interpretation that specifically applies to a transaction

IAS 8 provides specific guidance on the selection of accounting policies in case where there is no IFRS or Interpretation that specifically applies to a transaction, event or condition. It refers an entity to the following sources in descending order:

- ▶ The requirements and guidance in Standards and Interpretations dealing with similar and related issues, and
- ▶ The definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

IAS 8 also permits management to consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework in making this judgement.

There is no specific guidance under AS 5.

Additional disclosure	
IAS 8 requires disclosure of an impending change in accounting policy when an entity is yet to implement a new Standard or Interpretation that has been issued but not yet come into effect.	There is no such specific requirement under AS 5.
Events after the balance sheet date	
Adjusting and non-adjusting events	
Amounts recognized in the financial statements should be adjusted for events that provide additional evidence of conditions that existed at the balance sheet date and should not be adjusted for events that provide evidence of conditions that did not exist at the balance sheet date. Under IAS 10, material non-adjusting events are required to be disclosed in the financial statements.	Indian GAAP is similar to IFRS, except that under AS 4, non-adjusting events are required to be disclosed in the report of the approving authority, for example, the board report.
Authorization date for issue of financial statements	
The date of authorization for issue of financial statements and the authorizing authority should be specifically mentioned in the financial statements itself as required by IAS 10.	There is no such requirement.
Proposed dividend	
If dividends to holders of equity instruments are proposed or declared after the balance sheet date, an entity should not recognize those dividends as a liability at the balance sheet date. An entity should disclose the amount of dividends that were proposed or declared after the balance sheet date, but before the financial statements were authorized for issue.	Companies are required to make provision for proposed dividend, even-though they are proposed after the balance sheet date.

Presentation and disclosures

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IFRS	Indian GAAP
Presentation of financial statements	
Measurement basis	
The four measurement bases are historical cost, current cost, realizable value and present value. Exceptions to historical cost are fair valuation of financial instruments, other biological assets, revaluation of tangible fixed assets/intangible assets, impairment of assets, etc.	Indian GAAP is in line with IFRS, though, in some situations it disregards fair valuation, for e.g., provisions are not allowed to be discounted or investments are valued at lower of cost or market value.
Component of financial statements	
A set of financial statements should contain a Statement of Financial Position, a Statement of Comprehensive Income (SCI), a Statement of Changes in Equity (SOCIE), a Statement of Cash Flows and notes to the accounts. A statement of financial position as at the beginning of the earliest comparative period has to be presented when an entity applies an accounting policy retrospectively, or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.	A set of financial statements contains a balance sheet, income statement, cash flow statement and notes to accounts. The concept of SOCIE and SCI does not prevail, however, the information relating to appropriation of profits, movement in capital and reserves, etc., is presented on the face of the profit and loss account and/or in the captions of share capital and reserves and surplus in the balance sheet.
Disclosure of critical judgement and capital disclosures	
IAS 1-R requires disclosure of critical judgements made by management in applying accounting policies and key sources of estimation uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. It also requires disclosure of information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.	There is no such specific disclosure requirement in AS 1 or Schedule VI.

Statement of financial position and statement of comprehensive income format

For statement of financial position and statement of comprehensive income, there is no prescribed rigid formats. Illustrative format of statement of financial position and statement of comprehensive income have been provided under IFRS. IAS 1-R prescribes minimum information to be presented on the face of the statement of financial position and statement of comprehensive income.

Even though AS 1 does not prescribe any minimum structure of financial statements, Schedule VI of the Companies Act prescribes a detailed format for balance sheet. There is no format prescribed for income statement, however, Schedule VI specifies disclosures to be made in the income statement.

Extraordinary items

Disclosure of items as extraordinary items, either on the face of the statement of comprehensive income or in the notes, is prohibited.

Extraordinary items are defined as income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the entity and, therefore, are not expected to recur frequently or regularly. The nature and the amount of each extraordinary item should be separately disclosed in the statement of P&L in a manner that its impact on current profit or loss can be perceived.

Statements of Comprehensive Income (SCI)

The statement of comprehensive income presents all items of income and expense recognized in profit or loss, together with all other items of recognized income and expense. Entities may either present all items together in a single statement, or present two linked statements – one displaying the items of income and expense recognized in profit or loss (the income statement), and the other statement beginning with profit or loss, and displaying all the items included in 'other comprehensive income' (the statement of comprehensive income).

The concept of 'other comprehensive income' does not prevail under Indian GAAP. All items are recognized in the income statement in accordance with AS 5, unless required otherwise by any other accounting standard. Credits for certain items are directly taken to reserves and surplus, for e.g., revaluation of fixed assets. The transitional provisions of certain standards require first-time adjustment and their consequential tax effect to be made directly into reserves and surplus.

Statements of Comprehensive Income (SCI) (cont'd.)

The components of other comprehensive income include:

- ▶ Changes in revaluation surplus,
- ▶ Foreign exchange translation differences,
- ▶ Actuarial gains and losses, if entity adopts policy of recognizing the same directly in equity,
- ▶ Gains and losses on re-measuring available for sale financial assets, and
- ▶ Effective portions of gains and losses on hedging instruments in a cash flow hedge.

Information relating to movement in reserves, etc., is generally presented in the caption reserves and surplus in the balance sheet.

Statements of Changes in Equity (SOCIE)

On the face of SOCIE, the following shall be disclosed:

- ▶ Total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to minority interest,
- ▶ For each component of equity, the effects of retrospective application or retrospective restatement recognized under IAS 8,
- ▶ The amounts of transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners, and
- ▶ For each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each change.

A SOCIE is not required under Indian GAAP. All items are recognized in the income statement in accordance with AS 5, unless required otherwise by any other accounting standard. Credits for certain items are directly taken to reserves and surplus, for e.g., revaluation of fixed assets. The transitional provisions of certain standards require first time adjustment and their consequential tax effect to be made directly into reserves and surplus. A schedule is given for equity and reserves and surplus, showing opening and closing position as on the balance sheet date, and movements along with other disclosures prescribed by Schedule VI of the Companies Act. The information relating to appropriation of profit is presented on the face of the profit and loss account.

Segment reporting/operating segments

IASB has recently issued IFRS 8 which supersedes IAS 14 on which AS 17 is based. IFRS 8 is applicable for accounting periods on or after 1 January 2009. Earlier application is permitted. Keeping in view the current applicability, the comparison given below with regard to segment information is based on IFRS 8 *Operating Segments*.

Operating segment

An operating segment is a component of entity:

- ▶ That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity, i.e., vertical segment),
- ▶ Whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
- ▶ For which discrete financial information is available.

Operating segments exhibiting similar long-term financial performance if they have similar economic characteristics may be aggregated into a single operating segment.

Indian GAAP requires two sets of segments to be identified – one based on related products and services (business segment) and the other on geographical areas (geographical segment) using risk and rewards as basis for identification.

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments.

Reportable segments

A reportable segment is an operating segment identified as above:

- ▶ Whose internal and external revenue is 10% or more of the combined revenue (internal and external), Its segment result – as an absolute percentage – exceeds 10% or greater of:
 - ▶ The combined results of all profitable segments, or
 - ▶ The combined results of all segments in loss.

A business segment or geographical segment should be identified as a reportable segment if:

- ▶ Its revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal, of all segments, or
- ▶ Its segment result, whether profit or loss, is 10% or more of:
 - ▶ The combined result of all segments in profit,

Reportable segments (cont'd.)

- ▶ Its assets are 10% or more of the combined assets of all operating segments.

If the total external revenue reported by operating segments constitutes less than 75% of the entity's revenue, additional operating segments shall be identified as reportable segments until at least 75% of the entity's revenue is included in reportable segments.

Under IFRS 8, a segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10% criteria, should continue to be a reportable segment for the current period notwithstanding that its revenue, result and assets no longer exceed the 10% criteria, if the management of the entity judges the segment to be of continuing significance.

- ▶ The combined result of all segments in loss, whichever is greater in absolute amount, or

- ▶ Its segment assets are 10% or more of the total assets of all segments.

Reporting on primary and secondary segments is required.

If reported segments are below 75% threshold of total, additional segments are reported till the 75% threshold is reached.

Additional operating segments may be considered reportable and separately disclosed where management believes that disclosure would be useful.

AS 17 is stricter in this regard as the option to management to make an exception of the above provision based on its judgement on continuing significance of the segment is not available.

Accounting policies/bases of preparation

IFRS 8 uses 'management approach' in reporting operating segment, i.e., the amount reported for each operating segment item is based on the same measurement basis reported to the chief operating decision maker. It may not be in accordance with accounting policies used in presenting the entity's financial statements.

Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the entity as a whole.

IFRS 8 does not define, segment revenue, segment expense, segment result, segment assets and segment liabilities. It requires an explanation of how segment profit or loss, segment assets and segment liabilities are measured for each reportable segment.

Defines, segment revenue, segment expense, segment result, segment assets and segment liabilities, and requires reporting accordingly in for each reportable segment in segment reporting.

Disclosures

General Information should be disclosed as follows:

- ▶ The factors used to identify the entity's reportable segments, discussion of how the entity is organized and whether operating segments have been aggregated
- ▶ The types of products and services from which each reportable segment receives its revenue

There is no specific requirement to disclose general information under AS 17.

Specific information about each reportable segment is required, as follows:

- ▶ A measure of profit or loss,
- ▶ A measure of total assets,
- ▶ A measure of liabilities if such an amount is regularly provided to the chief operating decision maker,
- ▶ Amounts of any of the following that are either included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to him:
 - ▶ Revenues from external customers,
 - ▶ Revenues from transactions with other operating segments within the entity,
 - ▶ Interest revenue and expenses,
 - ▶ Depreciation and amortization, Material items of income and expense disclosed in accordance with IAS 1,
 - ▶ The entity's interest in profit or loss of associates and joint ventures accounted for by the equity method, Income tax expense and income, and
 - ▶ Material non-cash items other than depreciation and amortization

Indian GAAP requires disclosure of the following for primary segment identified:

- ▶ Segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments,
- ▶ Segment result,
- ▶ Total carrying amount of segment assets,
- ▶ Total amount of segment liabilities,
- ▶ Total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets),
- ▶ Total amount of expense included in the segment result for depreciation and amortization in respect of segment assets for the period, and
- ▶ Total amount of significant non-cash expenses, other than depreciation and amortization in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

Indian GAAP requires disclosure of the following for secondary segment identified:

In case the primary segment is a business segment:

Disclosures (cont'd.)

- ▶ Any of the following items that are either included in the measure of segment assets reviewed by or otherwise regularly provided to the chief operating decision maker:
 - ▶ Investment in equity-accounted associates and joint ventures, and
 - ▶ Total additions to non-current assets other than financial instruments, deferred tax assets, post employment benefits and rights arising under insurance contracts
- ▶ Segment revenue from external customers by geographical area based on the geographical location of its customers, for each geographical segment whose revenue from sales to external customers is 10% or more of enterprise revenue.
- ▶ The total carrying amount of segment assets by geographical location of assets, for each geographical segment whose segment assets are 10% or more of the total assets of all geographical segments, and
- ▶ The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets) by geographical location of assets, for each geographical segment whose segment assets are 10% or more of the total assets of all geographical segments.

An explanation of the measurement basis of segment information, including:

- ▶ The basis of accounting for inter-segment transactions.
- ▶ If not apparent from the reconciliations described below, the nature of any differences between the measurement of the profit or loss before income tax and discontinued operations, assets and liabilities in the entity's financial statements in accordance with IFRS as well as accounting policy differences, measurement between the measurement of the profit or loss before income tax and discontinued operations, assets and liabilities in the entity's financial statements in accordance with IFRS as well as accounting policy differences, measurement differences might include policies for allocating central costs or jointly used or shared assets and liabilities to individual segments.

If the primary segment is a geographical segment, it should also report the following segment information for each business segment whose revenue from sales to external customers is 10% or more of enterprise revenue, or whose segment assets are 10% or more of the total assets of all business segments:

- ▶ Segment revenue from external customers,
 - ▶ The total carrying amount of segment assets, and
 - ▶ The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets).
-

Disclosures (cont'd.)

- | | |
|---|--|
| <ul style="list-style-type: none"> ▶ The nature of any changes from prior periods in the measurement methods used to determine segment profit or loss and the effect, if any. ▶ The nature and effect of any asymmetrical allocations to reportable segments. | <ul style="list-style-type: none"> ▶ Segment revenue from external customers, ▶ The total carrying amount of segment assets, and ▶ The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets). |
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Reconciliation between reportable segments and entity's revenue, profit or loss, segment assets, liabilities and material item of information segments should be disclosed. Also the major details of reconciliation are also required to be disclosed.

A reconciliation is required only for primary segment figures reported.

Entity-wide disclosures to the extent that this information is not provided as part of the reportable segment information:

- ▶ External revenues on an IFRS basis for each group of similar products or services,
 - ▶ External revenues on an IFRS basis attributed to:
 - ▶ The entity's country of domicile
 - ▶ All foreign countries, with separate disclosure of revenue attributed to individual foreign countries, if material, the entity must disclose the basis on which revenues have been attributed to different countries.
 - ▶ Non-current assets on an IFRS basis other than financial instruments, deferred tax assets, post employment benefit assets, and rights arising under insurance contracts, and
-

AS 17 requires disclosure of revenue for primary and geographical segments but no specific disclosure is required for revenue for each product/services or revenue based on each countries.

Disclosures (cont'd.)

If revenue from a single external customer amount to 10% or more of the entity's revenues, the total revenues from the customer concerned and the identity of the segments reporting the revenues must be disclosed.

There is no disclosure required for customer concentration.

Restatement

Restatement is required in case of an entity changes the structure of its internal organization, vis-à-vis reportable segment, corresponding information for earlier periods, including interim period shall be restated.

In Indian GAAP, for change in segment accounting policies, disclosure of the impact arising out of the change is required to be made, as is the case for changes in accounting policies relating to the entity as a whole. Prior period figures are not restated, i.e., no retroactive restatement is required.

Related party disclosures

Identification of related parties

IAS 24 uses the term 'financial and operating decisions' in defining related party.

The AS 18 definition of related party is: "Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions." Therefore, it appears that the AS 18 definition is more stringent in this regard.

IFRS includes post employment benefit plans as related parties.

Unlike IFRS, AS 18 does not include post employment benefit plans as related parties.

IAS 24 includes close members of the families of KMPs as related party as well as of persons who exercise control/significant influence.

AS 18 covers only relatives of KMPs.

Definition of control

IAS 24 contains principle based definition of the term 'Control'. Under IAS 24, control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

AS 18 defines control as:

- Ownership, directly, or indirectly, of more than one half of the voting power of an entity,
 - Control of composition of the board of directors or the governing body, and
 - A substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of an entity.
-

Significant influence

Under IAS 24, significant influence is the power to participate in both financial and operating policy decisions of an entity, but is not control over those policies. Under IFRS, significant influence may be gained by share ownership, statute or agreement. IAS 24, however, does not specify any particular share holding or voting power which would result into significant influence.

Under AS 18, an entity is considered to have significant influence over the other entity even if it has the power to participate in either financial or operating policy decisions or both of the other entity, but not control of those policies. AS 18 specifies rebuttable presumptions that an entity is considered to have a substantial interest in another entity if that entity owns, directly or indirectly, 20% or more interest in the voting power of the other entity.

Close relatives

IAS 24 adopts a 'substance over form' based approach in defining relatives as close members of the family, i.e., they are those who influence and can be influenced by the individual in his/her dealings with the reporting entity. IAS 24 does not limit the same to any specific relations.

AS 18 includes specific relations as relatives.

Information to be disclosed

Relationships between parents and subsidiaries shall be disclosed, irrespective of whether there have been transactions between those related parties. An entity shall disclose the name of the entity's parent and, if different, the ultimate controlling

Name of the related party and nature of the related party relationship, where control exists, should be disclosed irrespective of whether or not there have been transactions between the related parties.

Information to be disclosed (cont'd.)

party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions, and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:

- ▶ The amount of the transactions,
- ▶ The amount of outstanding balances and:
 - ▶ Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement, and
 - ▶ Details of any guarantees given or received,
- ▶ Provisions for doubtful debts related to the amount of outstanding balances, and
- ▶ The expense recognized during the period in respect of bad or doubtful debts due from related parties.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting entity should disclose the following:

- ▶ The name of the transacting related party,
- ▶ A description of the relationship between the parties,
- ▶ A description of the nature of transactions,
- ▶ Volume of the transactions either as an amount or as an appropriate proportion,
- ▶ Any other elements of the related party transactions necessary for an understanding of the financial statements,
- ▶ The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date, and
- ▶ Amounts written off or written back in the period in respect of debts due from or to related parties.

IAS 24 provides that an entity discloses that the terms of related party transactions are equivalent to those that prevail in arm's length transactions, only if such terms can be substantiated.

AS 18 has no such stipulation on substantiation of related party transactions when the same is disclosed to be on arm's length basis.

IAS 24 requires disclosure of terms and conditions of outstanding items pertaining to related parties.

There is no such disclosure requirement under AS 18.

Definition of key management personnel

The definition of KMP under IAS 24 includes any director whether executive or otherwise.

AS 18 read with ASI 18 excludes non-executive directors from the definition of KMP.

IFRS requires disclosure of the compensation of key management personnel in total and by category of compensation.

AS 18 does not require disclosure by category. However, more elaborate disclosures are required under Schedule VI.

Exemption from disclosures

There is no exemption provided for disclosure under IFRS in cases where disclosure of information would conflict with duties of confidentiality in terms of statute or regulating authority.

Related party disclosure requirements as laid down in AS 18 do not apply in circumstances, where providing such disclosures would conflict with the reporting entity's duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority. Exemption is granted from disclosure in cases where such disclosure of information would conflict with confidentiality requirements, in terms of statute or regulating authority.

There is no exemption for state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

Earning per share (EPS)

Basic EPS

An entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period. There is no requirement for calculating basic EPS for separate calculation of profit or loss from continuing operations.

Treatment of preference dividend

1. The after-tax amount of preference dividends that is deducted from profit or loss is:

- ▶ The after-tax amount of any preference dividends on non-cumulative preference shares declared in respect of the period, and
- ▶ The after-tax amount of the preference dividends for cumulative preference shares required for the period, whether or not the dividends have been declared.

The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

2. Preference shares that provide for a low initial dividend to compensate an entity for selling the preference shares at a discount, or an above-market dividend in later periods to compensate investors for purchasing preference shares at a premium, are sometimes referred to as increasing rate preference shares. Any original issue discount or premium on increasing rate preference shares is amortized, to retained earnings using the effective interest method and treated as a preference dividend for the purposes of calculating earnings per share.

The amount of preference dividends for the period that is deducted from the net profit for the period is:

- ▶ The amount of any preference dividends on non-cumulative preference shares provided for in respect of the period, and
- ▶ The full amount of the required preference dividends for cumulative preference shares for the period, whether or not the dividends have been provided for.

The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.

AS 20 does not provide any specific guidance on points (2) to (5). However, normally, such practices are not followed under Indian GAAP.

Treatment of preference dividend (cont'd.)

3. Preference shares may be repurchased under an entity's tender offer to the holders. The excess of the fair value of the consideration paid to the preference shareholders over the carrying amount of the preference shares represents a return to the holders of the preference shares, and a charge to retained earnings for the entity. This amount is deducted in calculating profit or loss attributable to ordinary equity holders of the parent entity.
 4. Early conversion of convertible preference shares may be induced by an entity through favourable changes to the original conversion terms, or the payment of additional consideration. The excess of the fair value of the ordinary shares or other consideration paid over the fair value of the ordinary shares issuable under the original conversion terms, is a return to the preference shareholders, and is deducted in calculating profit or loss attributable to ordinary equity holders of the parent entity.
 5. Any excess of the carrying amount of preference shares over the fair value of the consideration paid to settle them is added in calculating profit or loss, attributable to ordinary equity holders of the parent entity.
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Shares issued as part of cost of business combination, etc.

Ordinary shares issued as part of the cost of a business combination are included in the weighted average number of shares from the acquisition date. This is because the acquirer incorporates into its income statement the acquiree's profits and losses from that date.

AS 20 deals only with treatment of equity shares issued as part of consideration in an amalgamation. Under AS 20, equity shares issued as part of the consideration in an amalgamation in the nature of purchase are included in the weighted average number of shares as of the date of the acquisition because the transferee incorporates the results of the operations of the transferor into its statement of profit and loss from the date of acquisition. Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included in the calculation of the weighted average number of shares from the beginning of the reporting period, because the financial statements of the combined entity for the reporting period are prepared as if the combined entity had existed from the beginning of the reporting period.

Therefore, the number of equity shares used for the calculation of basic earnings per share in an amalgamation in the nature of merger is the aggregate of the weighted average number of shares of the combined entities, adjusted to equivalent shares of the entity whose shares are outstanding after the amalgamation.

Treatment of share application money

There is no specific guidance under IFRS.

Share application money pending allotment or any advance share application money as at the balance sheet, which is not statutorily required to be kept separately and is being utilized in the business of the entity, is treated in the same manner as dilutive potential equity shares for the purpose of calculation of diluted earnings per share.

Written put option

Contracts that require the entity to repurchase its own shares, such as, written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share, if the effect is dilutive. If these contracts are 'in the money' during the period (i.e., the exercise or settlement price is above the average market price for that period), the potential dilutive effect on earnings per share shall be calculated.

There is no specific guidance under Indian GAAP.

Disclosures

In addition to disclosure of EPS on continuing operations, an entity that reports a discontinued operation shall disclose the basic and diluted amounts per share for the discontinued operation either on the face of the income statement or in the notes to the financial statements. Under IFRS, disclosure of extraordinary items is prohibited.

Disclosure of basic and diluted EPS with and without extra-ordinary items is required. Basic and diluted EPS may also be provided voluntarily based on other measurements. AS 20 does not require any separate EPS disclosure for continuing and discontinued operations.

Interim financial reporting

Basis

The basis for interim financial reporting primarily requires a discrete approach, though integral approach is followed in a few cases.

Indian GAAP is similar to IFRS.

Compliance with requirements of law, etc.

IFRS does not recognize law/regulator prescribing format of financial statements.

If an entity's interim financial report is described as complying with IAS 34, it must comply with all of the requirements of this Standard, including requirements relating to presentation and disclosure.

A statute governing an entity or a regulator may require an entity to prepare and present certain information at an interim date which may be different in form and/or content as required by AS 25.

In such a case, the recognition and measurement principles as laid down in AS 25 are applied in respect of such information, unless, otherwise specified in the statute or by the regulator.

Minimum content of Interim financial reporting

Condensed statement of financial position, condensed statement of comprehensive income (SCI), condensed statement of changes in equity (SOCIE), condensed statement of cash flows and selected explanatory notes and disclosures like EPS etc. are required.	Condensed balance sheet, condensed income statement, condensed cash flow statement and selected explanatory notes and disclosures like EPS etc. are required. The concept of SOCIE and SCI does not prevail
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Disclosure of compliance with IFRS/GAAP

If an entity's interim financial report is in compliance with IAS 34, that fact should be disclosed. An interim financial report should not be described as complying with IAS 34 unless it complies with all of the requirements of each applicable Standard/IFRIC.	There is no such requirement even though interim financial statements should comply with all Accounting Standards.
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Change in accounting policy

A change in accounting policy, other than one for which the transition is specified by a new Standard or Interpretation, shall be reflected by restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of any prior financial years that will be restated in the annual financial statements in accordance with IAS 8.	Revised Clause 41 of the <i>Listing Agreement</i> and AS 25 requires retroactive restatement only for all interim periods of the current year.
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Accounting for leave benefits in interim financial statements

IAS 34 provides detailed guidance for accounting for leave benefits and manufacturing cost variances in interim financial statements.	There is no specific guidance under Indian GAAP.
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A high-angle, nighttime photograph of a dense urban skyline. Numerous skyscrapers are visible, their windows glowing with warm yellow and orange light. The buildings are packed closely together, creating a complex pattern of light and shadow. The sky is dark, and the overall atmosphere is one of a bustling city at night.

Assets and liabilities



IFRS	Indian GAAP
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Property, plant and equipment In 2005, ASB of ICAI had issued an Exposure Draft of the revised AS 10 <i>Tangible Fixed Assets</i> , to bring the same in line with IAS 16. Since, the Exposure Draft has not been issued as final standard till date, the major differences between IAS 16 and the existing AS 10 are listed below.	
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Cost of PPE Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction, or where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other IFRS. The costs include: ▶ The purchase price (less any discounts and rebates), import duties and non-refundable taxes, ▶ Any directly attributable costs of bringing the asset to its working condition, and ▶ The initial estimate of the costs of dismantling and removing the item, and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. Under IAS 23 (revised 2007), borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should also be capitalized as part of the cost of that asset.	Indian GAAP is similar to IFRS except the following: ▶ No general guidance is given for capitalization of dismantling and site restoration cost. However, the <i>Guidance note on Accounting for Oil & Gas Producing Activities</i> states that entities involved in those activities should capitalize the dismantling and site restoration cost. ▶ There is no guidance under AS 10 specifying treatment of fixed assets acquired on deferred settlement terms. Generally, financing element is not separated from the total price paid even if payment is deferred beyond normal credit terms.
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Cost of PPE (cont'd.)

General and administrative overheads, and start-up costs other than those necessary to bring the asset to its working condition, can not be capitalized.

Where government grants have been received in connection with the acquisition of property, plant and equipment, the carrying amount may be reduced by the amount of the grant in accordance with the requirements of IAS 20.

The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit, unless such interest is recognized in the carrying amount of the item in accordance with IAS 23.

Component accounting

IAS 16 mandates component accounting. This requires each major part of an item of property plant and equipment, with a cost that is significant in relation to the total cost of the item, to be depreciated separately.

AS 10 does not require full adoption of the component approach. It merely recognizes the approach, by stating that accounting for a tangible fixed asset may be improved if total cost, thereof, is allocated to its various parts.

Subsequent costs

IAS 16 requires the subsequent expenditure on an asset to be evaluated on the same recognition principles as the initial cost, to determine whether it should be expensed or recognized as an item of property, plant and equipment. By applying this principle, routine maintenance expenditure and costs of day-to-day servicing are expensed as incurred.

An entity recognizes, in the carrying amount of an item of property, plant and equipment, the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognized simultaneously.

Costs of major inspection are recognized in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognized. This occurs regardless of whether the cost of the previous inspection was identified in the transaction, in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was, when the item was acquired or constructed.

Subsequent routine and non-routine maintenance expenditure, including the replacement of parts and major inspection or overhaul, are normally expensed immediately. Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value. There is no requirement as such for decapitalizing the carrying amount of the replaced part under AS 10.

Revaluation of PPE

IAS 16 requires an entity to choose either the cost model or the revaluation model as its accounting policy. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

AS 10 recognizes revaluation of fixed assets. However, the revaluation approach adopted therein is adhoc in nature. It provides that when revaluations do not cover all the assets of the given class, it is appropriate that the selection of the asset to be revalued be made on systematic basis, e.g., an entity may revalue a class of assets within one unit and ignore assets in the same class at another unit.

Depreciation on revalued portion cannot be recouped out of revaluation reserve (forming part of other comprehensive income in statement of comprehensive income).

Depreciation on revalued portion can be recouped out of revaluation reserve.

The revaluations must be kept sufficiently up to date, so that the carrying amount does not differ materially from the fair value. This requires regular revaluations of all PPE when the revaluation policy is adopted. Management must consider at each year end, whether fair value is materially different from carrying value.

There is no such requirement to perform revaluation at regular intervals.

Depreciation

An item of property, plant and equipment should be depreciated over its estimated useful life, and the depreciation charge must be recognized as an expense, unless it has to be included in the carrying amount of another asset. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item, should be depreciated separately. On initial recognition, an entity allocates the amount recognized in respect of an item to its significant parts and depreciates separately each such part.

The depreciable amount of each asset should be allocated on a systematic basis over its useful life. All companies need to ensure that minimum depreciation is provided at the rates prescribed in schedule XIV to the Companies Act, 1956. Further, top-up depreciation should be charged to comply with AS 6 requirements, in case the useful life of an asset is shorter than that envisaged in Schedule XIV.

Depreciation (cont'd.)

A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge. Though not required, an entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.

Apart from AS 10 recognizing component approach in one paragraph, by stating that accounting for a tangible fixed asset may be improved if total cost thereof is allocated to its various parts, there is no requirement under Indian GAAP for separate depreciation on significant parts of an asset.

The residual value and the useful life of an asset shall be reviewed at least at each financial year-end, and if expectations differ from previous estimates, the change (s) shall be accounted for as a change in an accounting estimate.

There is no need for an annual review of estimates of useful life and residual value. An entity may review the same, periodically.

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method.

Permitted methods of depreciation are *Straight Line Method* and *Written Down Value Method*.

A periodic review of depreciation method is required.

The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made, only if the adoption of the new method is required by statute or for compliance with an accounting standard, or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise.

A change in depreciation method is treated as change in accounting estimate and accounted for prospectively.

A change in depreciation method is treated as change in accounting policy.

Spare parts, servicing equipment, etc.

Spare parts are usually carried as inventory and recognized in profit or loss as consumed. However, major spare parts qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.

Machinery spares are usually charged to the profit and loss statement, as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item.

Major standby equipments qualify as property, plant and equipment when an entity expects to use them during more than one period.

Indian GAAP is similar to IFRS.

Servicing equipments is usually carried as inventory and recognized in profit or loss as consumed.

Servicing equipment is normally capitalized.

Decommissioning and restoration

To the extent decommissioning and restoration relates to the fixed asset, the changes are added/deducted (after discounting) from the asset. However, the amount deducted is restricted to the carrying value of the relevant asset. The unwinding of discount, is taken to profit or loss as a finance charge.

There is no guidance under Indian GAAP. The *Guidance Note on Accounting for Oil and Gas Activities* contains more specific provision relating to such costs, to the extent it relates to oil and gas producing entities.

Retirement and disposal

IAS 16 prohibits gains or losses arising from derecognition of an item of property, plant and equipment to be classified as revenue. However, when an entity routinely sells items of property, plant and equipment held for rental in the course of its ordinary activities, it shall transfer such assets to inventories at their carrying amount, when they cease to be rented and become held for sale. The proceeds from sale of such assets shall be recognized as revenue.

Gains or losses arising from disposal of assets are recognized in profit or loss for the period. There is no specific requirement to include/exclude such gains/losses from revenue.

Compensation for impairment

Compensation from third parties for impairment or loss of items of property, plant and equipment are included in profit or loss account when compensation becomes receivable.

There is no guidance under Indian GAAP.

Leases

Initial direct costs

IAS 17 prescribes initial direct cost incurred by lessor to be included in lease receivable amount in case of finance lease, and in the carrying amount of the asset in case of operating lease. It does not mandate any accounting policy related disclosure.

AS 19 requires initial direct cost incurred by lessor with respect to a finance lease to be either charged off at the time of incurrence or to be amortized over the lease period. It requires disclosure of the accounting policy in the financial statements of the lessor. Initial direct costs incurred specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognized as an expense in the statement of profit and loss in the period in which they are incurred.

Sale and leaseback

If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount shall not be immediately recognized as income by a seller-lessee. Instead, it shall be deferred and amortized over the lease term.

If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss shall be recognized immediately. If the sale price is below fair value, any profit or loss shall be recognized immediately, except that, if the loss is compensated for by future lease payments at below market price, it shall be deferred and amortized in proportion to the lease

Indian GAAP is similar to IFRS, except that on a sale and leaseback arrangement which results in a finance lease, AS 19 requires excess/deficiency both to be deferred and amortized over the lease term in proportion to the depreciation of the leased asset.

Sale and leaseback (cont'd.)

payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value shall be deferred and amortized over the period for which the asset is expected to be used.

Incentive on operating leases received by lessee

These are recognized over the term of the lease.

There is no guidance under Indian GAAP.

Lease of land

IAS 17 deals with lease of land. Under IAS 17, leases of land are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee normally does not receive substantially all of the risks and rewards incidental to ownership, in which case the lease of land will be an operating lease.

AS 19 excludes lease of land (and therefore composite leases) from its scope. As per the recent Expert Advisory Committee opinion, lease of land which is for a period of 99 years and is renewable for a similar period has the effect of passing significant rights of ownership to the parties concerned. Thus, such a lease would be in the nature of sale of plots and should be accounted for accordingly.

Determination whether an arrangement contains lease

IFRIC 4 requires an entity to determine whether an arrangement, comprising a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments, is a lease. Such determination shall be based on the substance of the arrangement and requires an assessment of whether:

There is no guidance for such arrangement. Amounts are generally recognized in accordance with the legal form of the transaction, rather than its substance. However, there is no prohibition from treating such arrangements as lease.

Determination whether an arrangement contains lease (cont'd.)

- ▶ Fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset), and
- ▶ The arrangement conveys a right to use the asset.

For example, power purchase agreements and outsourcing contracts may have the substance of lease.

Evaluating the substance of transactions involving the legal form of a lease

A series of transactions that involve the legal form of a lease is linked and should be accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole. This is the case, for example, when the series of transactions are closely interrelated, negotiated as a single transaction, and takes place concurrently or in a continuous sequence. In such cases, the accounting shall reflect the substance of the arrangement.

There is no specific guidance under Indian GAAP.

Borrowing costs

Scope

An entity is not required to apply IAS 23 to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, measured at fair value.

There is no such scope exclusion under AS16.

Qualifying assets

Qualifying assets are those assets that require a substantial period of time to get ready for their intended use or sale are not routinely produced in large quantities or on a repetitive basis over a short period of time, and are not ready for their intended use or sale when acquired.

Indian GAAP is similar to IFRS. However, the term 'substantial period of time' has been interpreted to generally mean more than 12 months.

Capitalization rate

The disclosure requirements of IAS 23 require an entity to disclose separately the capitalization rate used to determine the amount of borrowing costs.

There is no such separate disclosure required under AS 16.

Impairment of assets

When should impairment review be conducted

An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity should estimate the recoverable amount of the asset. Irrespective of whether there is any indication of impairment, an entity shall test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. In addition, goodwill acquired in a business combination is tested annually for impairment.

An entity should assess at each balance sheet date, whether there is any indication that an asset may be impaired. If any such indication exists, the entity should estimate the recoverable amount of the asset. However, intangible assets which are not yet available for use or intangible assets which are amortized for greater than 10 years are tested for impairment annually irrespective of, whether there are any indications for impairment.

The impairment trigger under IAS 36 is the higher of an asset's fair value less costs to sell and value in use, which incorporates discounting.

Indian GAAP is similar to IFRS, except that in AS 28, terminology used is 'net selling price' instead of 'fair value less costs to sell'. The two terms are, otherwise, defined in the same manner.

Reversal of impairment losses

An impairment loss recognized for goodwill shall not be reversed in a subsequent period.

An impairment loss recognized for goodwill should not be reversed in a subsequent period unless the impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events have occurred that reverse the effect of that event.

Allocation of goodwill in case of a Cash Generating Unit (CGU)

For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's CGU, or groups of CGU, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall represent the lowest level within the entity at which the goodwill is monitored for internal management purposes, and not be larger than an operating segment determined in accordance with IFRS 8.

In testing a CGU for impairment, an entity should identify whether goodwill that relates to that CGU is recognized in the financial statements. If this is the case, goodwill is allocated to the CGU based on bottom-up approach, i.e., identify whether it can be allocated to a particular CGU on consistent and reasonable basis and then, compare the recoverable amount of the CGU under review to its carrying amount and recognize any impairment loss.

However, if in performing the 'bottom-up' test, the entity could not allocate the carrying amount of goodwill on a reasonable and consistent basis to the CGU under review, the entity should also perform a 'top-down' test, that is, the entity should identify the smallest CGU that includes the cash-generating unit under review and to which the carrying amount of goodwill can be allocated on a reasonable and consistent basis (the 'larger' CGU). The entity should then compare the recoverable amount of the larger CGU to its carrying amount and recognize impairment loss.

Non-current assets held for sale

Under IFRS these are measured at lower of carrying amount and fair value less cost to sell.

Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realizable value.

Disclosure

The IASB Improvement Project 2008 requires that if 'fair value less costs to sell' is determined using the discounted cash flows projections, additional disclosure would be made regarding the assumptions used.

There is no such requirement under AS 28.

Intangible assets

Intangibles acquired as a part of business combination

In accordance with IFRS 3-R *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. The intangible asset is recorded by the acquirer irrespective of whether the asset had been recognized by the acquiree before the business combination. For an intangible asset acquired in business combination, the requirement that the asset will generate future economic benefits is always considered to be met, since the fair value of the asset reflects such expectations. Similarly, if the asset is separable or arises from contractual or other legal rights, it is presumed that sufficient information exists to measure reliably the fair value of the asset. Thus, an entity need not evaluate future economic benefits and measurement criteria separately for recognition of intangible asset arising from business combination.

If an intangible asset is acquired in an amalgamation in the nature of purchase, the same should be accounted at cost or fair value, depending upon cost/fair value method for amalgamation under AS 14 and provided that cost/fair value can be reliably measured. If the same is not reliably measurable, it is included as a part of goodwill. Where the consideration is allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation, then intangible asset is recorded even if that intangible asset had not been recognized in the financial statements of the transferor.

Intangible assets acquired in an amalgamation in the nature of merger, or acquisition of a subsidiary are recorded at book values, which means that if the intangible asset was not recognized by the acquiree, the acquirer would not be able to record the same.

Research and development (R&D)

No intangible asset arising from research shall be recognized.

Expenditure on research is recognized as an expense when it is incurred.

An intangible asset arising from development shall be recognized if, and only if, an entity can demonstrate all of the following:

- ▶ The technical feasibility of completing the intangible asset so that it will be available for use or sale,
- ▶ Its intention to complete the intangible asset and use or sell it,

Indian GAAP is similar to IFRS.

Research and development (R&D) (cont'd.)

- | | |
|--|---------------------------------|
| <ul style="list-style-type: none">▶ Its ability to use or sell the intangible asset,▶ How the intangible asset will generate probable future economic benefits,▶ The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset, and▶ Its ability to measure reliably the expenditure attributable to the intangible asset during its development. | Indian GAAP is similar to IFRS. |
|--|---------------------------------|

Research or development expenditure that relates to an in-process research or development project acquired separately or in a business combination is recognized as an intangible asset.

No specific guidance given on separately acquired in-process R&D. Since consolidation is based on book values rather than fair values, in-process R&D of an acquired subsidiary is not accounted for in the CFS.

Advertising and promotional activity

IAS 38 requires that expenditure on an internally developed intangible item is recognized as an expense when it is incurred. However, there was some ambiguity as to the interpretation of this requirement. For example, some believed that an entity should recognize expenditure on advertising and promotional activities as an expense when it received the goods or services that it would use to develop or communicate the advertisement or promotion. Others believed that an entity should recognize an expense when the advertisement or promotion was delivered to its customers or potential customers.

As part of the Annual Improvement Project 2008, the IASB has clarified this ambiguity to require an entity to recognize as an expense when the

No such guidance under Indian GAAP. Entities normally follow the practice of recognizing as an asset goods or services received for future advertising or promotional activities.

Advertising and promotional activity (cont'd.)

entity has a right to access the goods or when it receives the service. This means that all the expenditure on advertising and promotions should be expensed immediately and not deferred until they are delivered to customers.

Subsequent measurement

An entity shall choose either the cost model or the revaluation model as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets. The revaluation model is permitted only where there is an active market for the underlying intangibles.

After initial recognition, an intangible asset should be carried at its cost less any accumulated amortization and any accumulated impairment losses. Revaluation is prohibited.

Useful life

An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units, constituting, that useful life.

There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use.

Amortization

The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.

Amortization is charged over the useful life of the asset, but should not exceed 10 years, unless there is persuasive evidence for amortizing over a longer period.

Impairment

Intangible assets with finite lives are required to be tested for impairment, if impairment indicator exists. An intangible asset with an indefinite useful life, and which is not yet available for use should be tested for impairment annually, and whenever there is an indication that the intangible asset may be impaired.

In addition to the requirements of AS 28, an entity should estimate the recoverable amount of the following intangible assets at least at each financial year end even if there is no indication that the asset is impaired:

- An intangible asset that is not yet available for use, and

Impairment (cont'd.)	
	▶ An intangible asset that is amortized over a period exceeding 10 years from the date when the asset is available for use.
Investment property	
Definition	
Investment property is property (land or a building, or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services, for administrative purposes, or for sale in the ordinary course of business.	An investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing entity.
Initial measurement	
A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model for the asset recognized. This classification alternative is available on a property-by-property basis.	There is no guidance under Indian GAAP.
Subsequent measurement	
An entity has an option to apply either cost model or fair value model. If fair value model is adopted, then changes in fair value are recognized in profit or loss for the period in which it arises. In the fair value model, the carrying amount is not depreciated. In the cost model, the asset is carried at cost less depreciation.	AS 13 requires investment properties to be accounted for in the same manner as long term investments, i.e., these should be carried in the financial statements at cost, less provision for diminution to recognize other than temporary decline in the value. Depreciation on investment property is required to be provided as per DCA Circular (10) CL-VI/61 dated 27 September 1961 and under AS 6. Hence, the depreciated cost model is applied for subsequent measurement.

Subsequent measurement (cont'd.)

As per the Improvement Project 2008, applicable for effect from annual periods commencing from 1 January 2009, property that is being constructed or developed for future use as investment property is accounted for as investment property.

The fair value model is not allowed under Indian GAAP.

If an entity is unable to determine the fair value of an investment property under construction, but expects to be able to determine its fair value on completion, the investment under construction will be measured at cost until such time as fair value can be determined or construction is complete (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model.

Frequency/basis of revaluations

The fair value model differs from the revaluation model that is permitted for some non-financial assets. The fair value of investment property must reflect the actual market conditions and circumstances as of the reporting date. The standard does not require an independent and qualified valuer, but it is encouraged. Revaluations must be made with sufficient regularity that the carrying amount does not differ materially from fair value at the reporting date.

Revaluation is not permitted.

Transfers to/from investment property

IAS 40 provides detailed guidance for transfers to/from investment property.

There is no guidance under Indian GAAP.

Disposals

An investment property shall be derecognized (eliminated from the statement of financial position) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.

Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognized in profit or loss in the period of the retirement or disposal.

Compensation from third parties for investment property that was impaired, lost or given up shall be recognized in profit or loss when the compensation becomes receivable.

There is no specific guidance, however, normally, the same or similar treatment is followed.

Inventory

Recently, the ASB of ICAI has issued an Exposure Draft of revised AS 2 *Inventories*, to bring the same in line with IAS 2. Since, the Exposure Draft has not been issued as final standard till date, the major differences between IAS 2 and the existing AS 2 are listed below.

Cost formulae

Specific identification, FIFO and weighted average are acceptable methods of determining cost. However, same cost formula should be used consistently for all inventories that have a similar nature and use to the entity. The LIFO method is prohibited.

Similar to IFRS, except that it is not expressly mandated in AS 2 to use the same cost formula consistently for all inventories that have a similar nature and use to the entity. AS 2 provides that the formula used should reflect the fairest possible approximation, to the cost incurred in bringing the items of inventory, to their present location and condition.

Biological assets

A biological asset should be measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs. All changes in fair value should be recognized in the income statement in the period in which they arise.

There is no guidance available.

Inventories acquired on deferred settlement terms

IAS 2 specifically requires that where inventory is acquired on deferred settlement terms, the excess over the normal price is to be accounted as interest over the period of financing.

There is no guidance under AS 2 for treatment of inventories acquired on deferred settlement terms. Recently, the ICAI has issued AS 30 and has issued a Limited Revision to AS 2 which requires that where inventory is acquired on deferred settlement terms, the excess over the normal price is to be accounted as interest over the period of financing. The Limited Revision is recommendatory from 1 April 2009 and mandatory from 1 April 2011.

Commodity broker-traders

IAS 2 does not apply to measurement of inventories of commodity broker-traders to the extent that they are measured at fair value less costs to sell.

AS 2 applies to commodity broker-traders too.

Inventories of a service provider

IAS 2 includes provisions relating to the work-in-progress of a service provider. Service providers generally accumulate costs in respect of each service for which a separate selling price will be charged.

AS 2 excludes work in progress arising in the ordinary course of business of service providers.

**Non-current asset held for sale and discontinued operations/
discontinuing operations**

Scope

IFRS 5 sets out requirements for the classification, measurement and presentation of non-current assets held for sale and the classification and presentation of discontinued operations.

There is no specific standard which prescribes classification, measurement and presentation for all non-current asset held for sale except for AS 10 which requires assets held for sale to be measured at lower of cost and net realizable value. AS 24 deals with disclosures relating to discontinuing operations.

Discontinued/discontinuing operations

A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and

- Represents a separate major line of business or geographical area of operations,
- Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or
- Is a subsidiary acquired exclusively with a view to resale.

A discontinuing operation is a component of an entity that the entity, pursuant to a single plan, is disposing of substantially in its entirety, or disposing of piecemeal, or terminating through abandonment; and that represents a separate major line of business or geographical area of operations and that can be distinguished operationally and for financial reporting purposes.

Period of disposal for non-current assets held for sale

The disposal should be completed within a year, with limited exceptions.

No time-frame is specified.

Measurement principles

The assets are measured at the lower of carrying value or fair value less costs to sell.

The entity is required to apply the relevant standards, e.g., for impairment - AS 28 is applied, for provisions - AS 29 is applied, etc.

Presentation

A single amount is presented on the face of the income statement comprising the post tax profit or loss of discontinued operations and an analysis of this amount either on the face of the income statement or in the notes for both current and prior periods. Separate classification on the balance sheet for assets and liabilities for the current period only.

The following is separately disclosed on the face of the profit and loss account separately from continuing operations:

- Pre-tax profit or loss and related taxes,
- Pre-tax gain or loss on disposal.

Income/expense line items from continuing and discontinuing operations are segregated and disclosed in the notes to account; but is presented on a combined basis in the income statement.

Service concession arrangements

Recently, the ICAI has issued Exposure Draft of *Guidance Note on Accounting for Service Concession Arrangements* in line with IFRIC 12. Since, the Exposure Draft has not been issued as Guidance Note till date; the same has been ignored in the comparison below.

Applicability

IFRIC 12 applies to accounting by operators for public-to-private service concession arrangements. It applies to public-to-private service concession arrangements if:

- ▶ The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price, and
- ▶ The grantor controls any significant residual interest in the infrastructure at the end of the term of the arrangement.

There is no specific guidance under Indian GAAP.

Recognition of assets

The operator cannot recognize infrastructure as its own asset, as the operator does not control the use of public service infrastructure, such as roads, bridges and tunnels, but is merely a service provider. Rather, it would recognize the consideration receivable as:

- a. A financial asset, or
- b. An intangible asset.

There is no specific guidance under Indian GAAP. Common practice is to recognize infrastructure as fixed asset in the balance sheet.

Revenue recognition

The operator acts as a service provider. Therefore, the operator recognizes the revenue and costs relating to construction or upgrade service in accordance with IAS 11 and revenue in accordance with IAS 18 for services it performs. The consideration receivable for construction or upgrade services is recognized at its fair value.

There is no specific guidance under Indian GAAP. However, normally, no revenue is recognized during construction phase.

Provisions, contingent liabilities and contingent assets

Applicability to financial instruments

IAS 37 does not apply to financial instruments (including guarantees) that are within the scope of IAS 39.

AS 29 applies to financial instruments (including guarantees) that are not carried at fair value. The ICAI has recently issued accounting standards on financial instruments and limited revision to AS 29. The limited revision brings the scope in line with IFRS. However, this limited revision is recommended for accounting periods commencing on or after 1 April 2009, and mandatory for accounting periods commencing on or after 1 April 2011.

Definitions

IAS 37 defines the terms 'legal obligation', and 'constructive obligation' which are not there in AS 29.

AS 29 contains definitions of the terms 'present obligation' and 'possible obligation' which are not defined in IAS 37.

Measurement

The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. Detailed guidance is available on measurement.

Provisions are based on the best estimate. No detailed guidance is available.

IAS 37 employs a statistical notion of expected value in estimating the settlement value of a provision. The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under IAS 12.

Provisions are based on the best estimate. There is no detailed guidance available.

Present value

Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

The amount of a provision should not be discounted to its present value.

Restructuring provision	
Restructuring provision should be made based on constructive obligation.	Restructuring provision should be made based on legal obligation.
Onerous contracts	
If an entity has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision.	The guidance is similar to IFRS, except that discounting of the onerous provision is prohibited.
Contingent assets	
A contingent asset is disclosed in financial statements where an inflow of economic benefits is probable.	A contingent asset should not be disclosed in financial statements. However, it can be disclosed in Director's Report.

Revenue and expenses

iv



IFRS	Indian GAAP
Revenue	
Measurement	
Revenue should be measured at the fair value of the consideration received or receivable. Where the inflow of cash or cash equivalents is deferred, discounting to a present value is required.	Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. Discounting of deferred revenue is normally not required. However, for installment sales, discounting would be required.
Revenue recognition – services rendered	
When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognized by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied: ▶ The amount of revenue can be measured reliably, ▶ It is probable that the economic benefits associated with the transaction will flow to the entity, ▶ The stage of completion of the transaction at the balance sheet date can be measured reliably, and ▶ The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.	AS 9 recognizes both completed contract method and proportionate completion method to be used in measurement of performance while recognizing revenue from rendering of services, whichever relates the revenue to the work accomplished should be used for recognition of revenue.

Interest, royalties and dividend

Revenue arising from the use by others of entity assets yielding interest, royalties and dividends should be recognized when:

- ▶ It is probable that the economic benefits associated with the transaction will flow to the entity, and
- ▶ The amount of the revenue can be measured reliably.

Revenue shall be recognized on the following bases:

- ▶ Interest shall be recognized using the effective interest method,
- ▶ Royalties shall be recognized on an accrual basis in accordance with the substance of the relevant agreement, and
- ▶ Dividends shall be recognized when the shareholder's right to receive payment is established.

Guidance is similar to IFRS except that, interest is recognized based on time-proportion basis taking into account the amount outstanding and the rate applicable.

Under the requirements of Schedule VI to the Companies Act, 1956, dividends from subsidiary companies are recognized even if the same are declared after the date of the balance sheet, but pertain to the period ending on or before the date of the balance sheet.

Specific revenue recognition issues

Customer loyalty programmes

Under IFRIC 13, an entity accounts for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the 'initial sale'). The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

The consideration allocated to the award credits shall be measured by reference to their fair value, i.e., the amount for which the award credits could be sold separately.

If the entity supplies the awards itself, it shall recognize the consideration allocated to award credits as revenue

There is no specific guidance.

Customer loyalty programmes (cont'd.)

when award credits are redeemed and it fulfils its obligations to supply awards. The amount of revenue recognized shall be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (i.e., as the principal in the transaction) or on behalf of the third party (i.e., as an agent for the third party). If the entity is collecting the consideration on behalf of the third party, it shall measure its revenue as the net amount retained on its own account, i.e., the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards, and recognize this net amount as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted.

Alternatively, if the customer can choose to claim awards from the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party. If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits, and recognize the revenue when it fulfils its obligations in respect of the awards.

Accounting for multiple-element contracts

IAS 18 provides limited guidance with respect to multiple element contracts. It states that the recognition criteria are usually applied separately to each transaction, however, in certain circumstances, it is necessary to apply the recognition criteria to separately identifiable components of a single transaction, in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognized as revenue over the period, during which the service is performed. The IASB has recently issued IFRIC 13 which deals with allocating part of the consideration received or receivable from the sales transaction to the award credits. Earlier IFRIC has mentioned that the guidance in IFRIC 13 for allocation of consideration may be applied to other multiple element contracts also.

There is no specific guidance under the current Indian GAAP except for an Expert Advisory Committee opinion (in the context of cargo handling) which requires revenue to be recognized by attributing the fair value to individual components. Recently, the Research Committee of ICAI has issued an Exposure Draft of proposed Monograph on *Revenue Recognition for Arrangements with Multiple Deliverables*. The proposed Monograph is an adaptation of EITF 00-21 under US GAAP and purports to establish criteria to determine:

- Whether multiple deliverables in an arrangement qualifies as a separate unit of accounting, and
- How the arrangement consideration should be measured and allocated to separate units of accounting.

Since US GAAP follows a rule-based approach as compared to a principle-based approach under IFRS, application of the Monograph based on US GAAP requirements will significantly reduce the scope of judgement by the preparers and will limit flexibility available to them under IFRS. In addition, some of these requirements may be contrary to IFRS.

Barter transactions

When goods or services are exchanged or swapped for goods or services that are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. Revenue on exchanges of dissimilar goods or services is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. If the fair value of the goods or services received cannot

There is no specific guidance other than in the *Guidance Note on Accounting by Dot-com Companies*. It deals with advertising barter transactions. Revenue from barter transactions should be recognized only when, the fair values of similar transactions are readily determinable from the entity's history.

Barter transactions (cont'd.)

be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Real estate sales

IFRIC 15 provides specific guidance on determining when the agreement would be treated as construction contract or as rendering of service or as sale of goods.

If the agreement is determined to be a sale agreement, the entity recognizes revenue by reference to the stage of completion, using the percentage of completion method, if and only if, it transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. These conditions should be applied to the underlying real estate in its current state, not to the buyer's right to acquire the fully constructed real estate at a later date. On the other hand, if the entity transfers to the buyer control, and the significant risks and rewards of ownership, of the real estate in its entirety at a single time (e.g., at completion, upon or after delivery), it should recognize revenue only when all the criteria of IAS 18 are satisfied. When the entity is required to perform further work on real estate already delivered to the buyer, it shall recognize an expense in accordance with IAS 18. The liability shall be measured in accordance with IAS 37.

Under the *Guidance Note on Recognition of Revenue by Real Estate Developers*, issued by the ICAI, revenue for real estate sales should be recognized when all significant risks and rewards of ownership have been transferred to the buyer, and other conditions for recognition of revenue as laid down in AS 9 are satisfied. When the seller has transferred to the buyer all significant risks and rewards of ownership, and other conditions for recognition of revenue are satisfied, it would be appropriate for the seller to recognize, provided that the seller has no further substantial acts to complete under the contract. Under the Guidance Note, if the seller has entered into a legally enforceable agreement for a sale with the buyer, all significant risks and rewards of ownership are considered to be transferred even before passing the legal title and/or the possession of the real estate to the buyer, if certain conditions laid down in the Guidance Note are satisfied. If the seller is obliged to perform significant acts after the transfer of all significant risks and rewards, revenue should be recognized on proportionate basis as the acts are performed, i.e., by applying percentage completion method as explained in AS 7.

Real estate sales (cont'd.)

If the agreement is within the scope of IAS 11 and its outcome can be estimated reliably, the entity shall recognize revenue by reference to the stage of completion of the contract activity in accordance with IAS 11.

Construction contracts

Estimated contract losses

Estimated losses are recognized immediately, irrespective of stage of completion.

The guidance under Indian GAAP is similar to that under IFRS.

Type of construction contracts

IFRS provides different sets of conditions for determining whether the outcome of a contract can be estimated reliably, depending on whether it is a fixed-priced contract or a cost-plus contract.

The guidance under Indian GAAP is similar to that under IFRS.

Reliable estimate of the outcome of a construction contract

IFRS requires that if a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract, if separate proposals have been submitted for each asset, each asset has been subject to separate negotiation, and the costs and revenues of each asset can be identified. In addition, IFRS requires that a group of contracts, whether with a single customer or with several customers, be treated as a single construction contract, if the contracts are negotiated as a single package, closely interrelated, and performed concurrently or in a continuous sequence.

The guidance under Indian GAAP is similar to that under IFRS.

Incentive revenue

Incentive payments are recognized as contract revenue when, "it is probable that they will result in revenue and are capable of being reliably measured". IAS 11, however, does not define the term 'probable'.

The guidance under Indian GAAP is similar to that under IFRS.

Accounting for government grants

The ASB of the ICAI has issued an Exposure Draft of revised AS 12 *Accounting for Government Grants and Disclosure of Government Assistance*, for comments. Since, the Exposure Draft has not been issued as final standard till date, the major differences between IAS 20 and the existing AS 12 are listed below.

Grants in the form of non-monetary assets

IAS 20 provides an option to entities to account for government grants in the form of non-monetary assets, given at a concessional rate, either at their fair value or at the acquisition cost.

AS 12 does not provide such option. It requires government grants in the form of non-monetary assets, given at a concessional rate, to be accounted for on the basis of their acquisition cost only. If a non-monetary asset is given free of cost, it should be recorded at a nominal value.

Grants in the nature of promoter's contribution

IAS 20 does not recognize the concept on recognizing grants directly in reserves. Government grants shall be recognized as income over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis. They shall not be credited directly to shareholders' interests.

AS 12 requires certain grants, viz., grants in the nature of promoter's contribution and grants related to non-depreciable assets, which do not have any conditions attached to them, to be recognized directly in 'capital reserve' which is a part of 'shareholders' funds'.

Refundable grants

If government grants relating to a specific fixed asset becomes refundable, IAS 20 requires retrospective re-computation of depreciation to be done. It also requires that cumulative additional depreciation, that would have been recognized as an expense in the absence of the grant, should be recognized immediately as an expense.

If government grant relating to a specific fixed asset becomes refundable, AS 12 requires depreciation on the revised book value to be provided prospectively over the remaining useful life of the asset.

Government loan at below-market rate

IAS 20 has been amended as part of Annual Improvement Project 2008. As per the amendment, the benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognized and measured in accordance with IAS 39. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with IAS 39 and the proceeds received.

AS 12 or AS 30 is silent on the matter.

Disclosures

IAS 20 requires additional disclosure of unfulfilled conditions and other contingencies attached to government assistance that has been recognized

AS 12 does not require any such additional disclosure.

Employee benefits

Accounting for defined benefit plan discount rate

The discount rate to be used for determining the defined benefit obligation is by reference to market yields at the balance sheet date on high quality corporate bonds (or, in countries where there is no deep market in such bonds, government bonds) of a currency and term consistent with the currency and term of the post-employment benefit obligations.

The discount rate to be used for determining the defined benefit obligation is by reference to market yields at the balance sheet date on government bonds of a currency and a term consistent with the currency and term of the post-employment benefit obligations.

Actuarial gains and losses

IAS 19 provides options to recognize actuarial gains and losses as follows:

- ▶ All actuarial gains and losses can be recognized immediately in profit or loss for the period,

Actuarial gains or losses are recognized immediately in profit or loss for the period.

Actuarial gains and losses (cont'd.)

- ▶ All actuarial gains and losses can be recognized immediately in Other Comprehensive Income, or
 - ▶ Actuarial gains and losses below the 10% corridor need not be recognized and those above the 10% corridor can be deferred over the remaining service period of employees or on accelerated basis.
-

Past service cost

IFRS requires the recognition of past service cost as an expense on a straight-line basis over the average period, until the benefits become vested. If benefits are vested immediately following the changes to a defined benefit plan, an entity should recognize past service cost immediately.

The guidance under Indian GAAP is similar to that under IFRS.

Asset ceiling

If the net amount determined to be recognized in the balance sheet is negative (an asset), the recognition of the asset is limited to the lower of:

- ▶ The asset resulting from applying the standard, and
- ▶ The net total of any unrecognized actuarial losses and past service cost and the present value of any available refunds from the plan or reduction in future contributions to the plan.

IFRIC 14 provides further guidance on certain issues relating to recognition of an asset under defined benefit plans.

If the net amount determined to be recognized in the balance sheet is negative (an asset), recognition of the asset is limited to the lower of:

- ▶ The asset resulting from applying the standard, and
- ▶ The present value of any economic benefits available in the form of refunds from the plan or reductions, in future contributions to the plan.

Guidance similar to IFRIC 14 is not available under Indian GAAP.

Termination benefits

An entity should recognize termination benefits as a liability and an expense only when it is demonstrably committed to either:

- ▶ Terminate the employment of an employee before the normal retirement date, or
- ▶ Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

An entity should recognize termination benefits as a liability and an expense when, and only when:

- ▶ The entity has a present obligation as a result of a past event,
- ▶ It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
- ▶ A reliable estimate can be made of the amount of the obligation.

An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan for the termination, and is without realistic possibility of withdrawal. If the termination benefits fall due more than one year after the balance sheet date, they should be discounted using a rate determined by reference to the market yields on high quality corporate bonds, at the balance sheet date. In countries where there is no deep market in such bonds, the market yields (at the balance sheet date) on government bonds should be used.

Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted using the discount rate determined by reference to market yields at the balance sheet date on government bonds of a currency and term consistent with the currency and term of the benefit.

Under IFRS, option to defer the termination benefit expenditure is not available.

The transitional provision of AS 15 provides an option to defer termination benefits incurred before 1 April 2009 and amortize the same over the pay-back period. However, the expenditure cannot be carried forward to accounting periods commencing on or after 1 April 2010.

Share-based payment

Scope

IFRS 2 applies to both employee and non-employee stock based payments.

The Guidance Note on Accounting for Employee Share-based Payments, issued by the ICAI, covers only employee share based payments. Non-employee share based payments are covered by other Accounting Standards, e.g., AS 10 deals with fixed assets acquired against issuance of shares.

For listed entities, the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, prescribe the treatment to be followed for such schemes. Thus, listed entities are required to follow these Guidelines instead of the Guidance Note issued by the ICAI. Though, there is no major difference between the principle requirements of the SEBI Guidelines and ICAI Guidance, there are differences of detail between the two.

Measurement

For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired, and the liability incurred at the fair value of the liability. Until the liability is settled, the

The guidance is similar to IFRS except that *Guidance Note on Accounting for Employee Share-based Payments* permits the use of intrinsic value method also to account employee share-based payment.

Measurement (cont'd.)

entity shall remeasure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

The guidance is similar to IFRS except that *Guidance Note on Accounting for Employee Share-based Payments* permits the use of intrinsic value method also to account employee share-based payment.

Graded vesting

Entities need to determine the vesting period for each portion of the option separately, and amortize the compensation cost of each such portion on a straight-line basis, over the vesting period of that portion. The option to recognize the expense over the service period for the entire award period is not available.

The ICAI Guidance Note and the SEBI Guidelines provide the following two options in this regard:

- ▶ Determine the vesting period for each portion of the option separately, and amortize compensation cost of each such portion on a straight-line basis over the vesting period of that portion.
 - ▶ The amount of employee compensation cost shall be accounted for and amortized on a straight-line basis over the aggregate vesting period of the entire option (that is, over the vesting period of the last separately vesting portion of the option). Provided that the amount of employee compensation cost recognized, at any date, at least equals the fair value or the intrinsic value, as the case may be, of the vested portion of the option at that date.
-

Group and treasury share transactions

IFRIC 11 discusses various issues arising from such transactions. It requires the subsidiary, whose employees receive such compensation to measure services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions with a corresponding increase recognized in equity as a contribution from the parent.

Detailed guidance on issues arising from such transactions is not available. Common practice is that the entity whose employees receive such compensation does not account for any compensation cost because it does not have settlement obligation.

Income taxes

Approach

IAS 12 requires entities to account for taxation using the balance sheet liability method, which focuses on temporary differences in accounting for the expected future tax consequences of events.

Deferred tax is accounted using the Income Statement approach, which focuses on timing differences.

Recognition of deferred tax assets

Deferred tax assets should be recognized to the extent that it is probable that future profits will be available against which the deductible temporary difference can be utilized. The existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognizes a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilized by the entity.

Except when enterprise has unabsorbed depreciation or carry-forward of losses under tax laws, deferred tax assets should be recognized and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized. However, if an entity has unabsorbed depreciation or carry forward of losses under tax laws, recognition of deferred tax assets is based on different criterion. In such a case all deferred tax assets are recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realized.

Recognition of deferred tax on investment made in subsidiaries, branches, associates and joint ventures (undistributed profits)

An entity should recognize a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is not recognized.

Deferred tax arising on business combination

Deferred tax is provided on difference between fair value of assets recorded in books and tax base of those assets, unless tax base is also stepped up to fair value.

There is no single standard that comprehensively deals with business combinations. AS 21, which deals with acquisition of a subsidiary, requires acquisition accounting in the CFS based on book values rather than fair values. Hence, question of re-measuring deferred tax in CFS does not arise.

If the potential benefit of the acquiree's income tax loss carry-forwards or other deferred tax assets does not satisfy the recognition criteria for separate recognition when a business combination is initially accounted for but is subsequently realized, the acquirer shall recognize that benefit as income in accordance with IAS 12.

There is currently no specific guidance available on the matter. ICAI had earlier issued ASI 11 on the matter. Under ASI 11, if any deferred tax asset was not recognized by the acquiree at the time of initial recognition because the recognition criteria was not met and the same is subsequently satisfied, the treatment of resulting deferred tax assets in the books of the amalgamating company would depend upon whether the amalgamation is in the nature of merger or in the nature of an acquisition and whether the criteria are satisfied by the first annual balance sheet date following the amalgamation or after the first annual balance sheet date. Recently, ICAI has withdrawn ASI 11.

Recognition of deferred tax on elimination of intra-group transactions

Deferred tax should be recognized on temporary differences that arise from the elimination of profits and losses resulting from intra-group transactions.

Deferred tax is not recognized. The deferred taxes in the CFS are a simple aggregation of the deferred tax recognized by the group entities.

Recognition of deferred tax on foreign non-monetary assets/liabilities when the tax reporting currency is not the functional currency

Deferred tax is recognized on the difference between the carrying amount determined using the historical rate of exchange and the tax base determined using the balance sheet date exchange rate.

No deferred tax is recognized.

Fringe Benefits Tax (FBT)

Included as part of the related expense which gave rise to FBT.

Disclosed as a separate line item after PBT on the face of the P&L. In other words, FBT is treated at par with income tax.

The effects of changes in exchange rates

Integral and non-integral foreign operations

No distinction is made between integral and non-integral foreign operations under IAS 21. All entities are required to prepare their financial statements in functional currency. Any exchange gain/loss to record a transaction in its functional currency is recognized in profit or loss for the period. In translating the financial statements from functional currency to presentation currency, the reporting entity should use the following procedures:

- ▶ Assets and liabilities, both monetary and non-monetary, should be translated at the closing rate,
- ▶ Income and expense items should be translated at exchange rates at the dates of the transactions, and
- ▶ All resulting exchange differences should be accumulated in foreign currency translation reserve, until the disposal of the net investment.

AS 11 distinguishes between integral and non-integral foreign operations and accordingly prescribes separate accounting treatment for integral operations and non-integral one. The financial statements of an integral foreign operation should be translated using the principles and procedures as if the transactions of the foreign operation had been those of the reporting entity itself. In translating the financial statements of a non-integral foreign operation for incorporation in its financial statements, the reporting entity should use the following procedures:

- ▶ Assets and liabilities both monetary and non-monetary of the non-integral foreign operation should be translated at the closing rate,
 - ▶ Income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions, and
 - ▶ All resulting exchange differences should be accumulated in foreign currency translation reserve until the disposal of the net investment.
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Concept of functional currency

Functional currency is defined as the currency of the primary economic environment in which the entity operates. Under IAS 21, when a reporting entity prepares financial statements, each individual entity included in the reporting entity- whether it is a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch) has to determine its functional currency, and measure its results, and financial position in that currency.

There is no concept of determining the functional currency by the entities involved under AS 11. The reporting entity here has to follow the prescribed methods given, for conversion based on integral or non-integral operations of the respective entity.

Foreign currency is defined as a currency other than the reporting currency of the entity.



Acquisition and consolidation

V

IFRS	Indian GAAP
Business combinations	
Scope	
IFRS 3-R applies to most business combinations – both amalgamations (where the acquiree loses its existence) and acquisition (where the acquiree continues its existence). IFRS 3-R does not apply to business combinations under common control transactions, formation of joint ventures and acquisition of asset/group of assets that does not constitute a business.	There is no comprehensive standard dealing with all business combinations. AS 14 applies only to amalgamation, i.e., where acquiree loses its identity. AS 21, AS 23 and AS 27 apply to accounting for investments in subsidiaries, associates and joint ventures, respectively. AS 10 applies where a demerged division is acquired on a lump-sum basis by another entity.
Method of accounting	
Use of the pooling of interest is prohibited. All business combinations should be accounted under purchase method. There is no guidance under IFRS 3-R for business combination scoped out of IFRS 3-R, and therefore, these could be accounted for in a number of ways.	Amalgamations are accounted for by applying either the purchase method or the pooling of interest method. There are five conditions all of which need to be fulfilled for application of the pooling method. In addition to amalgamation, one company may purchase the shares of another company. In the stand-alone accounts of the investor, the same would be accounted for as an investment. In the CFS of the investor, the same would be accounted for as an investment, subsidiary, joint venture or associate as the case may be. Acquisition accounting under AS 21, 23 and 27 are done on book value basis. Acquisition accounting under AS 10 for lump-sum purchase is done on fair value basis. Acquisition accounting under AS 14 in respect of 'amalgamation in the nature of purchase' is done on the basis of either fair value or book value. The pooling method is required for an 'amalgamation in the nature of merger'.

Acquisition date

The date on which the acquirer effectively obtains control of the acquiree is the acquisition date.

The date of amalgamation as defined in the amalgamation/acquisition scheme is the acquisition date.

Cost of acquisition

The acquirer shall measure the cost of a business combination as the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree.

The consideration for the amalgamation may consist of securities, cash or other assets. In determining the value of the consideration, an assessment is made of the fair value of its elements.

Acquisition-related costs

An acquirer should recognize acquisition-related costs as an expense in the period incurred. However, the costs relating to the issue of debt or equity securities shall be recognized in accordance with IAS 32 and IAS 39.

There is no specific guidance on acquisition related costs. There is an EAC Opinion which requires that due diligence cost incurred for acquiring business should be expensed immediately in the period incurred.

Contingent consideration

When a business combination agreement provides for an adjustment to the cost of the combination that is contingent on future events, the acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

Subsequent adjustments to the contingent consideration are generally not adjusted to goodwill, other than for changes resulting from additional information about the facts and circumstances existing at the acquisition date, provided such additional information is obtained within a twelve month period from the date of acquisition. Other IFRS's govern subsequent accounting for contingent consideration. For example, if contingent consideration is

Under AS 14, "many amalgamations recognize that adjustments may have to be made to the consideration in the light of one or more future events. When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration. In all other cases, the adjustment is recognized as soon as the amount is determinable." There is no guidance relating to contingent consideration in situations other than amalgamation. However the practice is to adjust the goodwill amount.

Contingent consideration (cont'd.)

classified as equity, it is not remeasured subsequently. If contingent consideration is classified as derivative or financial instrument, it is measured at fair value at each reporting date and gain/loss is recognized in profit or loss for the period.

Accounting for identifiable assets and liabilities taken over

The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognizing the acquiree's identifiable assets, liabilities and contingent liabilities at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale which shall be recognized at fair value less costs to sell. It is irrelevant if the acquiree had recorded those assets/liabilities.

The acquirer shall determine the classification and designation of all assets acquired and liabilities assumed at the date of acquisition, based on the contractual terms, economic conditions, its operating or accounting policies and other relevant factors as at that date. However, in the case of leases and insurance contracts, such classification shall happen on the basis of contractual terms and other conditions at inception of contract.

Under purchase method, the transferee entity accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor entity on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor entity. No specific guidance is given for accounting of contingent liabilities and assets held for sale. However, the normal practice is not to record contingent liability in books of acquirer. Under pooling of interest method, the transferee accounts for the amalgamation by incorporating the assets/liabilities at their carrying values. Acquisition accounting under AS 21, AS 23 and AS 27 are done on book value basis. Acquisition accounting under AS 10 is done on fair value basis.

Step acquisitions

At the date of obtaining control, the acquirer re-measures any previously held equity interest to fair value and recognizes any resulting gain/loss in profit or loss for the period.

AS 21 recognizes step acquisitions; however at each step the valuation is done on the basis of book values rather than fair values.

Reverse acquisitions	
Acquisition accounting is based on substance. Accordingly, legal acquirer is treated as acquiree and legal acquiree is treated as acquirer for IFRS 3-R purposes.	Acquisition accounting is based on legal form. Legal acquirer is treated as acquirer and legal acquiree is treated as acquiree for legal as well as accounting purposes.
Restructuring provisions	
The acquirer recognizes the liability as part of the acquisition accounting only if the acquiree has an existing liability at the acquisition date in accordance with IAS 37.	Provisions are based on legal liability rather than constructive liability.
Contingent liabilities	
The acquiree's contingent liabilities are recognized separately by the acquirer at the acquisition date as part of acquisition accounting, if they are present obligation arising from past events and their fair values can be measured reliably.	Contingent liabilities are not recognized.
Minority interests at acquisition	
Minority interest is stated either at acquisition-date fair value or at non-controlling interest's proportionate share of acquiree's identifiable net assets.	Minority interest is valued at its proportionate share of historical book value of net assets.
Accounting for goodwill	
At the acquisition date, the acquirer shall recognize goodwill as an asset and measure the same as below: Cost of acquisition Plus amount of non-controlling interest Plus if business combination is achieved in stages, the acquisition-date fair value of previous equity interest in the acquiree Less net acquisition-date amount of assets acquired and liabilities assumed	Firstly, contingent liabilities are never considered for purposes of determining goodwill in business combinations. Secondly, treatment of goodwill differs in different accounting standards. Goodwill arising on amalgamation in nature of purchase is amortized to P&L A/c over five years. Goodwill arising under AS 10, AS 21, AS 23 and AS 27 need not be amortized though there is no prohibition. In case of amalgamation in nature of merger, excess amount over net assets taken over is adjusted against revenue

Accounting for goodwill (cont'd.)

After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less any accumulated impairment losses. Goodwill amortization is prohibited.

reserves. After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less any accumulated amortization and accumulated impairment losses.

Bargain purchase

If the goodwill as computed per IFRS 3-R is negative, the acquirer needs to reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination. If negative goodwill remains, this should be recognized immediately in profit or loss.

If the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized exceeds the cost of the business combination, the excess shall be disclosed as 'capital reserve'.

Subsequent adjustments to assets and liabilities

If the initial accounting for business combination is incomplete by the end of the reporting period in which the combination occurs, the financial statements are prepared using provisional amounts for the items for which the accounting is incomplete. Revised IFRS 3 permits adjustments to items recognized in the original accounting for a business combination, for a maximum of one year after the acquisition date, where new information about facts and circumstances existing at the acquisition date is obtained. Any such adjustments are made retrospectively as if those adjustments had been made at the acquisition date.

No adjustment is permitted, except for certain deferred tax adjustment.

Deferred taxation

A DTL/DTA should be recognized for differences between the assigned values and the tax base of assets/liabilities taken over. Under IAS 12, if a DTA of an acquiree, which was not recognized at the time of the combination, is

In case of amalgamation, deferred taxes would be determined based on ASI 11, which prescribes separate treatment depending upon whether the amalgamation is in the nature of merger or in the nature of an acquisition.

Deferred taxation (cont'd.)

subsequently recognized, the resulting credit is taken to income for the period, except for adjustments arising from new information about the facts and circumstances existing at the acquisition date, and provided the initial accounting for income-taxes was provisional.

Pre-existing relationships, re-acquired rights, indemnification assets and replacement share-based payment awards

IFRS 3-R specifically deals with initial recognition as well as subsequent accounting for pre-existing relationships, re-acquired rights, indemnification assets, and replacement share-based payment awards. It requires a reacquired right/pre-existing relationship to be recognized separately from goodwill. An indemnification asset is initially measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible items.

Accounting for Replacement SBP depends on whether acquirer is under an obligation to replace the acquiree awards. If it was not obliged to replace those awards and does so voluntarily, none of the market-based measure of the awards is included in measuring the consideration transferred in the business combination. If it was obliged to replace, a portion of the replacement is consideration for the combination and remainder is a post-combination remuneration expense.

There is no specific guidance under Indian GAAP.

Consolidated and separate financial statements

Presentation of Consolidated Financial Statements (CFS)

Each parent shall present CFS in which it consolidates its subsidiaries except the parent which satisfies certain conditions.	It is not mandatory for entities to prepare CFS under AS 21. However, SEBI requires all listed entities to prepare and present CFS.
CFS includes all subsidiaries.	Preclude consolidation of a subsidiary when: ▶ Control is intended to be temporary because it is acquired and held exclusively with a view to its subsequent disposal in the near future (i.e., twelve months), or ▶ It operates under severe long term restrictions, which significantly impair its ability to transfer funds to the parent. In the CFS, such subsidiaries are accounted under AS 13 and the reasons for not consolidating are disclosed.

Meaning of subsidiary

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent). Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Under IAS 27-R, control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. The definition of 'control' is based on substance rather than form and an entity can obtain control over the other entity without holding more than one-half of the voting power of the other	A subsidiary is an entity that is controlled by another entity (known as the parent). Control means, a. the ownership, directly or indirectly through subsidiary/subsidiaries, of more than one-half of the voting power of an entity, or b. control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case for any other entity so as to obtain economic benefits from its activities. Under ASI 24, an entity can be subsidiary of two entities when, as per the definition of the term 'control' the entity is controlled by both entities – one by control over the governing body and other through majority in voting power.
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Meaning of subsidiary (cont'd.)

entity and without having control of the composition of the board of directors, e.g., it can have control pursuant to agreement with other shareholders.

SIC 12 states that a Special Purpose Entity (SPE) should be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity.

There is no specific guidance available for consolidation of SPE.

Determination of control – potential voting rights

The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

Under ASI 18, potential voting rights are not considered for determining significant influence in the case of an associate. An analogy can be drawn that they are not to be considered for determining control in the case of a subsidiary, as well.

Separate financial statements

An entity which is exempt from preparing CFS is specifically required to prepare separate financial statements. IAS 27-R requires that a parent's investment in a subsidiary be accounted for in the separate financial statements:

- ▶ At cost, or
- ▶ As available-for-sale financial assets as described in IAS 39.

Under Indian GAAP, all entities are required to prepare and present separate financial statements, without any exception. Under AS 21, in a parent's separate financial statements, investments in subsidiary should be accounted for in accordance with AS 13, AS 13 requires such investments to be valued at cost as adjusted for any diminution, other than temporary in the value of those investments.

Recently with the issuance of accounting standards on financial instruments, the ICAI has also made a limited revision to AS 21. As per the revision, a parent's investment in a subsidiary be accounted for in the separate financial statements:

Separate financial statements (cont'd.)

- At cost, or
- Under AS 30.

This revision is recommended for periods beginning on or after 1 April 2009 and mandatory for periods beginning on or after 1 April 2011.

Consolidation procedures

Intra-group elimination

Intra-group balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intra-group transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full. Intra-group losses may indicate an impairment that requires recognition in the CFS. Deferred tax should be calculated on temporary differences that arise from the elimination of profits and losses resulting from intra-group transactions.

Similar to IFRS, except no deferred tax is recognized on elimination of intra-group transactions.

Losses of subsidiary

Under IAS 27-R, losses incurred by the subsidiary have to be allocated between the parent and non-controlling interests, even if this results in deficit balance of non-controlling interest.

The losses exceeding the minority interest in the equity of the subsidiary, have to be adjusted against the majority interest, except to the extent that the minority has a binding obligation to, and is able to make good the losses.

Reporting periods

The financial statements of the parent and its subsidiaries used in the preparation of the CFS shall be prepared as at the same reporting date. When the financial statements of a subsidiary used in the preparation of CFS are prepared as of a reporting date different from that of the parent, adjustments shall be made for the effects of significant transactions or events, that occur

Similar to IFRS, except that the difference between reporting dates should not be more than six months.

Reporting periods (cont'd.)

between that date and the date of the parent's financial statements. In any case, the difference between the reporting date of the subsidiary and that of the parent shall be no more than three months.

Uniform accounting policies

Compliance with uniform accounting policies is mandatory.

CFS should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the CFS, that fact should be disclosed together with the proportions of the items in the CFS to which the different accounting policies have been applied.

Non-controlling interest

Non-controlling interests shall be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent. Non-controlling interests in the comprehensive income of the group shall also be separately presented.

Minority interests should be presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders. Minority interests in the profit or loss of the group should also be separately presented.

Changes in ownership interest that does not result in loss of control

Changes in the ownership interest of a subsidiary (that do not result in loss of control) will be accounted for as an equity transaction and will have no impact on goodwill nor will it give rise to gain or loss in the statement of comprehensive income.

No specific guidance under AS 21 is available. However, the common practice is to account for gain/loss on such transactions as adjustment to goodwill or capital reserve on acquisition.

Loss of control

In calculating the gain/loss arising from the loss of control, retained interest in the former subsidiary is measured at its fair value at the date when control is lost.

The carrying amount of the investment at the date on which an entity ceases to be its subsidiary is regarded as cost thereafter.

Investments in associates

Mutual funds and venture capital organizations

IAS 28 does not apply to investments in associates held by mutual funds, or venture capital organizations, etc., that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with IAS 39.

There is no such exemption under AS 23. Thus, entities such as mutual funds and venture capital organizations would be required to account for their investments in associates under AS 23 in their CFS. Recently, with the issuance of accounting standards on financial instruments, ICAI has also made a limited revision to AS 23. As per the revision, a similar exclusion has been provided in AS 23 also. This revision is effective for periods beginning on or after 1 April 2009 and is not mandatory for a period of two years.

Significant influence

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. If an investor holds, directly or indirectly (e.g., through subsidiaries), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.

Under AS 23, significant influence is the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies. The word 'or' is not there in IAS 28. Therefore, under IFRS, to have significant influence, the entity needs to have the power to participate in both the financial and operating policies, whereas, under AS 23, either one would suffice to determine significant influence. The other aspects of definition are the same as IFRS.

The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence.

Under ASI 18, potential voting rights are not considered for determining significant influence in the case of an associate.

Method of accounting

An investment in associate should be accounted using equity method of accounting. Goodwill determination is based on fair values of the assets and liabilities of the investee. Goodwill relating to associate is included in the carrying amount of investment. If this calculation results in gain, i.e., an investor's share of the fair value of the associate's net assets exceeds the cost of the investment, the excess is included as income in determination of the investor's share of the associate's profit or loss for the period in which the investment is acquired.

Indian GAAP is similar to IFRS, except that goodwill determination is based on carrying values rather than fair values of the assets and liabilities of the investee. Any gain arising on the acquisition of an investment is accounted for as capital reserve.

Profits and losses resulting from transactions between an investor and an associate are recognized in the investor's financial statements only to the extent of unrelated investor's interest in the associate. Therefore, the investor's share in the associate's profits and losses resulting from these transactions is eliminated.

In using the equity method for accounting for an investment in an associate, unrealized profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealized losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.

In separate financial statements, investments are carried at cost or in accordance with IAS 39.

In separate financial statements, investments are carried at cost less other than temporary decline in value of investments.

Recently, with the issuance of accounting standards on financial instruments, ICAI has also made a limited revision to AS 23. As per the revision, investment in an associate be accounted for in the separate financial statements either:

- At cost, or
- In accordance with AS 30.

This revision is effective for periods beginning on or after 1 April 2009 and is recommended only for a period of two years.

Method of accounting (cont'd.)

After applying the equity method, the investor applies the requirements of IAS 39 to determine whether it is necessary to recognize any impairment loss with respect to the investor's net investment in the associate. Whilst IAS 39 is used to determine whether it is necessary to recognize any further impairment, the amount of any impairment is calculated in accordance with IAS 36. An investment in an associate is treated as a single asset for the purpose of conducting impairment test, including any reversal of impairment. Therefore, any impairment is not separately allocated to any assets including goodwill included in investment.

There is no specific requirement for impairment testing of an investment in associate after applying the equity method.

Exceptions to equity accounting

An investment in an associate shall be accounted for using the equity method except when:

- ▶ An investment in associate held for sale is accounted in accordance with IFRS 5,
- ▶ The reporting entity is also a parent and is exempt from preparing CFS under IAS 27-R
- ▶ The reporting entity is not a parent, and
 - ▶ The investor is a wholly owned subsidiary itself (or a partially owned subsidiary), and its other owners, including those not entitled to vote, have been informed about and do not object to the investor not applying the equity method,
 - ▶ The investor's debt/equity are not publicly traded,

Equity method is required to be applied only if the entity prepares CFS. Where the reporting entity is not a parent, but has associates, it should not apply the equity method to its associates.

The equity method is also not applied when:

- ▶ The investment is acquired and held with a view to its subsequent disposal in the near future, or
- ▶ The associate operates under severe long term restrictions which significantly impair its ability to transfer funds to the investor.

An investment in such associates is accounted for under AS 13.

Exceptions to equity accounting (cont'd.)

- ▶ The investor is not planning a public issue of any of its class of instruments, and
- ▶ The ultimate or any immediate parent of the investor produces CFS available for public use that comply with IFRS.

Where the reporting entity is not a parent, but has associates, it will need to apply equity method to its associates in its own financial statements, if any of the above exemptions does not apply. These financial statements are not separate financial statements.

Reporting periods

The most recent available financial statements of the associate are used by the investor in applying the equity method. When the end of the reporting periods of the investor and the associate are different, the associate prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor unless it is impracticable to do so. The financial statements of an associate used in applying the equity method, if prepared as of a different date from that of the investor, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the investor's financial statements. In any case, the difference between the end of the reporting periods of the associate and that of the investor shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.

The most recent available financial statements of the associate are used by the investor in applying the equity method. They are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle requires that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period. When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor (or its consolidated subsidiaries) and the associate that occur between the date of the associate's financial statements and the date of the investor's consolidated financial statements. Unlike IFRS, there is no limit of three months for difference between the reporting dates.

Uniform accounting policies

The investor's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.

Investor usually prepares CFS using uniform accounting policies for the like transactions and events in similar circumstances. If it is not practicable to do so, that fact is disclosed along with a brief description of the differences between the accounting policies.

Display of goodwill

Goodwill included within the investment amount is not required to be separately identified.

Goodwill or capital reserves within the investment amount are required to be separately identified.

Disposition of associate

An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and shall account for the investment in accordance with IAS 39 from that date, provided the associate does not become a subsidiary or a joint venture. On the loss of significant influence, the investor shall measure any retained interest in its former associate at fair value and consider the same for calculation of gain/loss arising on disposition. The fair value of the investment at the date is regarded as fair value on initial recognition in accordance with IAS 39. If an investor loses significant influence over an associate, the investor shall also account for all amounts previously recognized in other comprehensive income in relation to that associate in profit or loss for the period.

The carrying amount of the investment at the date on which an entity ceases to be its associate is regarded as cost thereafter.

Financial reporting of interests in joint ventures

Mutual funds and venture capital organizations

IAS 31 does not apply to interests in joint ventures held by mutual funds or venture capital organizations, etc., that upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with IAS 39.

There is no such exemption under AS 27. Thus, entities such as mutual funds and venture capital organizations would be required to account for their interests in joint ventures under AS 27 in their CFS. Recently, with the issuance of accounting standards on financial instruments, ICAI has also made a limited revision to AS 27. As per the revision, a similar exclusion has been provided in AS 27 also. This revision is effective for periods beginning on or after 1 April 2009 and shall be recommended only for a period of two years.

Definition of joint venture

A joint venture is a contractual arrangement, whereby, two or more parties undertake an economic activity that is subject to joint control. Activities that have no contractual arrangement to establish joint control are not joint ventures.

The guidance is similar to that in IFRS. However, sometimes though a contractual arrangement may suggest a joint venture, the investee is accounted as a subsidiary if the investors share in the investee's equity is greater than 50%.

Accounting for Jointly Controlled Entities (JCEs)

IAS 31 prescribes proportionate consolidation method or equity method for recognizing interest in a jointly controlled entity in CFS. Equity method prescribed in IAS 31 is similar to that prescribed in IAS 28. However, the proportionate method of accounting is the more recommended approach.

Accounting for jointly controlled entities is required to be done using proportionate consolidation method.

Exceptions to JV accounting

Where the reporting entity is not a parent, but has JCE, it will need to equity account or proportionately consolidate its joint ventures in its own financial statements.

Proportionate consolidation is required to be applied only if the entity prepares CFS. Where the reporting entity is not a parent, but has JCE, it should not apply proportionate consolidation to its JCE.

Exceptions to JV accounting (cont'd.)

In separate financial statements, JCE are accounted at cost or in accordance with IAS 39.

In separate financial statements, JCE are accounted at cost less other than temporary decline in value of investments.

Recently, with the issuance of accounting standards on financial instruments, ICAI has also made a limited revision to AS 27. As per the revision, interest in JCE be accounted for in the separate financial statements either:

- At cost, or
- In accordance with AS 30.

This revision is effective for periods beginning on or after 1 April 2009 and shall be recommended for a period of two years.

Reporting periods

The most recent available financial statements of the JCE are used by the venturer. In any case, the difference between the reporting date of the JCE and that of the venturer shall be no more than three months.

The financial statements of the JCE used in applying proportionate consolidation are usually drawn up to the same date as the financial statements of the venturer. When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference in reporting dates is not more than six months.

Uniform accounting policies

The venturer's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.

The venturer usually prepares consolidated financial statements using uniform accounting policies for like transactions and events in similar circumstances. If it is not practicable to do so, that fact is disclosed together with the proportion of the items in the CFS to which different accounting policies have been applied.

Disposing of a joint venture

When an investor ceases to have joint control over an entity, it shall account for any remaining investment in accordance with IAS 39 from that date, provided that the former jointly controlled entity does not become a subsidiary or associate.

From the date of discontinuing the use of the proportionate consolidation, interest in a jointly controlled entity should be accounted for:

- ▶ In accordance with AS 21, if the venturer acquires unilateral control over the entity and becomes parent within the meaning of that Standard, and
 - ▶ In all other cases, as an investment in accordance with AS 13, or in accordance with AS 23, as appropriate. For this purpose, cost of the investment should be determined as under:
 - ▶ The venturer's share in the net assets of the jointly controlled entity as at the date of discontinuance of proportionate consolidation should be ascertained, and
 - ▶ The amount of net assets so ascertained should be adjusted with the carrying amount of the relevant goodwill/capital reserve as at the date of discontinuance of proportionate consolidation.
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Financial instruments

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Financial instruments

Under Indian GAAP, till recently, there was no accounting standard dealing with accounting for financial instruments in a comprehensive manner. To deal with the accounting of such instruments, the ICAI has issued AS 30, AS 31 and AS 32. These standards are effective from accounting period commencing on or after 1 April 2009 and will be recommendatory in nature for a period of two years. Also, these standards have not been notified under the Companies Act, 1956, as yet. Keeping this in view, the comparison given below for financial instruments is without considering the impact of these Standards. The comparison, however, has considered *ICAI Announcement – Accounting for Derivatives* issued on 29 March 2008.

Definition of financial instrument

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- ▶ cash,
- ▶ an equity instrument of another entity,
- ▶ contractual right:
 - ▶ to receive cash or another financial asset from another entity, or
 - ▶ to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity, or
- ▶ a contract that will or may be settled in the entity's own equity instruments, and is:
 - ▶ a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or

No specific standard on financial instruments.

Definition of financial instrument (cont'd.)

- a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

For this purpose, the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

- A contractual obligation:
 - to deliver cash or another financial asset to another entity, or
 - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity, or
- A contract that will or may be settled in the entity's own equity instruments, and is:
 - a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or
 - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

For this purpose, the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

Classification of financial instrument between liability and equity

The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument.

The instrument is an equity instrument if, and only if, both conditions mentioned below are met:

1. The instrument includes no contractual obligation:
 - ▶ to deliver cash or another financial asset to another entity, or
 - ▶ to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.
2. If the instrument will or may be settled in the issuer's own equity instruments, it is a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments, or a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

There is no specific standard on financial instruments. Classification based on form rather than substance. Preference shares are treated as capital, even though, in many cases, in substance, it may be a liability.

Treasury shares

If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognized in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments.

There is no specific standard on financial instruments. When an entity's own shares are repurchased, the shares are cancelled and shown as a deduction from shareholders' equity (they cannot be held as treasury stock). If the buy back is funded through free reserves, amount

Treasury shares (cont'd.)	
Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognized directly in equity.	equivalent to buy-back should be credited to Capital Redemption Reserve. Various alternatives are available for accounting premium payable on buy-back- adjusting the same against securities premium, etc.
Financial assets	
Financial assets are classified in four categories: ▸ financial asset at fair value through profit or loss, ▸ held to maturity, ▸ loans and receivables, and ▸ available for sale.	There is no specific standard on financial instruments. AS 13 classifies investments into long-term and current investments.
Traded category and those designated as FVPL are mark-to-market with changes taken to the income statement.	Under AS 13, current investments are measured at lower of cost or market value.
For held-to-maturity investments, initial measurement is at fair value plus transaction cost. Subsequent measurement is at amortized cost using effective interest method.	There is no specific standard on financial instruments. Long-term investments are carried at cost less provision for diminution for decline, other than temporary, in the value of investments. Interest is recognized on time proportion basis.
For loans and receivables, initial measurement is at fair value plus transaction cost. Subsequent measurement is at amortized cost using effective interest method.	There is no specific standard on financial instruments. Loans and receivables are stated at cost. Interest income on loans is recognized on time-proportion basis at the rates mentioned in loan agreement.
For AFS investments, initial measurement is at fair value plus transaction cost. Subsequent measurement is at fair value. Changes in fair value are accounted in equity and are recycled to income statement when investments are realized or impaired.	There is no specific standard on financial instruments. No such classification. All investments are classified into long-term and current investments.

Reclassification of financial assets

Reclassifications between categories are relatively uncommon under IFRS and are generally prohibited into and out of the fair value through profit or loss category.

However, an entity may, on certain conditions being met, reclassify some non-derivative financial assets out of the held-for-trading category:

- ▶ into loans and receivables, or
- ▶ in rare circumstances, into available-for-sale or held-to-maturity category.

Reclassifications from the held-to-maturity category as a result of a change of intent or ability are treated as sales and, other than in exceptional circumstances, result in the whole category being 'tainted'. The most common reason for a reclassification out of the category, therefore, is when the whole category is tainted and has to be reclassified as available-for-sale for two years.

There is no specific standard on financial instruments. Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer. Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

Recognition of impairment

An entity shall assess at each balance sheet date whether there is any objective evidence, that a financial asset or group of financial assets is impaired.

Current investments are recorded at lower of cost or market price. On long term investments, diminution other than temporary is provided for.

Reversal of impairment

For assets carried at amortized cost and AFS debt securities, if the amount of the impairment loss decreases in a subsequent period and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss shall be reversed. IAS 39 prohibits the reversal of an

Any reversal of reduction in impairment loss are credited to the profit and loss account.

Reversal of impairment (cont'd.)

impairment charge on AFS equity securities through profit or loss. IFRS prohibits reversal of impairment on unquoted equity instruments which are carried at cost because their fair value can not be measured reliably.

Derecognition

An entity shall derecognize a financial asset when:

- ▶ the contractual rights to the cash flows from the financial asset expire,
 - ▶ when the entity has transferred substantially all risks and rewards from the financial assets, or
 - ▶ when the entity has:
 - ▶ neither transferred substantially all, nor retained substantially all, the risks and rewards from the financial asset, but
 - ▶ at the same time has assumed an obligation to pay those cash flows to one or more entities and if the entity has not retained control of the asset.
-

The ICAI *Guidance Note on Accounting for Securitisation* requires derecognition of financial asset if the originator loses control of the contractual rights that comprise the securitized assets.

Financial liability

Classification and measurement

Financial liabilities are classified into two categories:

1. financial liability at fair value through profit or loss, and
2. residual category.

Initial measurement is at fair value, less transaction cost in case of financial liabilities not at fair value through profit or loss. Subsequently, financial liabilities at fair value through profit or loss are measured at fair value and the change is recognized in the income statement for the period.

There is no specific standard on financial instruments. Liabilities are normally carried at amount received. Interest expense on liabilities is recognized on time-proportion basis at the rates mentioned in the loan agreement.

Classification and measurement (cont'd.)

All other (non-trading) liabilities are carried at amortized cost. Gains or losses are recognized in the income statement through the amortization process.

Derecognition

IAS 39 provides detailed guidance on derecognition of a financial liability.

There is no specific standard on financial instruments.

Derivatives and hedging

Definition

IAS 39 provides definition of derivative.

The Announcement on 'Disclosures regarding Derivative Instruments', issued by the ICAI, explains the meaning of derivatives in the same manner as IAS 39.

Measurement of derivatives

Derivatives are initially recognized at fair value. After initial recognition, an entity shall measure derivatives at their fair values, without any deduction for transaction costs. Changes in fair value are recognized in income statement unless it satisfies hedge criteria. Embedded derivatives need to be separated and fair valued.

AS 11 deals with forward exchange contracts and the *Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options* deals with futures contracts and options on equity index and equity stock. As required by the ICAI Announcement on *Accounting for Derivatives*, losses are required to be recognized on all derivatives not covered under AS 11, keeping in view the principle of prudence as enunciated in AS 1. No specific guidance on embedded derivatives.

Hedge accounting

Criteria for hedge accounting

Hedge accounting is permitted if at the inception of the hedge and on an ongoing basis, the hedge will be highly effective within the 80% to 125% range. Stringent documentation criteria have also been prescribed.

No specific standard on financial instruments. In India, presently, AS 11 deals with forward exchange contracts entered into for hedging foreign currency risk of foreign currency assets and liabilities. AS 11 does not lay down any specific guidelines for determining hedge effectiveness, rather, the treatment is based on the purpose for which such contracts are entered into.

Hedged items, hedging instruments and hedge relationships	
IAS 39 provides detailed guidance on hedged items, hedging instruments and hedge relationships.	No specific standard on financial instruments.
Measurement	
IAS 39 provides detailed guidance on hedge accounting.	Under AS 11, the premium or discount arising at the inception of a forward exchange contract entered into for hedging purposes should be amortized as expense or income over the life of the contract. Exchange differences on such a contract should be recognized in the statement of profit and loss of the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognized as income or as expense for the period.
Financial instruments: disclosures	
IFRS 7 require entities to provide detailed disclosures in their financial statements that enable users to evaluate: ▶ the significance of financial instruments for the entity's financial position and performance, and ▶ the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks The disclosures required under IFRS 7 include quantitative as well as qualitative information.	The announcement on 'Disclosure regarding Derivative Instruments', issued by the ICAI, requires the following disclosures to be made in the financial statements: ▶ category-wise quantitative data about derivative instruments that are outstanding at the balance sheet date, ▶ the purpose, viz., hedging or speculation, for which such derivative instruments have been acquired, and ▶ the foreign currency exposures that are not hedged by a derivative instrument or otherwise.



Industry
related

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IFRS	Indian GAAP
Accounting for agricultural produce or biological asset	
Biological asset or agricultural produce	
IAS 41 provides detailed guidance on recognition and measurement of agricultural produce or biological asset at their fair value less estimated point-of-sale cost.	There is no specific guidance under Indian GAAP.
Exploration for and evaluation of natural resources	
Measurement at cost	
Exploration and evaluation assets shall be measured at cost. An entity shall determine a policy, specifying which expenditures are recognized as exploration and evaluation assets, and apply the policy consistently.	There is no specific standard apart from the <i>Guidance Note on Accounting for Oil and Gas Producing Activities</i> .
Measurement after recognition	
After recognition, an entity shall apply either the cost model or the revaluation model to the exploration and evaluation assets. If the revaluation model is applied, it shall be consistent with the classification of the assets.	There is no specific standard apart from <i>Guidance Note on Accounting for Oil and Gas Producing Activities</i> .

Appendix



Listing of IFRS

IFRS

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments

IAS

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Balance Sheet Date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits

IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture

IFRIC

- IFRIC 1** Changes in Existing Decommissioning, Restoration and Similar Liabilities
- IFRIC 2** Members' Shares in Co-operative Entities and Similar Instruments
- IFRIC 4** Determining whether an Arrangement contains a Lease
- IFRIC 5** Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- IFRIC 6** Liabilities arising from Participating in a Specific Market-Waste Electrical and Electronic Equipment
- IFRIC 7** Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
- IFRIC 8** Scope of IFRS 2
- IFRIC 9** Reassessment of Embedded Derivatives
- IFRIC 10** Interim Financial Reporting and Impairment
- IFRIC 11** IFRS 2 – Group and Treasury Share Transactions
- IFRIC 12** Service Concession Arrangements
- IFRIC 13** Customer Loyalty Programmes
- IFRIC 14** IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

IFRIC 15 Agreements for Construction of Real Estate

IFRIC 16 Hedges of a Net Investment in a Foreign Operation

IFRIC 17 Distributions of Non-Cash Assets to Owners

SIC

- SIC 7** Introduction of the Euro
- SIC 10** Government Assistance - No Specific Relation to Operating Activities
- SIC 12** Consolidation - Special Purpose Entities
- SIC 13** Jointly Controlled Entities - Non-Monetary Contributions by Venturers
- SIC 15** Operating Leases – Incentives
- SIC 21** Income Taxes – Recovery of Revalued Non-Depreciable Assets
- SIC 25** Income Taxes – Changes in the Tax Status of an Entity or its Shareholders
- SIC 27** Evaluating the Substance of Transactions Involving the Legal Form of a Lease
- SIC 29** Disclosure – Service Concession Arrangements
- SIC 31** Revenue – Barter Transactions Involving Advertising Services
- SIC 32** Intangible Assets – Website Costs

Listing of abbreviations

AFS	Available-for-Sale	IRDA	Insurance Regulatory and Development Authority
ARO	Asset Retirement Obligations	IRU	Indefeasible Right to Use
ASB	Accounting Standards Board	KPO	Knowledge Process Outsourcing
AS	Indian Accounting Standards	L&R	Loans & Receivables
BPO	Business Process Outsourcing	M&E	Media and Entertainment
CESR	Committee of European Securities Regulators	MCA	Ministry of Corporate Affairs
CFS	Consolidated Financial Statements	NACAS	National Advisory Committee on Accounting Standards
CFO	Chief Finance Officers	NPA	Non- Performing Asset
CGU	Cash-Generating Unit	OCI	Other Comprehensive Income
CODM	Chief Operating Decision Maker	RBI	Reserve Bank of India
EAC	Expert Advisory Committee of ICAI	ROI	Return on Investments
ESOP	Employee Stock Option Plan	R&D	Research and Development
EPS	Earning Per Share	SBP	Share Based Payments
EU	European Union	SEBI	Securities and Exchange Board of India
FVPL	Fair Value through Profit or Loss	SEC	US Securities and Exchange Commission
GAAP	Generally Accepted Accounting Principles	SIC	Standing Interpretations Committee
HFT	Held-for-Trading	SOCIE	Statement of Changes in Equity
HTM	Held-to-Maturity	SORIE	Statement of Recognized Income and Expenses
IAS	International Accounting Standards	SCI	Statement of Comprehensive Income
IASB	International Accounting Standards Board	SOX	Sarbanes-Oxley
IASC	International Accounting Standard Committee	SPE	Special Purpose Entities
IBNR	Incurred But Not Recognized	SPV	Special Purpose Vehicle
ICAI	The Institute of Chartered Accountants of India	VCF	Venture Capital Funds
IFRIC	International Financial Reporting Interpretations Committee	VCC	Venture Capital Company
IFRS	International Financial Reporting Standards	VRS	Voluntary Retirement Scheme
		US GAAP	US Generally Accepted Accounting Practice

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