

Understanding IFRS

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BACKGROUND:

International Financial Reporting Standards (IFRS) came into prominence when the EU (European Union) decided to adopt it for all its members starting 2005. Since then, IFRS has spread rapidly across the world.

There are now more than 100 countries where IFRS is required or permitted. The Institute of Chartered Accountants of India (ICAI) decided that Indian Accounting Standards will be fully in line with the IFRS from April 1, 2011, for public listed companies and extended to other entities in a phased manner.

The CFO of today is confronted with the challenge of multitude of reporting under different accounting frameworks, points out Mr Sanjay Hegde, executive director, PricewaterhouseCoopers. A single set of robust and well-understood standards is far more effective in promoting high-quality financial reporting than a complex body of accounting literature, he adds.

“The ICAI’s roadmap to convergence with IFRS would not only save companies undertaking significant reconciliation procedures, which otherwise results in additional costs and the risk of being exposed to errors in reporting under the different accounting frameworks, but also significantly enhances the quality of financial reporting.”

STRUCTURE OF IFRS:

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

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

QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS:

The Framework describes the qualitative characteristics of financial statements as having,

- ☐ Understandability
- ☐ Relevance
- ☐ Reliability
- ☐ Comparability
- ☐ Materiality
- ☐ Neutrality
- ☐ Substance over form
- ☐ Faithful representation
- ☐ Prudence
- ☐ Predictability

MEASUREMENT OF THE ELEMENTS OF FINANCIAL STATEMENTS:

Measurement is how the responsible accountant determines the monetary values at which items are to be valued in the income statement and balance sheet. The basis of measurement has to be

selected by the responsible accountant. Accountants employ different measurement bases to different degrees and in varying combinations. They include, but are not limited to:

- Historical cost
- Current cost
- Realizable (settlement) value
- Present value

Historical cost is the measurement basis chosen by most accountants

CONTENT OF FINANCIAL STATEMENTS:

IFRS financial statements consist of

- Statement of Financial Position.
- Comprehensive income statement
- either a statement of changes in equity(SOCE) or a statement of recognized income or expense ("SORIE")
- a cash flow statement or statement of cash flows
- notes, including a summary of the significant accounting policies

PRESENT IFRS STATEMENTS STATUS:

The following IFRS statements are currently issued:

1. IFRS 1 First time Adoption of International Financial Reporting Standards.
2. IFRS 2 Share-based Payment
3. IFRS 3 Business Combinations
4. IFRS 4 Insurance Contracts
5. IFRS 5 Non-current Assets Held for Sale and Discontinued Operations
6. IFRS 6 Exploration for and Evaluation of Mineral Resources
7. IFRS 7 Financial Instruments: Disclosures
8. IFRS 8 Operating Segments
9. IAS 1: Presentation of Financial Statements
10. IAS 2: Inventories
11. IAS 7: Cash Flow Statements
12. IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors
13. IAS 10: Events After the Balance Sheet Date
14. IAS 11: Construction Contracts
15. IAS 12: Income Taxes
16. IAS 14: Segment Reporting (superseded by IFRS 8 on January 1, 2008)
17. IAS 16: Property, Plant and Equipment
18. IAS 17: Leases
19. IAS 18: Revenue
20. IAS 19: Employee Benefits
21. IAS 20: Accounting for Government Grants and Disclosure of Government Assistance
22. IAS 21: The Effects of Changes in Foreign Exchange Rates
23. IAS 23: Borrowing Costs
24. IAS 24: Related Party Disclosures
25. IAS 26: Accounting and Reporting by Retirement Benefit Plans
26. IAS 27: Consolidated Financial Statements
27. IAS 28: Investments in Associates
28. IAS 29: Financial Reporting in Hyperinflationary Economies
29. IAS 31: Interests in Joint Ventures
30. IAS 32: Financial Instruments: Presentation
31. IAS 33: Earnings Per Share
32. IAS 34: Interim Financial Reporting
33. IAS 36: Impairment of Assets
34. IAS 37: Provisions, Contingent Liabilities and Contingent Assets
35. IAS 38: Intangible Assets
36. IAS 39: Financial Instruments: Recognition and Measurement

37.IAS 40: Investment Property

38.IAS 41: Agriculture

ADOPTION OF IFRS IN VARIOUS PART OF WORLD:

At present the IFRS are used in many parts of the world, including the

1. European Union,
2. Hong Kong,
3. Australia,
4. Malaysia,
5. Pakistan,
6. GCC countries,
7. Russia,
8. South Africa,
9. Singapore,
10. Turkey.

NEEDED, NEW PRIORITIES BEFORE ADOPTION OF IFRS:

IFRS's adoption by 2011 is expected to have a significant impact on all stakeholders, such as the ICAI, chartered accountants, regulators, preparers of financial statements, analysts, users of financial information, and so on.

The second priority, he says, should be for the ICAI to set up a formal accreditation process and impart IFRS training to existing as well as prospective members before 2011. "That is not going to be an easy task."

The importance of accounting literature and the changes that are occurring in the same due to the convergence projects cannot be undermined "as these will now play an even greater part in the structuring of businesses, acquisitions, amalgamations, etc., and will also be a major agenda in audit committees and board meetings henceforth."

With 2011 as the target date of IFRS adoption, preparers and regulators have four years to deliberate, apply and appreciate the consequences of these standards, which would ensure a smooth transition to IFRS, says Mr Hegde. "Therefore, it is advisable to adopt IFRS in phases, wherein listed entities may be required to adopt earlier than the non-listed entities."

ARDUOUS AND LONG DISTANCE:

Though the road to convergence seems long and difficult, many companies in India may already be preparing reporting packs under IFRS to meet the reporting requirements of their foreign parent or to meet their individual listing requirements in international markets.

But there are differences, though Indian standards are basically modelled on the basis of IFRS. "Significant differences exist between the two since Indian GAAP has not been able to keep pace with the changes that have taken place in IFRS," rues Mr Arora. "An example is accounting for amalgamations and mergers. Indian GAAP is very liberal. Another area of major difference is preparation of consolidated financial statements."

ROAD MAP:

Convergence of accounting standards across the globe is gaining increasing momentum. The Institute of Chartered Accountants of India (ICAI) has released a concept paper with KPMG on the Convergence with IFRSs in India, which details the strategy and roadmap for convergence of Generally Accepted Accounting Standards in India (Indian GAAP).

The KPMG report attempts to look into the following set of questions:

- 1) What are the potential benefits of converging to IFRS?

2) Is convergence realistic and feasible and what are the challenges to convergence in India?

3) How would converging with IFRS affect the financial position and financial performance reported by corporate India and what are the significant areas of impact?

4) What approach should be followed by individual companies to transition to IFRS?

BENEFITS OF CONVERGENCE:

- IFRS provides more compatibility among sectors, countries and companies. Due to its universal appeal, it can both improve and initiate new relationships with investors, customers and suppliers across the globe
- IFRS provides impetus to cross- border acquisitions, enables partnerships & alliances with foreign entities
- IFRS gives better access to global capital markets and reduces the cost of capital

CHALLENGES TO CONVERGENCE:

- The success of the convergence effort in India will depend on co-operation received by ICAI from the government, regulators, tax authorities, courts & tribunals
- Adoption of IFRS by approximately 5000 listed companies by 2011 would result in a significant demand for IFRS resources
- Due to the significant differences between Indian GAAP and IFRS, adoption of IFRS is likely to have a significant impact on the financial position and financial performance of most Indian companies

CRITICAL SUCCESS FACTORS FOR IFRS

- IFRS requires senior management to take responsibility for the project and to demonstrate clear leadership and sponsorship throughout its implementation
- Conversion teams typically need to include specialists with a wide range of professional background.

PROFESSIONAL OPPORTUNITIES FOR SMALL & MIDSIZE FIRMS:

Inside the growing footprint of IFRS lies something many small and midsize CA firms may be overlooking—rich opportunities for business development.

IFRS-related work in the India has largely been the domain of major accounting firms thus far. While national firms are filling many of the needs, there's a large space that small and midsize firms can occupy given the right positioning, knowledge and resources.

To carve out an international niche, firms must be realistic about the challenges. Reaching critical mass as you grow your IFRS client base will take time. Building IFRS bench strength inside your firm will likewise take a commitment. The effort may mean an outflow of cash for the first couple of years. Yet for small and regional firms willing to put in the work, developing that kind of niche can ultimately drive profit.

The Indian professional now trained under IFRS could well become a globe trotter. Even if a home bird, he still would be sought after by accounting firms and Indian entities converging to IFRS. "With the world changing to IFRS, BPO/KPO businesses in India would have a massive requirement for

IFRS resources, and Indian IFRS literate resources could feed this appetite and provide a huge fillip to this sector.”

CONCLUSION:

Despite its several advantages, there is feels that convergence would be a “challenge in view of the conflicting legal and regulatory requirements related to financial statements, the technical preparedness of industry and accounting professionals and economic environment prevailing in the country.” Another concept which will have a major impact is the greater use of fair-value measurement in international standards. Do markets in India possess the necessary depth and breadth for providing reliable fair values on measurement of various assets and liabilities,” This would require availability of valuation experts and comprehensive guidance on fair-value measurements under different situations and on the basis of relatively objective criteria.”

The adoption of IFRS in India would be a landmark achievement and a significant step towards global acceptability of Indian corporate and professionals.