An Insight to IFRS:

Why we need it and if we need why it is delayed

In the field of Accounting, we are expected to start a new reporting procedure coined as IFRS. It was to be applicable from 1st April 2011 but current status is not known but certainly not from April 2011. I do not pretend to be an expert in the field of IFRS. I however, being a Chartered Accountant Student, love this subject and it is my attempt to have glimpses of the journey of IFRS and pros and cons and why it's yet a bane to implement.

History and Development

All of us have studied, in the 11th standard only, the golden rules of bookkeeping, leading us to various types of accounts. Through the medium of real, personal and nominal accounts, we have also learnt the basis of preparation of ledger account, periodical trial balance, profit & loss account and a balance sheet.

The earliest evidence of present-day bookkeeping was traced back some 800 years, to an Italian Banker. The Italian monk Luca Paciolo is said to have time documented these bookkeeping principles. He did not claim to be an originator or an author of the system, but only a describer of a practice to write the books of accounts. Even the book (i.e. 'Summa') that documents this 'Bookkeeping' is a book on mathematics, containing some 36 chapters on bookkeeping and accounts. Since it is a part of a book on mathematics, the present golden rules of bookkeeping have been expressed in the said book in the form of algebraic equations and not in descriptive narration. Since every business transaction has a two-way effect, it was easy to put it in the form of an algebraic equation. It is rightly said, mathematics is the mother of all sciences.

The brief history of origin of bookkeeping emphasises that:

(a) Certain principles are fundamental and are not subject to the normal notion of **'Change'**.

(b) IFRS is making a sincere attempt to make the figures of P & L A/c and Balance Sheet more mathematics-based and avoiding hypothetical figures based on assumptions. It involves a lot of **valuation,** but again the valuation is based on **mathematical modules**.

Primary object of the book keeping of as early as 800 years are not changed however what has changed over the year is the trade or commerce in the following aspects:

(a) The nature of trade and commerce

(b) The volume and value of trade

(c) The geographical spread

(d) Entities carrying on the business.

(e) Number and groups of persons who need to know the results of operations.

In early days transactions were important for the businessmen and tax computation was not there instead ad-hoc duties were there. No specific laws, no stakeholders' activism, no geographical spread, no enterprises structure existed. Individuals existed only might be through a group for business in a mission to earn livelihood and not to acquire businesses, competition at large, mergers or acquisitions, etc.

Radically business and book keeping i.e. just a recording of transactions changed to complex accounting system with the advent of machine in machine age, concern of shareholders' money by shareholders and geographical spread. Stakeholders (the broader sense) became very active and always eager to put an eye into the business operations. Even the law changed radically to safeguard all in their respective interest and "true and fair view" word came into light. To help the industries Accounting Standards were formulated so as to tackle and guide uniformly on the light of transactions/situations and now with the diversified business operations similar Accounting Systems are also required.

WHAT ARE ACCOUNTING STANDARDS

Accounting standards are authoritative statement on how transactions are to be recorded and disclosed in the financial statements. They ensure uniformity amongst the various entities of the readers of financial statements. The compliance to standards is mandatory as per Section 211 to the Companies Act, 1956 to ensure that the accounts are true and fair.

This uniformity is now proposed to be spread from local boundaries to across the world with the advent of single global accounting standard, namely, IFRS.

INTRODUCTION TO IFRS

IFRSs are adopted by the International Accounting Standards Board (IASB), the independent standard-setting body of the International Accounting Standards Committee Foundation (IASC Foundation).

More than 100 countries now require or permit the use of IFRSs or are converging with the International Accounting Standards Board's (IASB) standards. EU recognised IFRS in 2005 and the SEC has in its announcement on November 2007 permitted IFRS without reconciliation with US GAAP for non-US companies. It is also proposed that soon U.S. will also adopt IFRS within coming few years.

Many of the accounting standards forming part of the IFRS are known by the earlier name of International Accounting Standards (IAS), which were issued between 1973 and 2001 by the board of International Accounting Standards Committee (IASC). In April 2001, IASB adopted all IAS and continued their development calling new standards as IFRS which consist of:

- IFRS standards issued after 2001 (Total- 9)
- IAS standards issued before 2001(Total- 29)
- Interpretations by International financial Reporting Interpretations Committee (IFRIC) (Total- 16) and,
- Standing Committee Interpretations (SIC) issued before 2001(Total- 21)

Thus, total 38 standards and 27 interpretations.

Financial statements under IFRS:

Under IFRS the financial statements would comprise:

- Statement of financial position as at end of the period and comparatives (Statement of changes in equity for the period),
- Statement of comprehensive income for the period,
- Statement of cash flow for the period
- Notes, comprising a summary of significant accounting policies and other explanatory information

INDIAN INITIATIVE TOWARDS IFRS

The Institute of Chartered Accountants of India (ICAI) has issued a ***'Concept paper on convergence with IFRS in India'*** in October 2007. The document lays down the convergence strategy. The roadmap of convergence were issued and was likely to start its implementation from April 2011 but its certainly not possible as still lot of questions are yet unanswered.

As envisaged, India has finally chosen to converge with IFRS, as opposed to adopting IFRS on the pretext that Indian regulators and standard-setters will review the existing IFRS standards and their applicability in Indian context and will issue converged accounting standards called as Ind-AS. Recently MCA had notified the 35 IndAS (IFRS) though the date of implementation is yet to be notified.

The final journey has just begun and we are already seeing deviations in new standards and we don't know how far or near we will be from IFRS though MCA have issued the text of Ind AS.

KEY DIFFERENCES BETWEEN IFRS AND INDIAN GAAP

- The adoption of IFRS affects more than a company's accounting policies, processes, and people. Ultimately, most aspects of a company's business and operations are affected potentially.
- IFRS is a principle-based approach to standard-setting. It is less reliant on bright lines and detailed rules as compared to the US GAAP.
- At various places IFRS provides scope of judgment and requires information to be presented on the basis of substance rather than rule. *For example,* redeemable preference shares may be treated as liability and convertible debentures as equity.
- While applying IFRS, usage by an investor is kept in mind and requirement of the law and management takes a backseat. *For example,* in case of the business combination the acquirer under IFRS could be different than the legal acquirer (like in case of reverse merger for tax benefit or other purposes).
- Financial statements under IFRS place more reliance on the management estimate. *For example,* in case of depreciation of assets this, under IFRS, would have to be based on estimated useful life as against the present Indian requirement to follow Schedule XIV of the Companies Act, 1956.
- The fair value concept is embodied in many of the IFRS (like IAS 30 on Financial Instruments, IAS 40 Investment Property, etc.). The concept of fair value poses several issues on valuation, valuation models and accuracy and reliability of the same for the purpose of accounting and presentation.
- Major overhauling cost for fixed assets which can be capitalised under IFRS (provided it meets certain criteria) as against the present requirement to expense out the same
- Inventory for service organisation for work which is in progress (already covered by proposed Indian Accounting Standard)
- Prior period items to be given effect retrospectively in opening equity
- Proposed dividend is not required to be reflected in financial statements under IFRS
- Under IFRS, provision made for dismantling of asset or for site closure can be capitalised
- Under IFRS, EPS to be disclosed separately for continuing and discontinuing operations, etc.

CHALLENGES UNDER IFRS

- *Joint ventures* : Consolidation proportionate or otherwise may become an issue. Consolidation method may impact the structure of new arrangements.
- *Debt/equity* : Possible reclassification of preference shares as liabilities
- *Subsidiaries and associates* : Different rules may impact the current treatment
- *Valuation* : Greater use of fair value
- Detailed hedge documentation, and ongoing effectiveness testing is required to achieve hedge accounting under IFRS
- *Embedded derivatives* : Possible requirement to fair value components of other instruments, including long-term contracts
- *Contracting* : Different rules will present different opportunities, challenges, management and accounting issues
- Financial communications will have to address changes in presentation of financial information as well as fundamental change towards fair value accounting and its impacts on traditional ratios and performance indicators
- Uncertainly about Income-tax Dept. response
- Requires multi-disciplinary participation
- Aiming at a moving target
    - Uncertain timetable for implementation
    - Uncertainty about final form of IFRS

CONVERSION/CONVERGENCE TO IFRS

The conversion to IFRS will have to be managed like any other large-scale project. Sufficient time must be incorporated into project plan, proper resources must be ensured and all key players must be involved in critical decision-making.

IFRS is more than an exercise for the accounting and finance department. Its impact is far reaching, affecting areas from internal control and sales to research and development.

Typically the following three phases will be involved in convergence to IFRS:

Stages	Key focus points
Pre-implementation phase	• Formulation to detailed plan • Identifying key areas of difference between existing accounting policies and requirements of the IFRS • Understanding the implications • Educating/training the accounting team
Transition phase	• Make changes in the controls, process, business documentation/SOP • Map the existing systems, process, controls with IFRS and identify the impacted areas
Post-implementation phase	• Validation of changes made — this involves testing of high-risk areas for accuracy of systems and procedure • Continuous monitoring of IFRS regulatory changes

IMPACT AND CONSIDERATIONS OUT OF IFRS

- First-time adoption could be a heavy task and hence it is essential to ensure that proper care and diligence is exercised so that there are no spill-over impacts in subsequent periods. IFRS 1 deals exhaustively with the first-time adoption.
- To ensure that the judgment, estimated and fair valuation concepts are not misused by the Management, lot of reliance would have to be placed on independent valuers.
- Proper planning is required for transition to IFRS and hence to ensure that the company must have a proper road map/strategy and resources to migrate to IFRS.
- Emphasis on transparent and exhaustive disclosure which would mean that the source of data, compilation process and methodology are more robust.
- To ensure that the commercial colour of the transaction is correctly reflected in the accounting of the same.
- More data analysis, narrative accounting and hence more qualitative accountants and more time will be required to review.
- The taxation team will have to work closely with the accounts teams to examine IFRS impact. Since, there is no response yet from taxation department then of course Tax laws are to be followed for their compliance.
- The CFO will need to focus on the underlying commercial nature of transactions and events. Other areas where more judgment is required include property, leases, revenue recognition, provisions and consolidation policy.
- Convergence to IFRS will have an impact on the processes which lead to recording of a specific transaction and necessitate re-engineering of those process and related internal controls.

IFRS would benefit all the users of financial statements. It would take accounting and financial reporting to a new level. However, it would in the initial years put too much burden on the preparers and reviewers of financial statements.

Lot of research and development is still under progress for various items like fair value, etc. and the evolved version would lead to better and more narrative financial statements.

IFRS in India is an opportunity for Indian enterprises to be in line with the global companies and would in turn help raise finances globally. It would be a boon to the accounting fraternity as it would expose them to international arena and would help service the global accounting market even now they are internationally honoured.

The decision to converge and not to adopt IFRS gives the flexibility to carve out and or deviate from the accounting principles and policies in IFRS. The important question is to what extent we should use this flexibility. If, we make significant changes in IFRS using the flexibility, the new accounting standards will not be fully convergent with IFRS and the purpose of convergence will be lost. Our accounting practices will fall short of globally accepted accounting practices. Inflow of foreign capital may be affected adversely. Indian companies, that are listed in stock exchanges in USA, Europe and other countries, using accounting standards fully convergent with IFRS, will have to prepare two sets of financial statements.

Moreover with tax authorities are still silent it appears that the converged accounting standards may not be acceptable for tax filings for next three to five years and till then the current Indian GAAP would be used for tax purposes. This will ultimately result into three sets of financial statements being prepared by Indian companies.

CONCLUSION

The first decade of the 21st Century noticed severe expectation gap between the stakeholders and those who managed the business. Sarbanes-Oxley also played its part. Earlier business failures were also bothering everyone and a need was felt to have a worldwide common accounting language, along with stringent corporate governance provisions. Even the US agreed to modify its own earlier tough stand and accepted in principle the worldwide common accounting language and IFRS has now evolved. Our country has also accepted gradual introduction of IFRS, to begin with, for listed companies. We the Chartered Accountants, in the interest of our professional development, are required to accept them, study them and should take part in their proper presentation. There should be neither an ecstasy nor any agony in the use of a common language.

Bookkeeping captured business transactions some 800 years back(as stated) through mathematical module and we are once again through IFRS, embracing in a way a mathematical base for presentation based on what is known as fair valuation. The truth is mathematics is pure, but mathematics can give many possible answers but the truth. What has happened on Wall Street and everywhere in the present situation is **all-round confusion**, giving rise to a **crisis** which has given rise to erosion in **confidence**, leading to **depression and doom**. Hope so that IFRS does not get caught by twisted mathematicians in the field of **fair valuations**. Certainty exist that India will soon be IFRS compliant one, after all India is having a huge professional resource, though there are many deviations or lacuna pointed through out to be IFRS-Compliant nation and again it is obvious that the Government and professional fraternity must be preparing themselves to find out the solution to the technical and the logical problem the nation is facing now.

In any debate on convergence or adoption, India must first aspire to uphold the purity of IFRS and be fully IFRS-compliant nation and second it should take a stand that it has full belief in the proposed deviations as being the best practices and then the confidence and conviction to influence the International Accounting Standards Board (IASB) through consensus about what it believes is right and the need to bring the required improvement/amendments in IFRS rather than remaining as a carved-out nation. **We cannot just take short-term local view rather we need to take long-term global view on IFRS.**

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