

Some of these major differences between US GAAP and Indian GAAP which give rise to differences in profit are highlighted hereunder:

1. **Underlying assumptions:** Under Indian GAAP, Financial statements are prepared in accordance with the principle of conservatism which basically means "Anticipate no profits and provide for all possible losses". Under US GAAP conservatism is not considered, if it leads to deliberate and consistent understatements.
2. **Prudence vs. rules :** The Institute of Chartered Accountants of India (ICAI) has been structuring Accounting Standards based on the International Accounting Standards (IAS) , which employ concepts and 'prudence' as the principle in contrast to the US GAAP, which are "rule oriented", detailed and complex. It is quite easy for the US accountants to handle issues that fall within the rules, while the International Accounting Standards provide a general framework of accounting standards, which emphasise "substance over form" for accounting. These rules are less descriptive and their application is based on prudence. US GAAP has thus issued several Industry specific GAAP , like SFAS 51 (Cable TV), SFAS 50 (Record and Music Industry) , SFAS 53 (Motion Picture Industry) etc.
3. **Format/ Presentation of financial statements:** Under Indian GAAP, financial statements are prepared in accordance with the presentation requirements of Schedule VI to the Companies Act, 1956. On the other hand , financial statements prepared as per US GAAP are not required to be prepared under any specific format as long as they comply with the disclosure requirements of US GAAP. Financial statements to be filed with SEC include
4. **Consolidation of subsidiary companies:** Under Indian GAAP (AS 21), Consolidation of Accounts of subsidiary companies is not mandatory. AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21. Thus, the financial income of any company taken in isolation neither reveals the quantum of business between the group companies nor does it reveal the true picture of the Group . Savvy promoters hive off their loss making divisions into separate subsidiaries, so that financial statement of their Flagship Company looks attractive .Under US GAAP (SFAS 94), Consolidation of results of Subsidiary Companies is mandatory , hence eliminating material, inter company transaction and giving a true picture of the operations and Profitability of the various majority owned Business of the Group.
5. **Cash flow statement:** Under Indian GAAP (AS 3) , inclusion of Cash Flow statement in financial statements is mandatory only for companies whose share are listed on recognized stock exchanges and Certain enterprises whose turnover for the accounting period exceeds Rs. 50 crore. Thus , unlisted companies escape the burden of providing cash flow statements as part of their financial statements. On the other hand, US GAAP (SFAS 95) mandates furnishing of cash flow statements for 3 years - current year and 2 immediate preceding years irrespective of whether the company is listed or not .
6. **Investments:** Under Indian GAAP (AS 13), Investments are classified as Current and Long term. These are to be further classified Government or Trust securities ,Shares, debentures or bonds Investment properties Others-specifying nature. Investments classified as current investments are to be carried in the financial statements at the lower of cost and fair value determined either on an

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individual investment basis or by category of investment, but not on an overall (or global) basis. Investments classified as long term investments are carried in the financial statements at cost. However, provision for diminution is to be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Under US GAAP (SFAS 115) , Investments are required to be segregated in 3 categories i.e. held to Maturity Security (Primarily Debt Security) , Trading Security and Available for sales Security and should be further segregated as Current or Non current on Individual basis. Debt securities that the enterprise has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealised gains and losses included in earnings. All Other securities are classified as *available-for-sale securities* and reported at fair value, with unrealised gains and losses excluded from earnings and reported in a separate component of shareholders' equity

7. **Depreciation:** Under the Indian GAAP, depreciation is provided based on rates prescribed by the Companies Act, 1956. Higher depreciation provision based on estimated useful life of the assets is permitted, but must be disclosed in Notes to Accounts. (Guidance note no 49). **Depreciation cannot be provided at a rate lower** than prescribed in any circumstance. Similarly, there is no compulsion to provide depreciation at a higher rate, even if the actual wear and tear of the equipments is higher than the rates provided in Companies Act. Thus, an Indian Company can get away with providing with lesser depreciation, if the same is in compliance to Companies Act 1956. Contrary to this, under the US GAAP , depreciation has to be provided over the estimated useful life of the asset, thus making the Accounting more realistic and providing sufficient funds for replacement when the asset becomes obsolete and fully worn out.
8. **Foreign currency transactions:** Under Indian GAAP (AS11) Forex transactions (Monetary items) are recorded at the rate prevalent on the transaction date .Year end foreign currency assets and liabilities (Non Monetary Items) are re-stated at the closing exchange rates. Exchange rate differences arising on payments or realizations and restatements at closing exchange rates are treated as Profit /loss in the income statement. Exchange fluctuations on liabilities incurred for fixed assets can be capitalized. Under US GAAP (SFAS 52), Gains and losses on foreign currency transactions are generally included in determining net income for the period in which exchange rates change unless the transaction hedges a foreign currency commitment or a net investment in a foreign entity. Capitalization of exchange fluctuation arising from foreign liabilities incurred for acquiring fixed assets does not exist. Translation adjustments are not included in determining net income for the period but are disclosed and accumulated in a separate component of consolidated equity until sale or until complete or substantially complete liquidation of the net investment in the foreign entity takes place. US GAAP also permits use of Average monthly Exchange rate for Translation of Revenue, expenses and Cash flow items, whereas under Indian GAAP, the closing exchange rate for the Transaction date is to be taken for translation purposes.
9. **Expenditure during Construction Period:** As per the Indian GAAP (Guidance note on "Treatment of expenditure during construction period") , all incidental expenditure on Construction of Assets during Project stage are accumulated and allocated to the cost of asset on completion of the project. Contrary to this, under the US GAAP (SFAS 7), such expenditure are divided into two heads – direct and indirect. While, direct expenditure is accumulated and allocated to the cost of asset, indirect expenditure are charged to revenue.

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10. **Research and Development expenditure:** Indian GAAP (AS 8) requires research and development expenditure to be charged to profit and loss account, except equipment and machinery which are capitalized and depreciated. Under US GAAP (SFAS 2), all R&D costs are expenses except intangible assets purchased from others and Tangible assets that have alternative future uses which are capitalised and depreciated or amortised as R&D Expense. Under US GAAP, R&D expenditure incurred on software development are expensed until technical feasibility is established (SOP 81.1) . R&D Cost and software development cost incurred under contractual arrangement are treated as cost of revenue.
11. **Revaluation reserve :** Under Indian GAAP, if an enterprise needs to revalue its asset due to increase in cost of replacement and provide higher charge to provide for such increased cost of replacement, then the Asset can be revalued upward and the unrealised gain on such revaluation can be credited to Revaluation Reserve (Guidance note no 57). The incremental depreciation arising out of higher book value may be adjusted against the Revaluation Reserve by transfer to P&L Account. However for window dressing some promoters misutilise this facility to hoodwink the shareholders on many occasions. US GAAP does not allow revaluing upward property, plant and equipment or investment.
12. **Long term Debts:** Under US GAAP, the current portion of long term debt is classified as current liability, whereas under the Indian GAAP, there is no such requirement and hence the interest accrued on such long term debt is not taken as current liability.
13. **Extraordinary items, prior period items and changes in accounting policies:** Under Indian GAAP (AS 5), extraordinary items, prior period items and changes in accounting policies are disclosed without netting off for tax effects. Under US GAAP (SFAS 16) adjustments for tax effects are required to be made while reporting the Prior period Items.
14. **Goodwill:** Under the Indian GAAP goodwill is capitalized and charged to earnings over 5 to 10 years period. Under US GAAP (SFAS 142) , Goodwill and intangible assets that have indefinite useful lives are not amortized ,but they are tested at least annually for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. However, if certain criteria are met, the requirement to test goodwill for impairment annually can be satisfied without a remeasurement of the fair value of a reporting unit.
15. **Capital issue expenses:** Under the US GAAP, capital issue expenses are required to be written off when incurred against proceeds of capitals, whereas under Indian GAAP , capital issue expense can be amortized or written off against reserves.
16. **Proposed dividend:** Under Indian GAAP , dividends declared are accounted for in the year to which they relate. For example, if dividend for the FY 1999-2000 is declared in Sep 2000 , then the corresponding charge is made in 2000-2001 as below the line item . Contrary to this , under US GAAP dividends are reduced from the reserves in the year they are declared by the Board. Hence in this case under US GAAP , it will be charged Profit and loss account of 2000-2001 above the line.
17. **Investments in Associated companies:** Under the Indian GAAP (AS 23) , investment in associate companies is initially recorded at Cost using the Equity method whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment is adjusted thereafter for the post acquisition change in the

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investor's share of net assets of the investee. The consolidated statement of profit and loss reflects the investor's shares of the results of operations of the investee are carried at cost. Under US GAAP (SFAS 115) Investments in Associates are accounted under equity method in Group accounts but would be held at cost in the Investor's own account.

18. **Preoperative expenses:** Under Indian GAAP, (Guidance Note 34 - Treatment of Expenditure during Construction Period), direct Revenue expenditure during construction period like Preliminary Expenses, Project related expenditure are allowed to be Capitalised. Further, Indirect revenue expenditure incidental and related to Construction are also permitted to be capitalised. Other Indirect revenue expenditure not related to construction, but since they are incurred during Construction period are treated as deferred revenue expenditure and classified as Miscellaneous Expenditure in Balance Sheet and written off over a period of 3 to 5 years. Under US GAAP (SFAS 7), the concept of preoperative expenses itself doesn't exist. SOP 98.5 also madates that all Start up Costs should be expensed. The enterprise has to prepare its balance sheet and Profit and Loss Account as if it were a normal running organization. Expenses have to be charged to revenue and Assets are Capitalised as a normal organization. The additional disclosure include reporting of cash flow, cumulative revenues and Expenses since inception. Upon commencement of normal operations, notes to Statement should disclose that the Company was but is no longer is a Development stage enterprise. Thus , due to above accounting anomaly, Accounts prepared under Indian GAAP , contain higher charges to depreciation which are to be adjusted suitably under US GAAP adjustments for indirect preoperative expenses and foreign currencies.
19. **Employee benefits:** Under Indian GAAP, provision for leave encashment is accounted based n actuarial valuation. Compensation to employees who opt for voluntary retirement scheme can be amortized over 60 months. Under US GAAP, provision for leave encashment is accounted on actual basis. Compensation towards voluntary retirement scheme is to be charged in the year in which the employees accept the offer.
20. **Loss on extinguishment of debt:** Under Indian GAAP, debt extinguishment premiums are adjusted against Securities Premium Account. Under US GAAP, premiums for early extinguishment of debt are expensed as incurred.

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