CHAPTER 2

International Financial Reporting Standards, their Interpretations and US GAAPs - An Overview

BASIC CONCEPTS

IFRS are considered a "principles-based" set of standards. In fact, they establish broad rules rather than 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
- Framework for the Preparation and Presentation of Financial Statements

Question 1

Briefly explain the following terms:

(i) IFRS

(ii) Convergence of Accounting Standards with IFRS

(iii) Need for IFRS.

Answer

(i) IFRS: The term IFRS refers to the International Financial Reporting Standards issued by International Accounting Standard Board (IASB). IFRS is a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements.

International Financial Reporting Standards (IFRS) are the globally accepted accounting standards adopted by International Accounting Standard Board (IASB) earlier known International Accounting Standard Committee (IASC).

IFRSs being principle-based standards have distinct advantage that the transactions can not be manipulated easily to achieve a particular accounting.

The basic objective of IFRS are as follows:

- *to develop*, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
- *to promote* the use and rigorous application of those standards;

It also encompasses the International Accounting Standards (IAS) issued by the International Accounting Standard Committee (IASC). Interpretations of IASs and IFRSs are developed by the International Financial Reporting Interpretations Committee (IFRIC). IFRIC is the new name for the Standing Interpretations Committee (SIC) approved by the IASC Foundation Trustees in March 2002. IFRS includes these interpretations also.

(ii) Convergence of Accounting Standards with IFRS: In general, convergence of Accounting Standards (AS) with International Financial Reporting Standards (IFRS) means to achieve harmony with IFRS. The term convergence can be considered as "to design and maintain national accounting standards in a way that financial statements prepared in accordance with rational AS are in convergence with IFRS". IAS I require financial statements to comply with all requirements of IFRS. This does not mean that IFRS should be adopted word by word. The local standard setters can add disclosure requirements or can remove some requirements which do not create non compliance with IFRS. Thus, convergence with IFRS means adoption of IFRS with exceptions wherever necessary. Thus, as today IFRS is being used in over 100 countries and it is expected that by 2014, all major countries will have adopted IFRS to some extent, so it was imperative for India also to adopt IFRS to ensure harmony in preparation and presentation of Financial Statements.

(iii) Indian Accounting Standards and Generally Accepted Accounting Principles (GAAP) are sufficient, relevant and clear when compared to global standards. But with the globalization of business requiring foreign capital and investors, there is need for financial reporting standards to be acceptable to most of the countries including India. IFRS are recognised in many parts of the world including the European Union, Hong Kong, Australia, Russia, South Africa, Singapore and Pakistan. US is also taking steps to converge its GAAPs with IFRS.

It has also been recognised that the use of the IFRS concepts can considerable improve the quality of financial reporting and boost international investors' confidence. IFRS are more flexible, dynamic and responsive to changes and can be applied to all types of Industries across many countries.

Question 2

Write short note on some key differences between IFRS, US GAAP and AS (applicable in India) with respect to:

(i) Fixed Assets

(ii) Changes in Accounting Policy and Prior period items.

(iii) Inventory

Answer

(i) Fixed Assets

	IFRS	US GAAPs	AS
Definition	Tangible Items that are held for use in the production or supply of goods or service, for rentals to others, or for administrative purpose; and are expected to be used during more than one period.	Fixed assets are carried at historical cost. Only downward revaluation is permitted for impairment. Exchange fluctuations on loans taken for purchase of fixed assets are expensed when incurred.	Fixed Asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the ordinary course of business.
Initial Measurement of cost	Initial measurement of cost also includes a) Fair value gains or losses on qualifying cash flow hedges relating to the purchase of Property, Plant and Equipment (PPE) in a foreign currency b) Cost of dismantling and removing the item or restoring the site on which PPE is located.	Similar to IFRS except hedge gains or losses on qualifying cash flow hedges are not included	No specific guideline on the Measurement of gains/ losses on qualifying cash flow hedges and capitalization of dismantling and site restoration cost
Capitalization	It mandates component Accounting. Each	Does not require a component approach for depreciation	AS 10 does not require full adoption of component

	major part of the plant to be depreciated separately		Accounting. It is stated that accounting of asset may be improved through allocation of cost to various parts of the asset
Determination of Depreciation	The depreciation amount of an item of PPE is allocated on a systematic basis over its useful life.	Similar to IFRS.	Higher of the following: a) Depreciation as per the rate specified in the Schedule XIV of the Companies Act. b) Depreciation as determined based on estimated useful life of the assets
Depreciation Method	A variety of depreciation methods can be used to allocate the depreciable amount on systematic basis over its useful life.	Similar to IFRS.	Either SLM or WDV can be followed.
Change in Depreciation Method	Changes in the depreciation method are considered as change in accounting estimate. Prospective effect in current period is made.	Similar to IFRS.	Changes in the depreciation method are considered as change in accounting Policies and effects to be quantified and disclosed. Retrospective effect in computation of depreciation is given.
Review of Useful Life and Residual Value	Re-assessment of useful life and residual value is required at least at each financial year end	Similar to IFRS.	AS 10 does not specify any such requirement.
Subsequent Costs	Cost of replacement is to be capitalized. The	Similar to IFRS.	Replacement cost is expensed. No

	carrying amounts of those parts that are replaced is to be derecognized.		requirement for decapitalizing the carrying amount of replaced items
Major inspection cost and overhaul expenditure	The cost of major inspection and overhaul expenses are to be capitalized.	Similar to IFRS.	The expenditure that increases the benefit over previously assessed capacity is capitalized. The inspection cost and overhaul expenses are expensed.
Revaluation	If an entity adopts the revaluation model, re valuation is required to be made with regular period to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.	Similar to IFRS.	No specific requirement on frequency of revaluation.
Group Revaluation	If an item of PPE is revalued, then the entire class of PPE to which that asset belongs to be revalued.	Similar to IFRS.	Revaluation Approach is adhoc in nature.
Depreciation on revaluation	Depreciation on revalued portion cannot be recouped out of revaluation reserve.		Depreciation on revalued portion can be recouped out of revaluation reserve.

(ii) Changes in Accounting Policy and Prior period items

	IFRS	US GAAPs	AS
Definition of Prior Period Errors	Broad definition of Prior Period items includes all the items in the financial statements.		AS 5 covers only Income and Expenses in the definition of prior period items.
Prior Period Errors	Prior Period errors are to be corrected retrospectively and restate the opening balances of assets, liability and equity	Reported as a prior period adjustment in current year results. Comparatives are not required to restate.	Similar to IFRS.
Extraordinary Item	It prohibits disclosure of any items as Extraordinary Items.		Separate disclosure is required as per AS 5.
Impending Changes	It requires disclosure of any impending change in accounting policy.	Similar to IFRS.	It does not require such Disclosure.
Absence of standard or interpretation	It provides specific guidance on the selection of accounting policies where there is no IFRS or interpretation that specifically applies to a transaction.		No specific guidance under AS 5.

(iii) Inventory

	IFRS	US GAAPs	AS
Scope	IAS 2 includes provisions relating to the work in progress of a service provider.	Similar to Indian GAAP.	AS 2 excludes work in progress arising in the normal course of business of service provider. Hence there is no guidance for the same.

Applicability	IAS 2 does not apply to inventories held by commodity traders.	Similar to Indian GAAP.	There is no scope exemption in AS 2 for any inventory held by commodity traders.
Inventory Valuation	Inventories are carried at the lower of cost or net realizable value.	Lower of cost or market subject to upper/lower limit of NRV.	Inventories are carried at the lower of cost or net realizable value.
Frequency of Assessment of NRV	A new assessment of Net Realizable Value is required to be made in each Reporting period		No specific guidance in AS 2.
Write Down	Reversal is required for a subsequent increase in value of inventory previously written down.	Reversal of write down of inventory is not permitted.	Reversal is required for a subsequent increase in value of inventory previously write down.
Cost Formula Application	The following cost formula allowed : a) FIFO Method b) Weighted Average Cost LIFO method is not allowed.	The following cost formula allowed : a) FIFO Method b) Weighted Average Cost c) LIFO Method	The following cost formula allowed : a) FIFO Method b) Weighted Average Cost LIFO method is not allowed.
Consistency in cost formula application	The same cost formula is used for all inventories that have a similar nature and use to the entity.	The same cost formula is used for all inventories that have a similar nature and use to the entity.	Not specified. However consistency is a fundamental principle.
Cost of Inventory	Cost of inventory excludes only Selling Cost, not Distribution Cost.	Similar to AS 2.	Cost of inventory does not include Selling & Distribution Cost as per AS 2.

Purchase under Deferred Settlement Terms	Difference between the purchase price of inventory for normal credit terms and the amount paid for deferred settlement terms is recognized as interest Expense.		Inventories purchased on deferred settlement terms are not explicitly dealt within the accounting standard on inventories.
Disclosure Requirements	Disclosure requirements are same except the following : a) Any write down and reversal of any write down b) Circumstances they led to reversal of a write down c) Carrying amount of inventory that are pledged as securities.		No specific requirements for disclosure.

Question 3

State the treatment of the following items with reference to 'Accounting Standards' (AS applicable in India) and International Financial Reporting Standards (IFRS):

(i) Extra ordinary items

(ii) Contingencies.

Answer

Accounting Standards	International Financial Reporting Standards
Extraordinary Items	
Events or transactions, clearly distinct from the ordinary activities of the entity, which are not expected to recur frequently and regularly, are termed as extra-ordinary items. Disclosure of the nature and amount of such item is required in the income statement to perceive the impact of current and future profits.	Not allowed.
Contingencies	
Contingent Liabilities are disclosed unless the probability of outflows is remote. Contingent gains are neither recognized nor disclosed.	Unrecognized possible losses and possible gains are disclosed.

Question 4

State the treatment of the following items with reference to Accounting Standards (applicable in India) and IFRS:

(i) Discontinued operations – definition and measurement

(ii) Acquired intangible assets.

Answer

Treatment under Indian Accounting Standard and IFRS

		Accounting Standards	IFRS
(i)	Discontinuing operation-definition and measurement	Operations and cash flows that can be clearly distinguished for financial reporting and represent major line of business or geographical area of operations are discontinued operations. Measurement of discontinued operations is based on AS 24.	Definition of discontinued operations under IFRS is similar to Indian Accounting Standards. However, it also includes a subsidiary acquired exclusively with a view to resale. Discontinued operations are measured at lower of carrying amount and fair value less cost to sell.
(ii)	Acquired intangible assets	If recognition criteria are satisfied then it can be capitalized. All intangibles are amortized over useful life with rebuttable presumption of not exceeding 10 years. Revaluations are not permitted.	If recognition criteria are satisfied then it can be capitalized. It is amortized over useful life. Intangibles assigned an indefinite useful life are not amortized but reviewed at least annually for impairment. Revaluations are permitted in rare circumstances.

Question 5

State the treatment of the following items with reference to Accounting Standards AS (applicable in India), IFRS and US GAAPs:

(i) Impairment of Assets

(ii) Business Combinations

Answer

Treatment under Indian AS, IFRS and US GAAPs

(i) Impairment of assets

	AS	IFRS	US GAAPs
Timing of impairment review	Annually	Annually	Whenever events or changes in circumstances indicate that the carrying amount may not be recovered.
Asset is impaired if	Recoverable amount < Carrying amount	Recoverable amount < Carrying amount	Fair value < Carrying amount
Recoverable amount/Fair Value	Recoverable amount is higher of Net Selling Price and Value in use	Recoverable amount is higher of Net Selling Price Value in use	Fair Value is the amount at which an asset or liability could be bought or settled in a current transaction between willing parties
Cash flows for calculating value in use/fair value	Use discounted cash flows for calculating the value in use	Use discounted cash flows for calculating the value in use	Use discounted cash flows for calculating the fair value
Reversal of impairment loss	Whenever there is a change in the economic conditions	Whenever there is a change in the economic conditions	Prohibited

(ii) Business combinations

Business combinations	No particular Standard has been issued by ICAI till date. However all business acquisitions are business combinations except pooling of interest method for certain amalgamations	All business acquisitions are Combinations as per IFRS 3	All business acquisitions are Combinations.
Date of acquisition	Date specified by the court or the purchase agreement	When control transferred	When assets received or equity issued

Valuation of assets and liabilities	In pooling of interests method-book value. In purchase method book value or fair value	Fair value	Fair value
Treatment of goodwill	Estimate the useful life and amortize accordingly	Capitalize and test for impairment	Capitalize and test for impairment
Negative goodwill	Disclose as capital reserve	Recognized in the income statement	Reduce fair value of non-monetary assets
Reverse acquisition	Acquisition accounting is based on form. Legal Acquirer is treated as acquirer and legal acquiree is treated as acquiree for legal as well as accounting purpose.	Acquisition accounting is based on substance. Accordingly legal acquirer is treated as acquiree and legal acquiree is treated as acquirer.	Similar to IFRS

Question 6

Explain the treatment of the following items with reference to AS (applicable in India), IAS/IFRS and US GAAPs:

(a) Presentation of associate results;

(b) Definition of joint venture;

(c) Definition of subsidiary.

Answer

(a) Presentation of associate results

ASs	IFRS/IAS	US GAAPs
In consolidated financial statements; equity method is used. Share of post-tax results is shown. In standalone financials; at cost less impairment.	In consolidated financial statements; equity method is used. Share of post-tax results is shown. In standalone financial; at cost or at fair value in accordance with IAS 39.	In consolidated financial statements; similar to IFRS.

(b) Definition of joint venture

Contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control. Exclusion if it meets the definition of a subsidiary	Contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control. Exclusion if investment is held-for-sale.	A corporation owned and operated by small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group.

(c) Definition of subsidiary

Definition of subsidiary is based on voting control or control over the composition of the board of directors. The existence of currently exercisable potential voting rights is not taken into consideration.	Control is presumed to exist when parent owns, directly or indirectly through subsidiaries, more than one half of an entity's voting power. The existence of currently exercisable potential voting rights is also taken into considerations. A parent could have control over an entity in circumstances where it holds less than 50% of the voting rights of an entity.	Similar to IFRS. However, a bipolar consolidation model is used, which distinguishes between a variable interest model and a voting interest model. Control can be direct or indirect and may exist with a lesser percentage of ownership (voting interest model).

Question 7

Explain the differences between IGAAP, US GAAP and IFRS with regard to

(a) True & Fair View;

(b) Comparative Position;

(c) Reporting Elements.

Answer

(a) True & Fair View: Under IFRS and IGAAP framework, there is an assumption that adoption of IFRS / IGAAP leads to a true and fair presentation, there is no such assumption under US GAAP.

(b) Comparative Position: Under IGAAP and IFRS, comparative financial figures are to be provided for one previous years, whereas under US GAAP (SEC requirement for listed companies) comparatives are to be provided for two previous years except for Balance Sheet.

(c) **Reporting Elements** - IFRS prescribes the minimum structure and content of financial statement including Statement of Changes in equity (in addition to Balance sheet, Income statement, Cash flow statement, notes comprising significant accounting pand other explanatory notes). Under US GAAP in addition to Statement of changes in Equity, Statement of Comprehensive Income is required. Both of these statements are not required under IGAAP.

Question 8

Explain the differences between IGAAP, US GAAP and IFRS with regard to Financial Statements.

Answer

Balance Sheet

Basis of Difference	IFRS	IGAAP	US GAAP
Format	IFRS **does not prescribe** any format, but stipulates minimum line items like PPE, Investment property, Intangible assets, Financial assets, Biological assets, Inventory, receivables, etc.	IGAAP **provides vertical format of Balance Sheet** (Part I of revised schedule VI to the Companies Act, 1956).	US GAAP **also does not prescribe any format**, but Rule S-X of SEC stipulates for listed companies minimum line items to be disclosed either on face of Balance sheet or Notes to Accounts.
Order	Under IFRS, line items are presented **in increasing order of liquidity.**	In IGAAP, line items are presented in **increasing order of liquidity.**	Under US GAAP, items in assets and liabilities are **presented in decreasing order of liquidity**.
Consolidation	Consolidation of Financial statements of subsidiaries is not compulsory until it is required under some other law or regulation		Under US GAAP consolidation of results of Subsidiaries and Variable interest entity (FIN 46R) is compulsory
Current/Non Current	An organisation has an option to adopt Current or	No such requirement	Bifurcation into current & non-current

	Non-current classification of assets and liabilities		items is compulsorily required.

Profit and Loss Statement

Basis of Difference	IFRS	IGAAP	US GAAP
Format	IFRS does not prescribe any standard format for income statement but prescribes minimum disclosure includes revenue, finance costs, share of post tax results of JV and associates using equity method.	Under Indian GAAP vertical format is prescribed for Profit and Loss Account in Part II of revised Schedule VI to Companies Act, 1956.	There is no prescribed format, SEC guidelines Rule S-X prescribe minimum line items to be shown on the face of income statement & suggest 2 alternatives a) a single step format where expenses are classified by function and b) a Multiple step format where Cost of sales is deducted from sales.
Prior Period Items	A prior period item/error should be corrected by retrospective effect by restatement of opening balance of assets, liabilities or equities	Requires separate disclosure of prior period in the current financial statement & no restatement of retained earnings are required.	Mandates retrospective application of error and requires restatement of comparative opening balance with suitable footnote disclosure.
Discounting	IFRS provides that where the inflow of cash is significantly deferred without interest, discounting is needed.	There is no concept of discounting under IGAAP.	US GAAP also permits discounting in certain cases for instance discounting is done in case of loans, debentures, bonds and upfront fees.
Change in accounting policy	IFRS requires retroactive application for the earliest period practical and adjustment of opening retained	Under IGAAP, effect for change in accounting policy is given with prospective effect, if the same is material.	Requires prospective application of change in accounting policy and proforma disclosure of effect on income before extraordinary items on the face of income statement

	earning.		as separate section. Only in specific case retrospective is applicable
Bifurcation of Cost	There is no specific provision in this regard	There is no specific provision in this regard. There are certain disclosure requirements under varied AS which should be complied.	Total cost is required to be shown separately under: a) Cost of Sales b) Selling and Administration c) R & D
Extra ordinary Events	Disclosure is prohibited	Distinct from the ordinary activities of the enterprise 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.	Nature should be both: a) Infrequent b) Unusual Disclosed separately on the face of Income Statement net of Taxes after results from operations

Cash Flow Statement

Basis of Difference	IFRS	IGAAP	US GAAP
Exemptions	No exemptions.	Unlisted enterprises, enterprises with a turnover less than ₹500 million and those with borrowings less than ₹100 million	Limited exemptions for certain investment entities.
Direct/Indirect Method	Both allowed.	Both allowed. Listed companies- Indirect method Insurance companies- Direct Method.	Both allowed.
Periods to be presented	2 years	2 years	3 years

Interest paid	Operating and financing activity	Financing. In case of a financial enterprise, operating activities	Operating activity (to be disclosed by way of a note)
Interest received	Operating or investing activity	Investing. In the case of a financial enterprise, operating activity.	Operating activity
Dividends paid	Operating or financing	Financing	Financing
Tax payments	Operating	Operating	Operating(to be disclosed by way of a note)
Dividends received	Operating or investing	Investing. In the case of a financial enterprise, operating activity.	Operating

Exercises

Question 1

Write short notes on:

(a) IASB.

(b) FASB.

(c) US GAAPs

(d) AICPA

Question 2

Explain significant differences and similarities between Accounting Standards (applicable in India), IFRS and US GAAPs on the issues of

(a) Changes in accounting policies.

(b) Inventories.