

# IFRS: A Conceptual Understanding And Framework

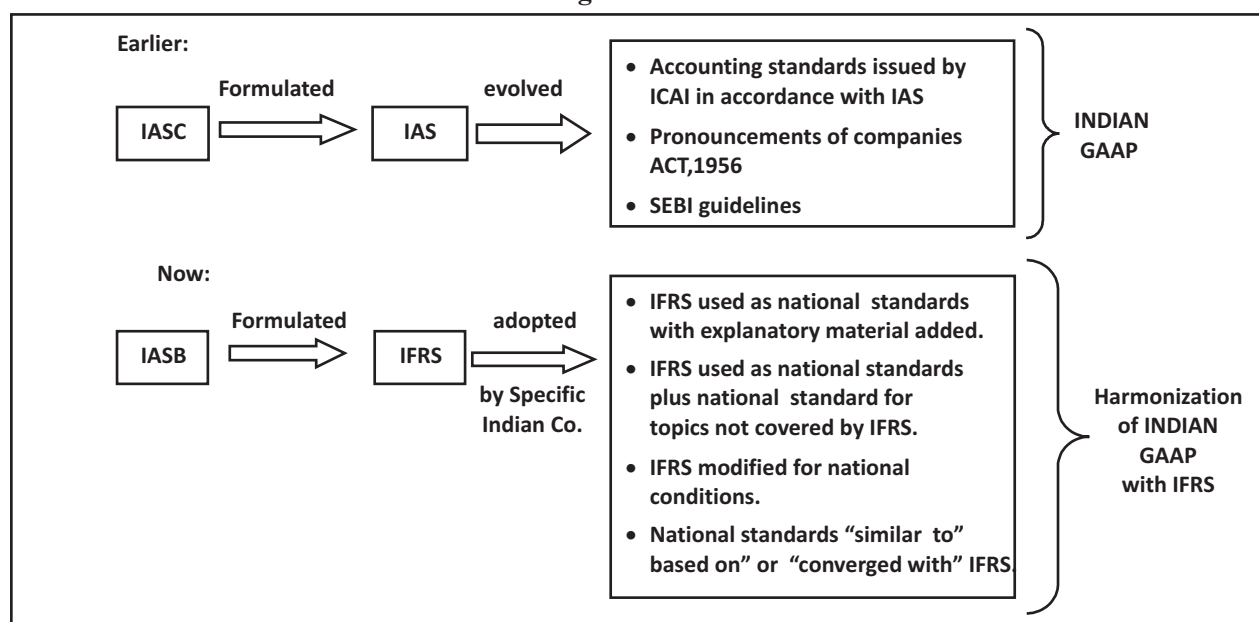
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## INTRODUCTION

✿ Initially, all multinational and global companies were required to prepare separate financial statements for each country in which they did business, in accordance with each country's GAAP, evolved from International Accounting standards (IAB) issued by International Accounting Standards Committee (IASC) from 1973 to 2001. During this period, a series of accounting standards (IAS) were released which were numbered numerically starting from IAS 1 and concluded with IAS 41 in December 2000.

✿ IASC lasted for 27 years till year 2001 when it was restructured to become IASB (International Accounting Standards Board). At the time of establishment of IASB, they agreed to adopt the revised set of standards issued by IASC, ie, IAS 1-41, but any standards to be published after that would follow a service known as IFRS.

Figure 1



✿ In 2002, the European Union (EU) adopted legislation that requires listed companies in Europe to apply IFRS in their consolidated financial statements w.e.f. 2005. This applied to more than 8000 companies in 30 countries.

✿ Outside Europe, many other countries have also been adopting IFRS. It has become mandatory in Africa, Asia and Latin America. In addition, countries such as Australia, Hongkong, New Zealand, Phillipines and Singapore have adopted national accounting standards that mirror IFRS. The table below provides a snapshot of IFRS acceptability globally:

Table 1: IFRS Acceptability

Domestic Listed Entities	No. of Countries
• IFRS required for all domestic listed companies.	85
• IFRS permitted for all domestic listed companies.	24
• IFRS required for some domestic listed companies.	4
	<b>113</b>

✿ IFRS are increasingly becoming the set of globally accepted accounting standards that meet the needs of the world's

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increasingly integrated global capital markets. The adoption of standards that require high-quality, transparent and comparable information is welcomed by investors, creditors, financial analysts and other users of financial statements to enable comparability of financial information prepared by entities located in different parts of the world. A use of single set of accounting standards facilitates investments and other economic decisions across borders increase market efficiency and reduces the cost of raising capital.

## HISTORICAL BACKGROUND

✿ International Accounting Standards were started in mid 1960's- precisely in 1966 with an initial proposal to enact institution and organization like ICAEW for England & Wales; AICPA for the United States; CICA for Canada to evolve accounting standards. Consequently, Accounts International Study Group (AISG) was founded in 1967 which aggressively championed for a single international body for evolving accounting standards. As a result, in 1973, an agreement was reached to establish an international body with the sole purpose of writing accounting standards to be used internationally.

✿ In mid 1973, IASC was established by agreement between the professional accounting bodies in nine countries and mandated with releasing new international standards which would be rapidly accepted and implemented worldwide. The objectives, as stated in its constitution, were to:

✿ Formulate and publish, in public interest, accounting standards to be observed in the presentation of financial statement and to promote their worldwide acceptance and observance.

✿ Work generally for the importance and harmonization of regulation, accounting standards and procedures relating to the presentation of financial statements.

✿ From 1982, members of ISAC consisted of all those professional accountancy bodies that were members of international federation of Accountants (IFAC) ie. Professional accountancy bodies in the more than 100 countries.

✿ The members of IASC delegated the responsibility for all IASC activities, including standard- setting activities to IASC board, which consisted of 13 country delegations representing members of ISAC and upto four other organizations appointed by the board.

✿ In 2000, the IASC received support from the International Organization Of Securities Commissioners (IOSCO), the primary forum for International Corporation among securities regulator. The IOSCO recommended its members (181 Organizations including USSEC and committee of European Securities Regulators) permit multinational companies (MNC's) to use IASC standards along with reconciliation to national GAAP.

**Table 2: IAS Still In Force For 2009 Financial Statements**

List IAS still in force for 2009 Financial statements	
IAS 1: Presentation of financial statements	IAS 24: Related party disclosure
IAS 2: Inventories	IAS 26: Accounting & reporting by Retirement benefit plans
IAS 7: Cash flow statements	IAS 27: Consolidated and separate financial statements
IAS 8: Accounting policies, changes in accounting estimates and Errors	IAS 28: Investment in Associates
IAS 10: Events after the reporting period	IAS 31: Investment in Joint Ventures
IAS 11: Construction Contracts	IAS 32: Financial Instruments- Presentation
IAS 12: Accounting Treatment for Income Taxes	IAS 33: Earning per share
IAS 16: Property, plant and equipment	IAS 34: Interim Financial reporting
IAS 17: Accounting for leases	IAS 36: Impairment of Assets
IAS 18: Revenue	IAS 37: Provisions contingent liabilities and contingent Assets
IAS 19: Employee benefits	IAS 38: Intangible Assets
IAS 20: Accounting for government grants	IAS 39: Financial Instruments- Measurement & Recognition
IAS 21: The effects of changes in Foreign Exchange rates	IAS 40: Investment property
IAS 23: Accounting for borrowing costs	IAS 41: Agriculture

✿ IASC issued 41 numbered standards, known as International Accounting Standards (IAS) as well as frameworks. Many have been withdrawn, many are still in force. In addition, some of the interpretations issued by the IASC's interpretive body (SIC) are still in force.

✿ In 2001, fundamental changes were made to strengthen the independence and quality of the international accounting standard-setting process. And so, IASC board was replaced by the International Accounting Standards Board (IASB) as the body in charge of setting the international standards. The interpretive body of the IASC (SIC) has been replaced by IFRIC.

The organization that comprises of both IASB and its trustees is International Accounting Standards Committee Foundation ("the IASC foundation"). The objectives of this foundation as stated in its constitution are:-

✿ 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 various capital markets of the world and other users of the information to make economic decisions.

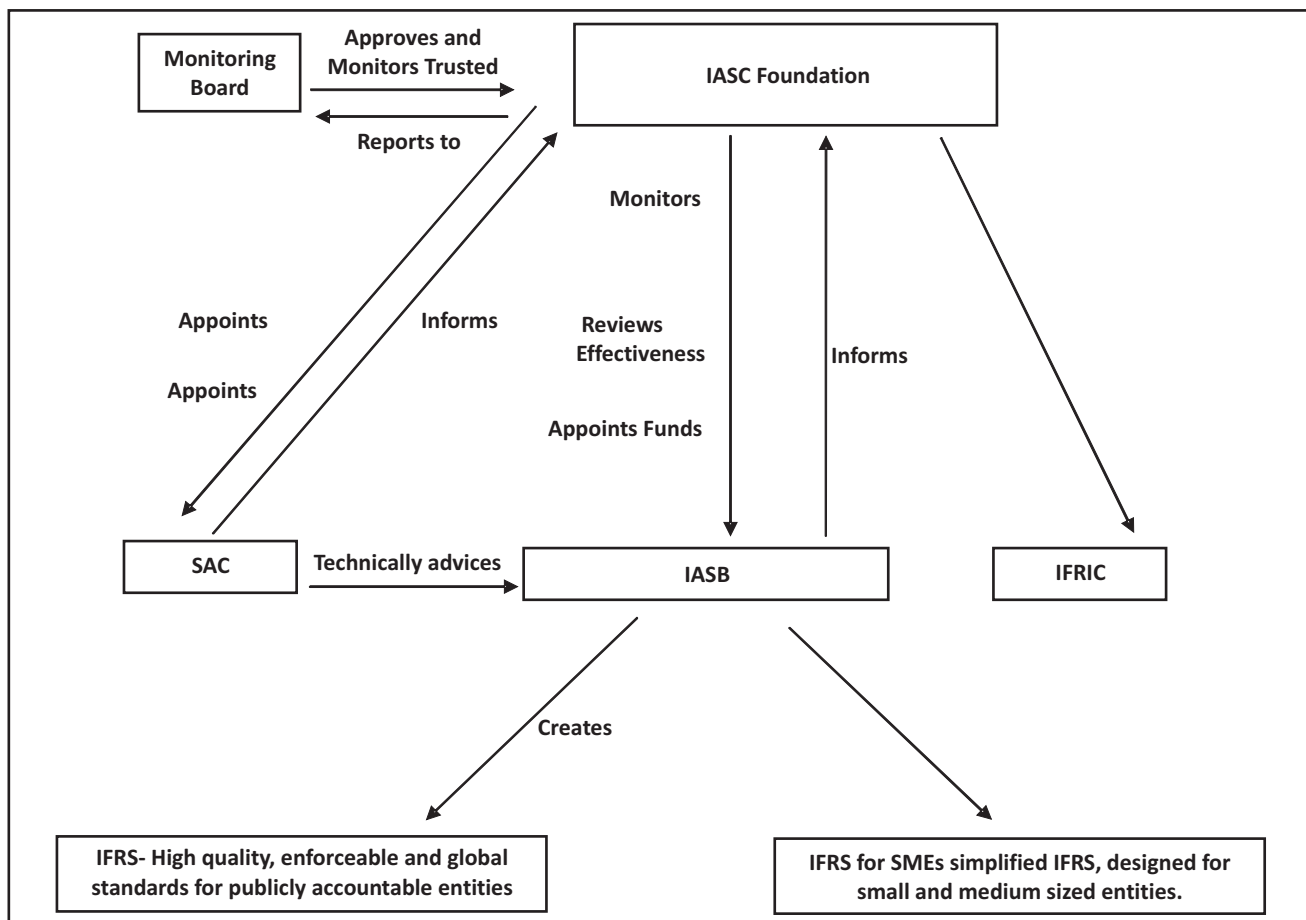
✿ To promote the use and rigorous application of those standards and,

✿ In fulfilling the above objectives, to take account of, as appropriate, the special needs of small and medium sized entities and emerging economies and,

✿ To bring about the convergence of national accounting standards and international financial reporting standards to High-quality solutions.

✿ In 2001, IASB adopted all IAS issued by IASC according to its own standards after some revision. Further new standards issued by IASB are known as IFRS.

**Figure 2: Process Of Evaluation**



**Table 3: List of IRS**

<u>List of IRS</u>
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: Explanation & Evaluation of mineral resources
IFRS 7: Financial Instruments; disclosure
IFRS 7: Operating segments

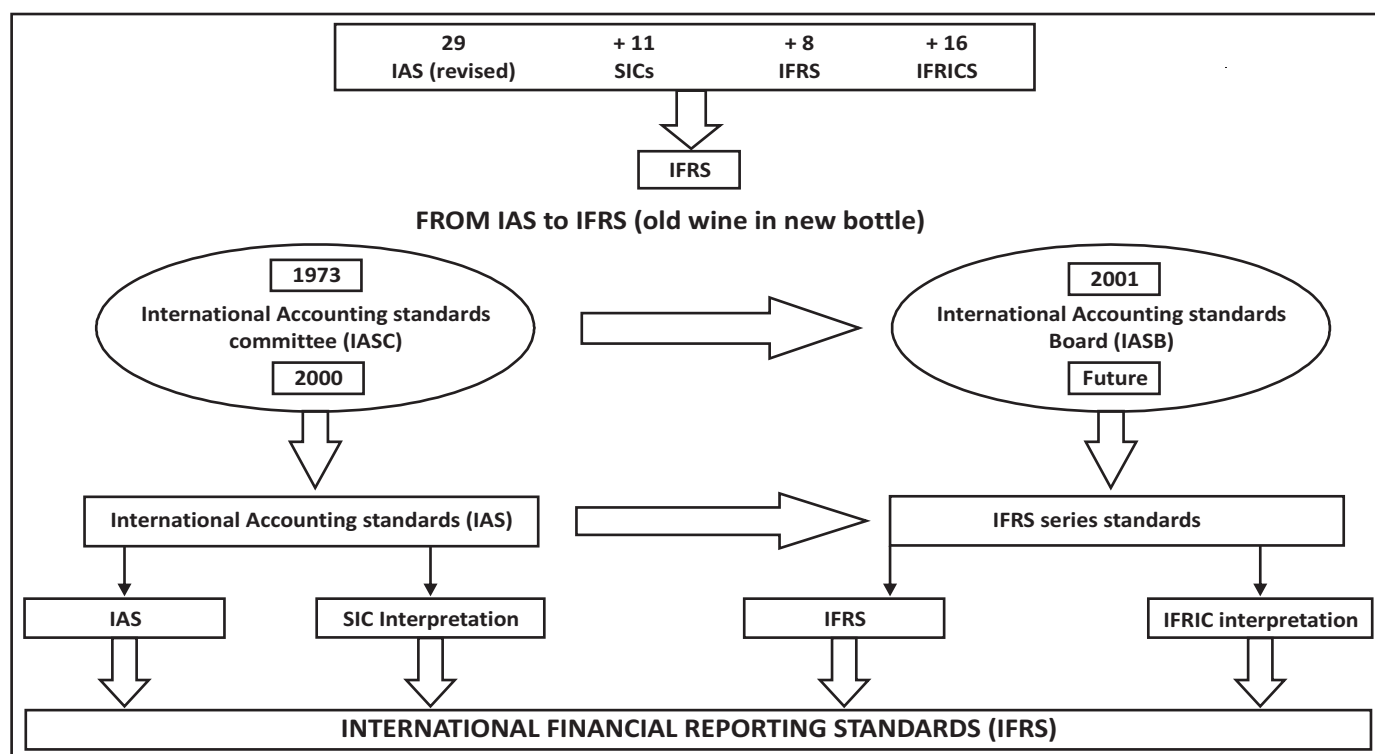
## WHAT IS IFRS? ITS MEANING

✿ IFRS are a set of international accounting standards stating how particular types of transaction and other events should be reported in financial statements. Other events should be reported in financial statements. They are guidelines and rules set by IASB - the companies and organizations can follow when compiling financial statements. The creation of international standards allows investors, organizations and governments to compare the IFRS supported financial statements with greater ease.

✿ The term IFRS has both a narrow and a broad meaning, Narrowly, IFRS refers to the new numbered series of pronouncements that IASB is issuing as distinct from the IAS series issued by its predecessor IASC. More broadly, IFRS refers to the entire body of IASB pronouncements, including standards and interpretations approved by IASB, IFRIC, IASC and SIC.

✿ 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

**Figure 3**



balance sheet right and hence can bring significant volatility to the income statement.

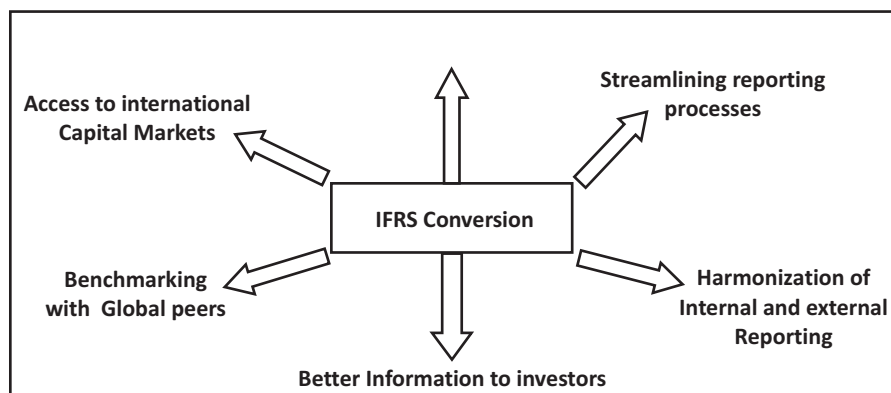
## ADVANTAGES OF ADOPTING IFRS

**1. Globalization:** Most of the countries of the European Union have switched over to IFRS. If companies in India also switched over to IFRS, it would make transaction and dealings with companies of other countries who operate under IFRS much easier. It would also give stock holders and other interested parties a common basis of comparability. Adopting a global financial reporting basis will enable the company to be understood in the global market place. It allows company to be perceived as an international player.

**2. Clarity & Productivity:** Under IFRS, makers of financial statements use their own professional judgment as to how to handle a specific transaction. This will lead to less time being spent trying to follow all rules/ complications that are coupled with rule based accounting. It will also allow prepares of financial information to keep statement on a simplistic and understandable form for investors and other companies interested in the said company's financial statements.

**3. Consistent Financial Reporting Basis:** A consistent financial reporting basis would allow a multinational company to apply common accounting standards with its subsidiaries worldwide, which would transform internal communications, quality of reporting and group decision making.

**Figure 4: Improved Management Information System**



**4. Improved Access To International Capital Markets:** Many Indian entities are expanding and making significant acquisition in the global arena, for which large amount of capital is required. The majority of the stock exchanges require financial information prepared under IFRS. Convergence to IFRS will enable Indian entities to have access to international capital markets, reducing the risk premium that is added to those reporting under Indian GAAP.

**5. Lower Cost Of Capital:** Migration to IFRS will lower the cost of raising funds, as it will eliminate the need for preparing dual sets of financial statements. It will also reduce accountant's fees, abolish risk premiums and will enable access to all major capital markets as IFRS is globally acceptable.

**6. 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 adjustments for preparing consolidated financial statements or filing financial statements in different stock exchange.

**7. Reflect True Value Of Acquisition:** In Indian GAAP, business combinations (with few exceptions) are recorded at carrying values rather than fair value of net assets. In the acquirer's book, it is usually not reflected separately in the financial statements, instead, the amount gets added to the goodwill. Hence, the true value of the business combination is not reflected in the financial statements. IFRS will overcome this flow as it mandates accounting for net assets taken over in a business combination fair value. It also requires recognition of intangible assets, even if they have not been recorded in the acquirer's financial statements.

**8. Benchmarking With Global Peers:** 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 based or global business environment,

rather than merely local ones.

## CHALLENGES

**1. Wide Gap:** IFRS is very much different from the present accounting policies being followed. There are big differences expected in accounting for financial instruments, deferred taxes, business combinations and employee benefits, valuation of PPE.

**2. Increased Responsibility:** The change to IFRS opens up certain choices a company will have to account for some items. This also carries with it the responsibility of explaining to investors the reasons for the choices and the impact on financial statements. A communication strategy should be developed to prepare the market and stakeholders for potential impacts of IFRS on key performance measures.

**3. Tax Implications:** IFRS convergence will have a significant impact on the financial statements and consequently tax liabilities. Tax authorities would ensure that there is clarity on the tax treatment of items arising from convergence to IFRS eg: The government authorities tax unrealized gains arising out of the accounting as required by the standard on financial instruments. From an entity's point of view, a thorough review of the existing tax planning strategies is essential to test their alignment with changes created by IFRS.

**4. 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 profit is still to be debated, in order to ensure that, distribution of unrealized profits will not eventually lead to reduction of share capital.

## CURRENT PERSPECTIVE IN INDIA

### A) PRESENT STATUS OF INDIAN ACCOUNTING STANDARD

✿ The accounting standards Board (ASB) of the Institute of chartered Accountants of India (ICAI) formulates Accounting standards (AS) based on the IFRS, keeping in view the local conditions including legal and economic environment, which have recently been notified by the central government under the companies Act 1956.

✿ Accordingly, the ASB depart from the corresponding IFRSs to maintain consistency with legal, regulatory and economic environment and keeping in view the level of preparation of the industry and the accounting professionals.

✿ In some cases, departures are made on account of conceptual differences with the treatments prescribed in the IFRSs.

### B) INDIAN CONVERGENCE TO IFRS

✿ In line with the global trend, the institute of chartered accountants of India (ICAI) has proposed a plan for convergence with IFRS w.e.f April 1, 2011.

✿ In India, the institute of chartered accountants of India (ICAI) has issued a document entitled “Concept Paper of Convergence with IFRS in India” to evaluate the need for Indian GAAP to change to IFRS. In this paper, the ICAI specifies that with globalization, it has become imperative for India to make a formal strategy for convergence with IFRS with the objective of harmonizing with globally accepted accounting standards.

✿ The paper recognizes the advantages arising from convergence to various stakeholders, viz, the economy, industry, investors and accounting professionals. It also highlights that convergence would require some fundamental changes in the corporate laws and regulations currently guiding the accounting and reporting space in India. Keeping all this in view, ICAI in its 269<sup>th</sup> meeting held on 2.4.2006 decided to converge with IFRS. It has given deadline of 1.4.2011 for adoption of IFRS by public interest entities such as listed companies, Banks, Insurance companies and Large-size entities.

### C) MEANING OF CONVERGENCE WITH IFRS

✿ Convergence means to achieve harmony with IFRS. It can be considered to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRSs, ie, National Accounting Standards comply with all the requirement if IFRSs.

✿ Convergence doesn't mean that IFRS should be adopted word by word. e.g.:- Replacing the term 'true & fair' for 'present fairly' in IAS I does not lead to non-convergence.

✿ The IASB accepts in its “Statement of best practice: working relationships between the IASB and other accounting



standards setters” that adding disclosure requirements or removing optional treatments do not create non-compliance with IFRSs. But, such changes should be made clear so that the users are aware of them.

## D) IFRS REPORTING IN INDIA

✿ Reporting under IFRS, as proposed by ICAI, would be applicable for accounting periods beginning on or after April 1, 2011.

✿ The first set of IFRS financial statements for the year ending March 31, 2012 would require preparation of:

Figure : 5

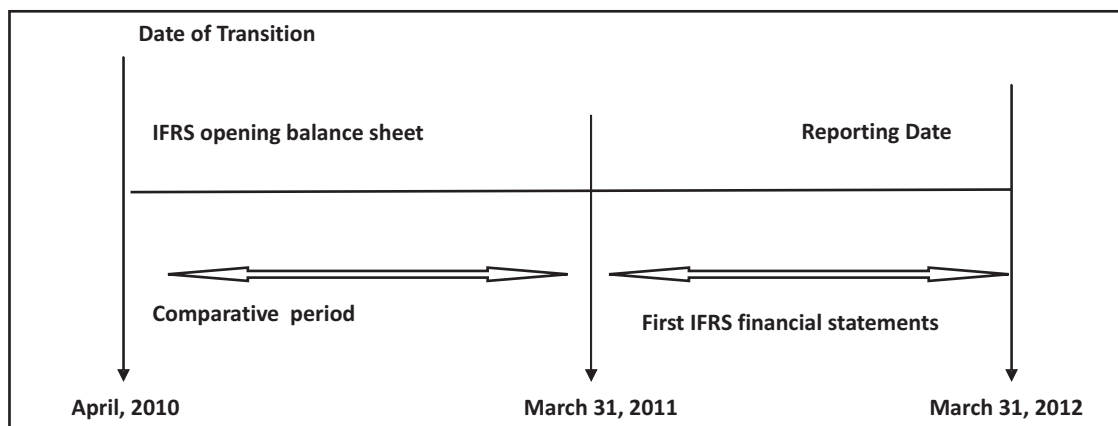
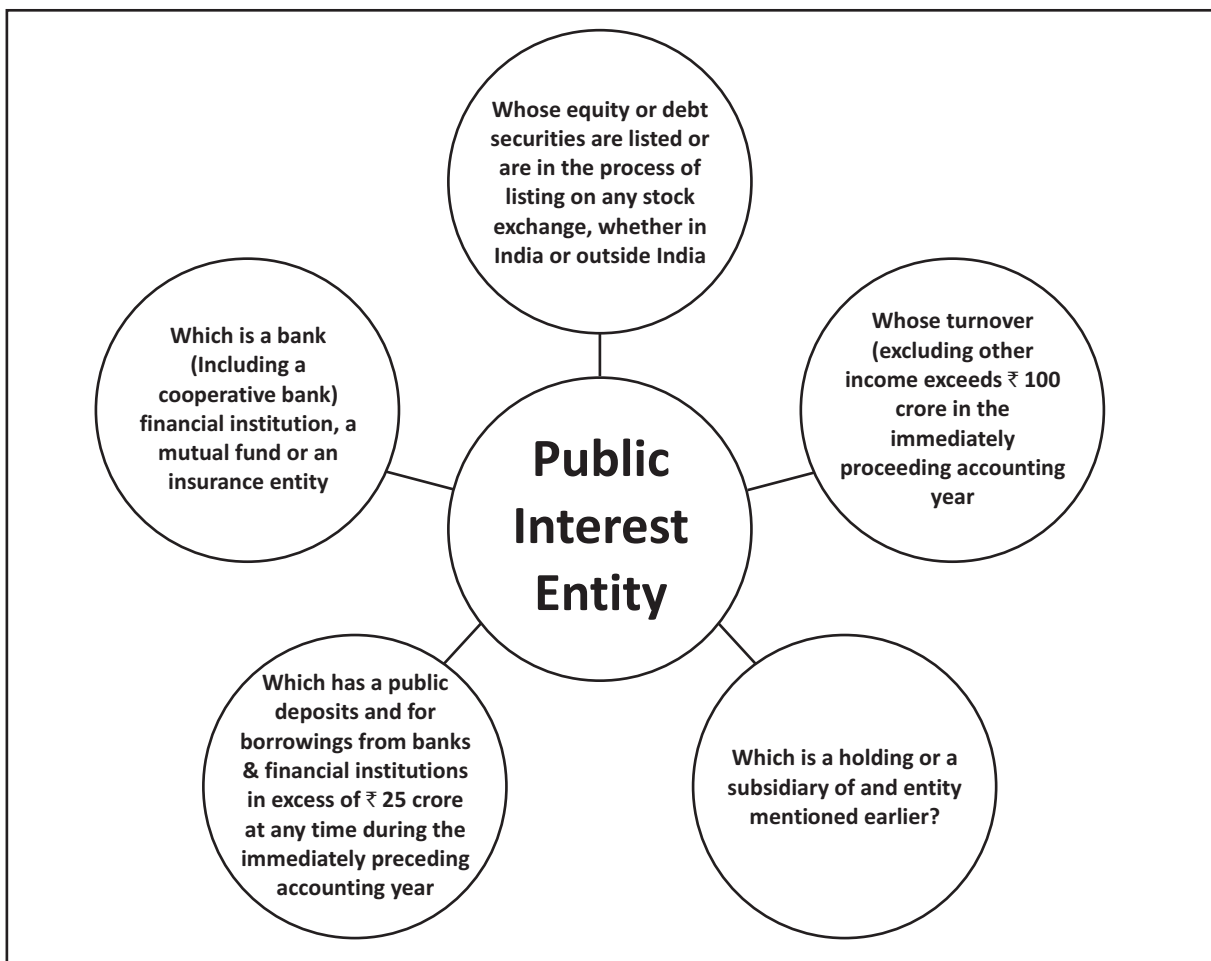


Figure : 6



- ✿ Opening balance sheet as on April 1, 2010.
- ✿ Comparative financial statements - Year ending March 31, 2011.
- ✿ Reporting enterprises would need to ensure preparation for IFRS reporting as early as April'2010.

## **E) ENTITIES COVERED UNDER CONVERGENCE STRATEGY IN INDIA.**

✿ Keeping in view the complex nature of IFRSs and the extent of differences between the existing accounting standards and the corresponding IFRSs, the ICAI is of the view that IFRSs, should be adopted for public interest entities from the accounting periods beginning on, or after 1<sup>st</sup> April'2011 e.g.:- listed entities, banking, insurance companies.

## **FORMAT OF IFRS IN INDIA**

- ✿ The format of IFRS to be adopted for public interest entities should be the same as that of IFRSs, including their numbers.
- ✿ The numbers of the existing accounting standards may be given in brackets for the purpose of easier identification.
- ✿ Wherever required, a section maybe at the end of the adopted IFRS indicating the Indian legal and regulatory position.
- ✿ The IFRSs, when adopted, will take into account the interpretation issued by IASB.

## **ROLE OF ACCOUNTING STANDARDS BOARD IN POST CONVERGENCE SCENARIO**

- ✿ To determine whether each IFRS meets specified criteria set out in local regulations/ legislation.
- ✿ Endorse the IFRSs in the form of IFRS equivalent Indian Accounting Standards for the local regulatory framework with changes such as removing optional treatments and adding disclosure requirements, where appropriate.
- ✿ Present the Indian Accounting standards so developed for approval of National Advisory Committee on Accounting Standards (NASAS) for the purpose of government notification.

## **IFRS FOR SMALL AND MEDIUM SIZED ENTITIES (SMEs)**

- ✿ SMEs need not adopt all the IFRS as it will be too voluminous for them.
- ✿ A separate standard for SMEs will be formulated based on the IFRS for SMEs which is still in exposure draft stage.
- ✿ The proposed standard represents a simplified set of standards for SMEs with recognition and measurement simplified and not relevant to SME's eliminated.
- ✿ Compliance with IFRS for SME's is not necessary to make India IFRS compliant.

## **CONCLUSION**

In this era of globalization, the world has become a global village. Cross border business transactions, multinational investments and dismantling barriers have transformed businesses during the last decade into a single market for the whole world. In order to strengthen the global financial markets, the accounting professionals and academicians across the world have realized the need to harmonize the accounting policies, financial disclosures and related issues. IFRS, a global set of accounting standards, provides benefits such as greater transparency and comparability of financial information across countries. As companies compete globally, the movement towards IFRS is rapidly becoming one of the most important issues for companies to address today.

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