

INTRODUCTION TO IFRS

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PRESENTATION CONTENTS

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- Nature of Accounting Standards
- Accounting Standards in India (IGAAP)
- Global Developments
- What is IFRS ?
- Time Lines for adoption of IFRS
- IFRS – Differences in Framework
- IFRS 1 – First Time Adoption of IFRS

NATURE OF ACCOUNTING STANDARDS

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- **PRINCIPLE BASED**: Standards lay down basic principles and are to be modified/adapted to individual requirements
 - (For e.g. IAS, IFRS, IGAAP)
- **RULE BASED**: Standards lay down detailed guidelines for every situation/possibility and are to be strictly followed.
 - (For e.g. US GAAP)
- Principle based standards are now more in favour
- Reason for shift is:
 - Growing belief that rules cannot be laid down for every conceivable situation
 - If no Rule exists for a particular situation, there is improper recognition, measurement or disclosure

OBSERVATIONS OF US ADVISORY COMMITTEE ON IMPROVEMENTS TO FINANCIAL REPORTING

Investors are likely to benefit from more emphasis on principles-based standards, since rules-based standards may provide a method, such as through exceptions and bright-line tests, to avoid the accounting objectives underlying the standards.

In other words, without the exercise of judgment, rules in the form of bright lines may result in a false consistency – that is, ostensibly uniform accounting for differing fact patterns.

If properly implemented, “principles-based” standards should improve the information provided to investors while reducing investor concerns about “financial engineering” by companies using the rules to avoid accounting for the substance of a transaction”.

WHAT IS IGAAP ?

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- All companies required to prepare financial statements as per section 211(3C) of Companies Act, 1956
- Under sec 211(3C) of the Companies Act, 1956, MCA through the National Advisory Council for Accounting Standards (NACAS) issues Accounting Standards
- MCA has notified Companies (Accounting Standards) Rules, 2006 and subsequent amendments to the same
- These rules contain AS 1 to AS 29 (except AS 8 which is deleted)
- Applicability of notified standards diluted for Small and Medium sized Companies (SMCs)

WHAT IS IGAAP ? ...

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- AS initially issued by ICAI, but need to be notified by NACAS
- ICAI has issued AS 30, as 31 and AS 32, but still not notified by NACAS
- IGAAP thus refers to:
 - Notified Standards u/s 211(3C)
 - Clarifications issued by ICAI/MCA for applicability of standards
 - AS issued by ICAI
 - Guidance Notes issued by ICAI
 - Announcements by ICAI on topical matters

GLOBAL DEVELOPMENTS

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- Currently, more than 100 countries require or permit listed entities (and banks, etc) the use of IFRS.
 - ❖ European Union (EU) required listed companies in its member states to follow IFRS from 2006 for CFS
 - ❖ China has adopted from 2008
 - ❖ Canada and Japan have set a date of 2011
 - ❖ **India 1st April 2011**
- By 2011, more than 150 countries would adopt IFRS
- In US, SEC now permits foreign companies to follow IFRS without doing a reconciliation with US GAAP.
- In future, SEC may allow even local (US based) companies to follow IFRS (by 2014)

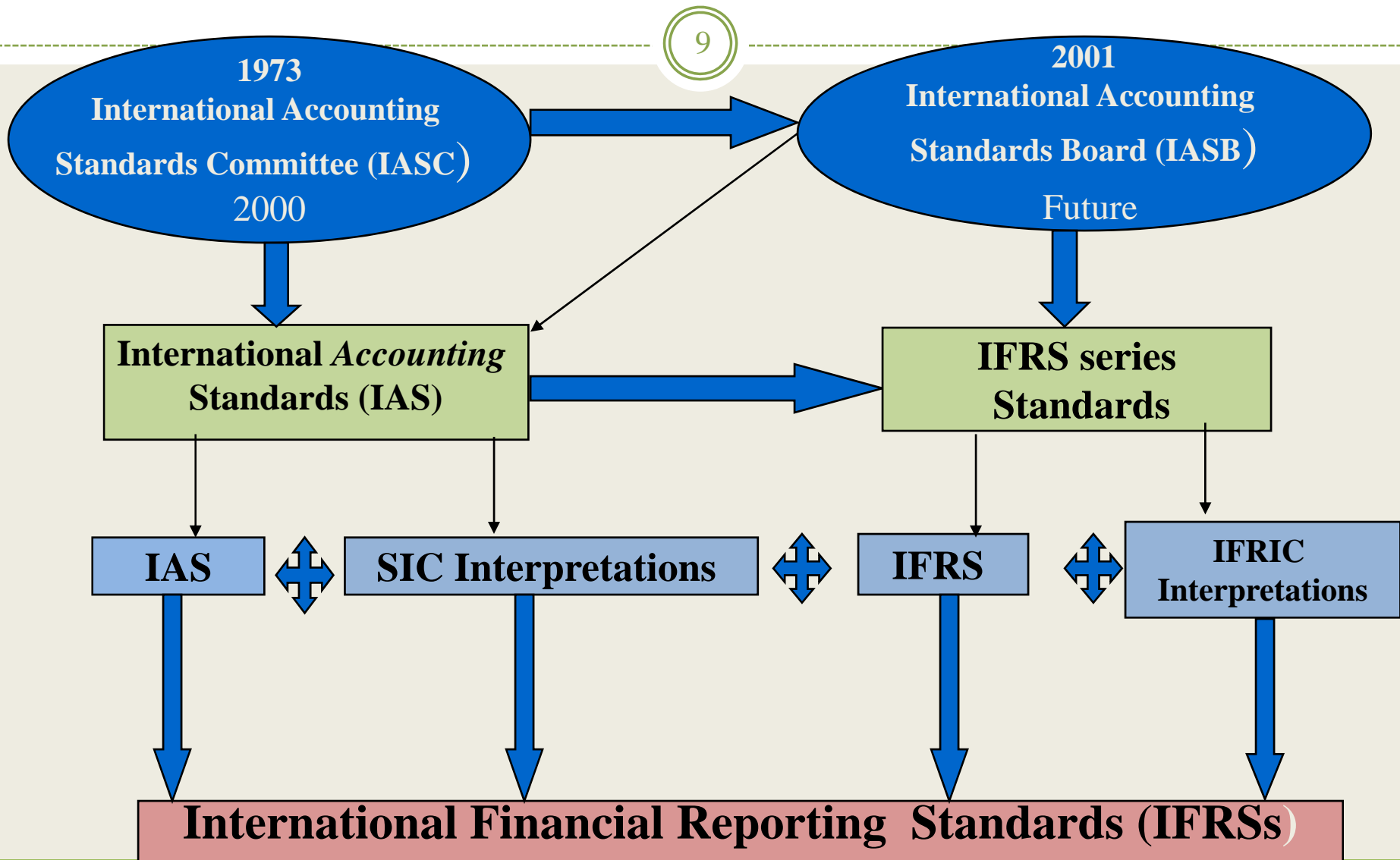
ADOPTION OF IFRS IN INDIA

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WHAT IS IFRS?

WHAT IS IFRS?

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WHAT IS IFRS? ...

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- **Number of IFRS-IAS issued to date:**
 - ❖ 9 IFRS
 - ❖ 29 IAS
 - ❖ 19 IFRIC
 - ❖ 11 SIC
- So far, IFRS covers appx. 3,000 pages
- Constant review of the above by IASB so as to carry out modifications as necessary
- US GAAP covers appx. 17,000 pages

WHAT IS IFRS? ...

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- Extensive consultative process before final issuance of any Standard
- Principle based – rather than Rule Based
 - ❖ Principles encourage compliance whereas Rules can promote avoidance
- Contains very few alternatives
- Detailed Disclosure requirements
- Judgement based – Involves subjectivity in many cases

IFRS CONTAINS SOME COMPLEX TERMS

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- IFRS contains increasing range of technical terms
- Most of these technical terms are difficult to understand and apply in practice and requires additional guidance.
- Can require subjective judgement to apply these terms in different situations
- Adoption of IFRS is across various countries – in some countries it is used after translation into local languages say., French, German, etc
- Some of these terms don't translate well into other languages

SOME COMPLEX TERMS USED IN IFRS ...

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- **May, Normally, Commonly, Substantially**
- **Virtually Certain, Reasonably Certain**
- **Rare, Extremely Rare, Rarely**
- **More likely than not, Extremely unlikely,**
- **Highly, Highly Abnormal,**
- **Unavoidable, No realistic alternative,**
- **Likely, Possible, Principally, Probable ...**

IFRS FRAMEWORK

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Historical Cost is not relevant

Fair Value more relevant for measurement of assets and liabilities.

Time Value of Money

Discounting to be done for future cash flows.

Substance over Form

Contractual Substance over Legal Form.

Balance Sheet is the focus rather than the PL a/c

Difference between 2 BS is Income statement

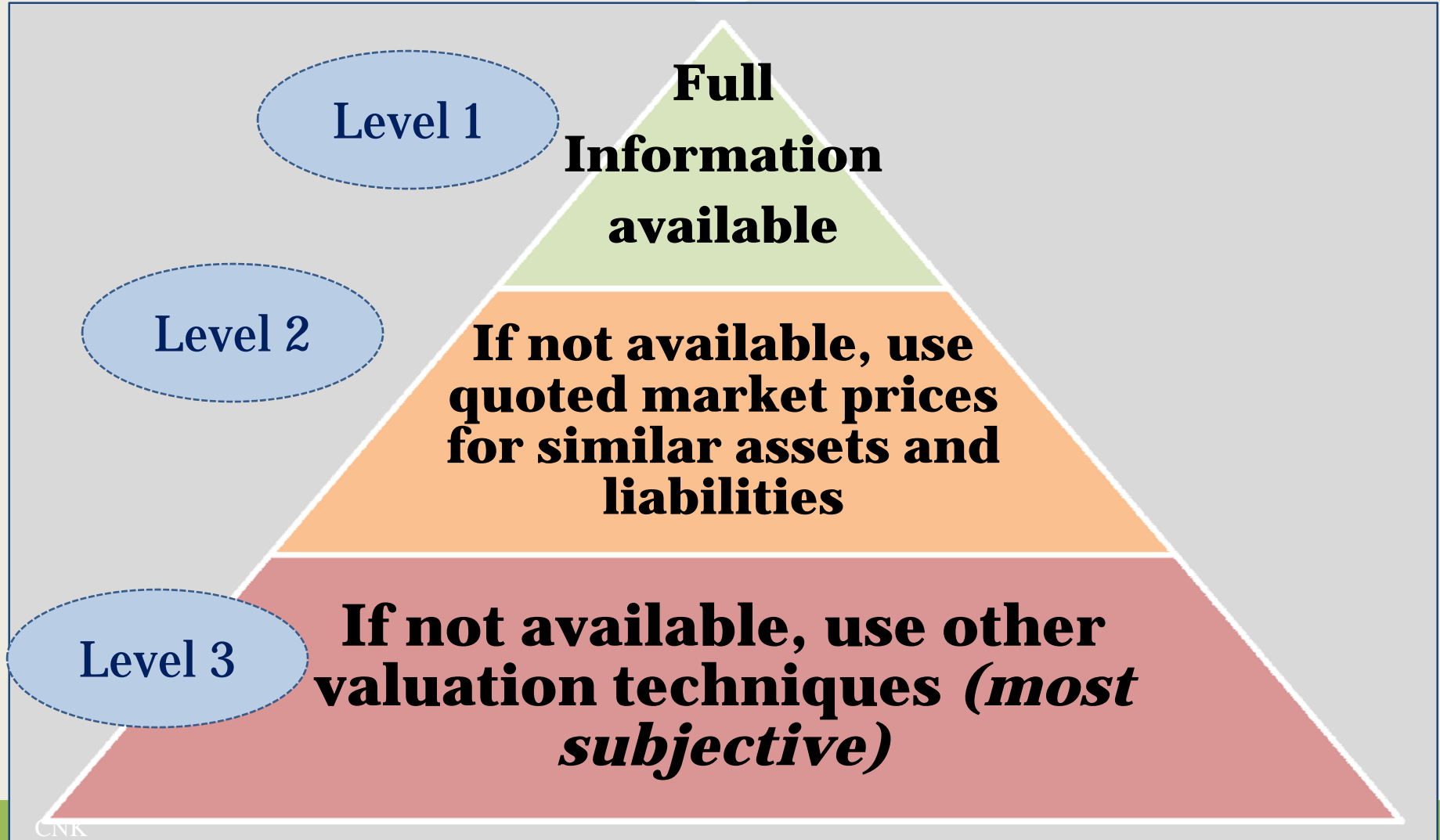
FAIR VALUE

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- IFRS extensively uses “**Fair Value**”
- All new and revised IFRS are based on an accounting model that focuses on Fair Value
- **Fair value concept relevant in IFRS for:**
 - ❖ Business Combinations (Amalgamations, etc)
 - ❖ Financial instruments;
 - ❖ Property, Plant and Equipment (optional – if revaluation is carried out)
 - ❖ Investments;
 - ❖ Share options;
 - ❖ Impairment; etc.

FAIR VALUE HIERARCHY

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TIME VALUE OF MONEY

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- Historical cost not relevant.
- Prudence principle therefore not to be followed.
- Appropriate discounting to be done.
- Amortised Cost method preferred method.
- Detailed rules for:
 - when and how discounting to be done,
 - discounting rate, etc.

SUBSTANCE OVER FORM

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- Legal Form vs. Contractual Substance.
- IFRS entirely based on “Contractual Substance”
- Illustrations:
 - VRS obligation arises on announcement rather than on acceptance by employees;
 - Acquisition of a company mainly with the intention to take over the premises;
 - Seasonal dealer incentives – reduction in Revenue
 - Redeemable Preference Shares / Fully Convertible Debentures – whether capital or liability?

BALANCE SHEET TO BE THE FOCUS

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- Correct position of all assets and liabilities at BS date most important.
- *“User should know what the preparer knows”*
- Income statement will be the difference of 2 BS.
- While valuing assets/liabilities at BS date, Fair Value and Time value of money to be considered.
- Some assets can still remain at Historical cost.
- Rules for different assets/liabilities.
- Income statement becomes more volatile, since no smoothening possible.

ADOPTION OF IFRS IN INDIA

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TIME LINES IN ADOPTION OF IFRS

IFRS ADOPTION ROADMAP GIVEN BY MINISTRY OF COMPANY AFFAIRS (MCA)

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Two sets of Accounting Standards as per Section 211(3C)

IGAAP as Converged with IFRS
(To be implemented for specified class of
Companies in Phases)

Existing IGAAP as applicable to Other
Companies Including SME

Phase 1:
(From 1/4/2011)

- a. Part of NSE 50
- b. BSE 30
- c. Listed on Stock Exchanges o/s India
- d. Companies with Net worth > Rs.1,000 Crores**

Phase 2.
(From 1/4/2013)
Companies with
Rs.500Crores<Netw
orth < Rs.1000Cr

Phase 3
(From 1/4/2014)
Listed Companies
With Networth<=
Rs.500 crores

- a. Non Listed Companies with Networkth <= Rs.500 Crores and not listed on Stock Exchanges O/s India
- b. SME

IFRS ROADMAP IN INDIA ...

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- **Whether comparative IGAAP figures for previous years?**
 - Only opening BS to be prepared as on 1st April 2011
 - Requirement for Comparatives not mentioned
 - Practically companies would like to give IFRS comparisons and hence would also convert for 2010-11
- **Date of determination of criteria:**
 - 31st March 2009
- **For Insurance Companies:**
 - Applicability from 1st April 2012 onwards
- **For Banks, NBFCs:**
 - Applicability from 1st April 2013 onwards in phased manner

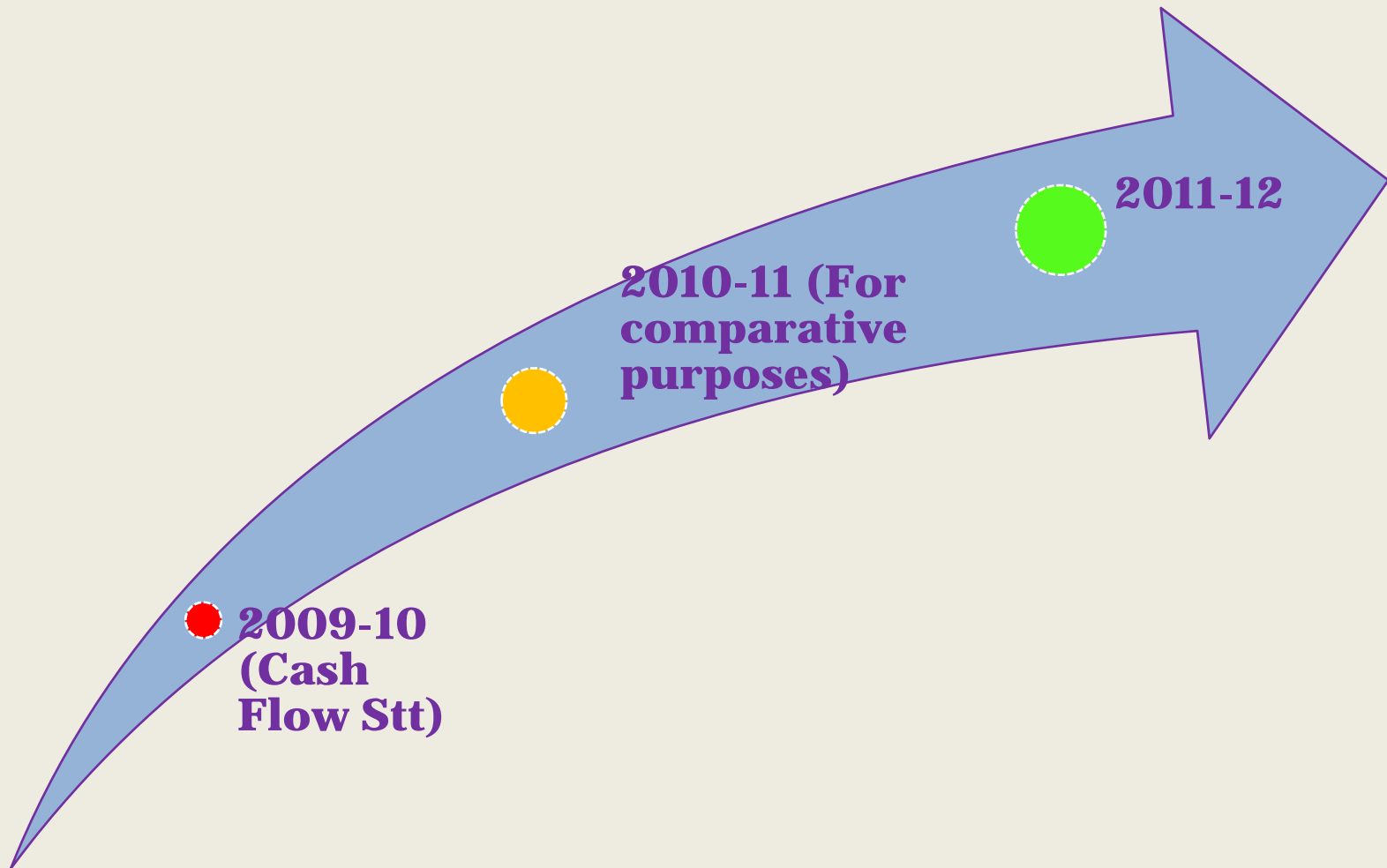
KEY DATES FOR FIRST TIME ADOPTION OF IFRS IN INDIA

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Financial Year	Balance Sheet	Income Statement	Cash Flow Statement	Remarks
2011-12	IFRS	IFRS	IFRS	As announced by MCA
2010-11	IFRS	IFRS	IFRS	For Comparative figures
2010-11	AS Rules	AS Rules	AS Rules	As per Companies Act
2009-10	IFRS			To prepare Cash Flow for 2010-11 and for opening balances
2009-10	AS Rules	AS Rules	AS Rules	As per Companies Act

KEY DATES FOR FIRST TIME ADOPTION OF IFRS IN INDIA

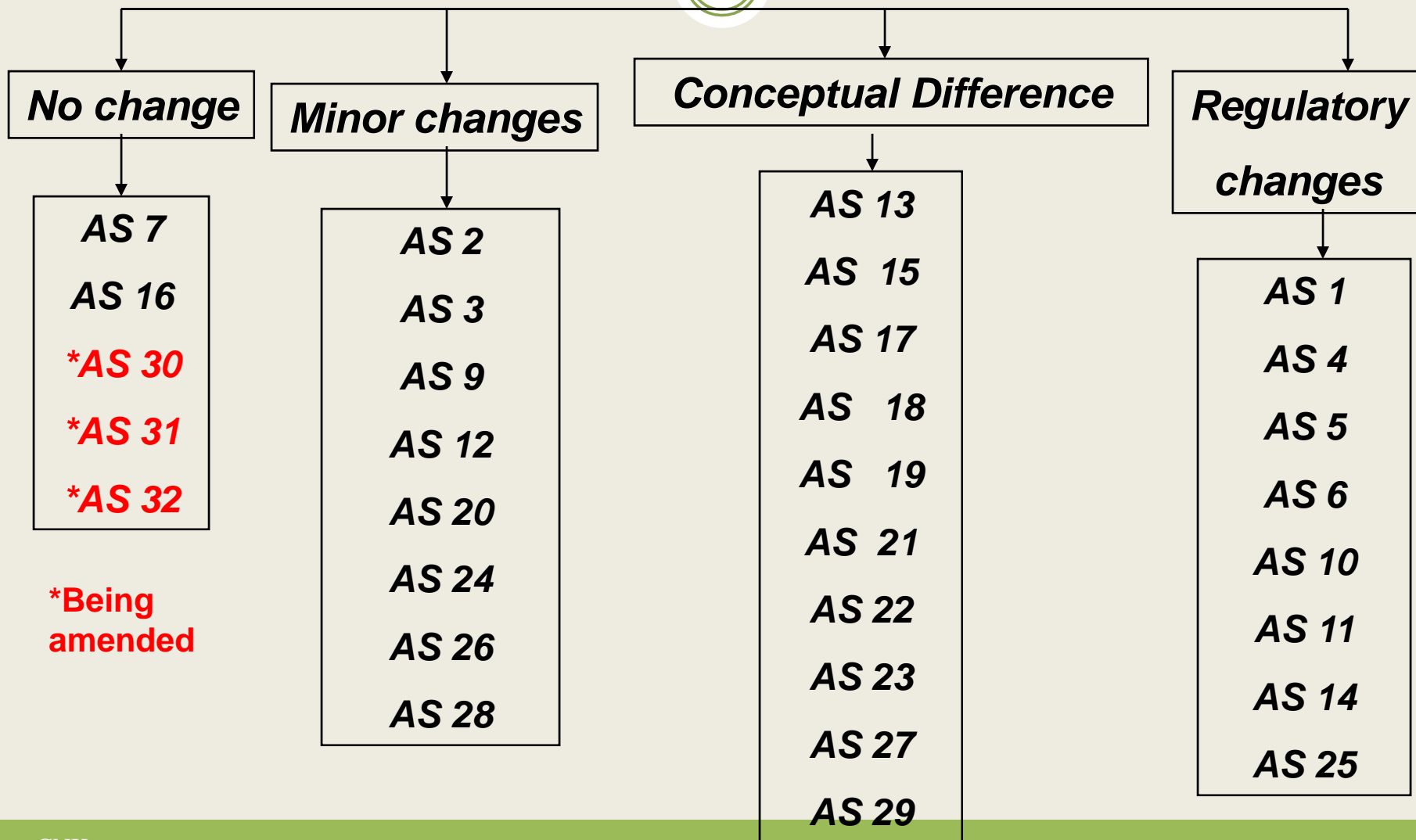
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IFRS – IGAAP CONVERGENCE

MAGNITUDE OF CHANGE ...

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IFRS 1

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First – Time Adoption Of International Financial Reporting Standards (IFRSs)

IFRS 1 – Objective

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- IFRS 1 applies to an entity that present its first IFRS Financial Statements.
- IFRS 1 was substantially rewritten in 2008 with the objective :
 - of making the Standard clearer and easier to follow.
 - to accommodate ongoing changes to the Standard in better way.
- The revised Standard is effective for periods beginning on or after 1 July 2009, with earlier application permitted.
- Objective of IFRS 1 is:
- To ensure entity's first IFRS Financial Statement contains high quality information that is :
 - Transparent for user and comparable over all periods presented.
 - provides suitable starting point for accounting under IFRS
 - Cost effective.

IFRS 1 - DEFINITIONS

- **First time Adopter:** An entity that presents its first IFRS financial statements.
- **First IFRS Financial Statement (FS):** The first annual FS in which an entity adopts IFRSs by an explicit and unreserved statement of compliance with IFRSs (for Phase I – F.Y. 2011-2012).
- **Transition Date:** The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements (01/04/2011).
- **Reporting Period:** The latest reporting period covered by an entity's IFRS financial statements (F.Y. 2011 -2012).
- **Deemed Cost:** An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation/ amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.

IFRS 1 – General Principles

- To comply with each IFRS effective at the end of first IFRS reporting period (i.e. for Phase I – 31/03/2012).
- Retrospective application of all IFRSs except for ‘exceptions’ and ‘exemptions’ provided in IFRS 1.
- At the date of transition effects of all adjustments resulting from the application of IFRSs to be recognised in retained earnings, except for reclassifications between goodwill and intangible assets.
- To comply with all the presentation and disclosure requirements of other Standards and Interpretations.
- Additional disclosure of reconciliations between amounts reported under previous GAAP and the equivalent measures under IFRSs

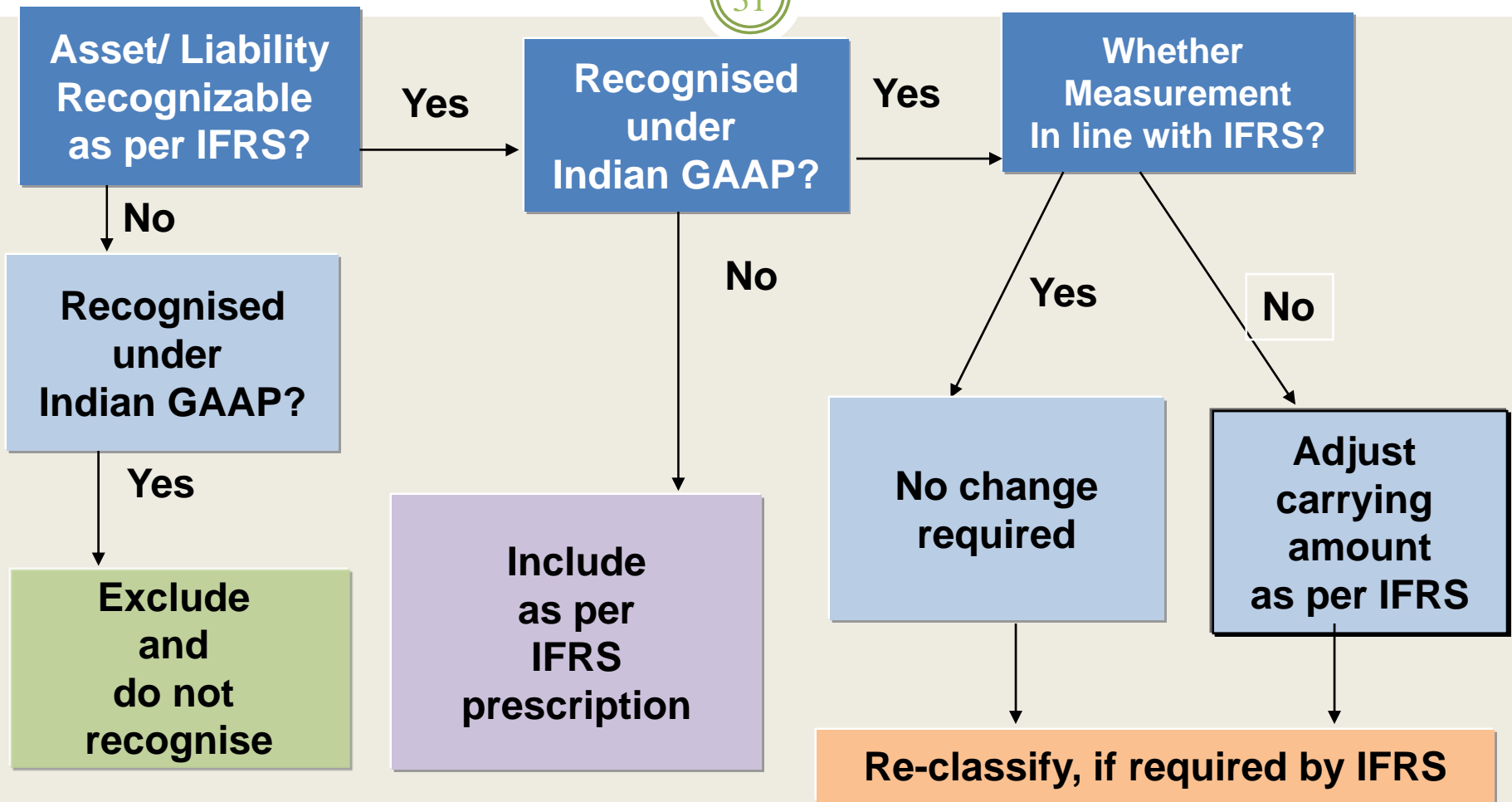
IFRS 1 – General Principle ...

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- Any errors in relation to an entity's previous GAAP financial statements – to show separately in reconciliation.
- Transitional provisions in other IFRSs are not applicable except as provided in IFRS 1.
- To recognise all assets and liabilities in accordance with the requirements of IFRSs, and derecognises assets and liabilities that do not qualify for recognition under IFRSs.

OPENING BALANCE SHEET

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IFRS 1 – EXEMPTIONS VS. EXCEPTIONS

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- Exemptions
 - Optional
 - Choice to be made judiciously
- Exceptions
 - Mandatory

PROGRESS OF IFRS IMPLEMENTATION IN INDIA

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- MCA (NACAS) is to issue converged standards in India
- These would be substantially in line with IFRS/IAS
- Exposure Drafts (ED) issued by ICAI for most standards in line with IFRS/IAS
- Converged Standards to be called **IND-AS xx**
- Changes in many IND-AS as compared to IFRS
- Final standards still not issued by ICAI

PROGRESS OF IFRS IMPLEMENTATION IN INDIA ...

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- Converged standards to be part of Companies Bill, 2009
- Companies Bill, 2009 introduced in Rajya Sabha in 2009
- Comments of Standing Committee in August 2010
- Revised Companies Bill to be introduced in Winter session or later
- Revised Bill to include converged standards
- Several other changes required in Companies Bill to make statute in line with IFRS

APPLICABILITY OF IFRS TO SMES

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- Whether to expose SMEs to IFRS of 3,000 pages?
- Applicability to SMEs – options possible:
 - **Modify IFRS to provide exemptions/relaxations,**
 - **Formulate and apply separate IFRS for SMEs**
- IFRS for SMEs issued in July 2009
- ED removes choice for accounting treatment, eliminating topics not generally relevant to SMEs and simplifying methods for recognition & measurement.
- IFRS for SMEs reduced to only 250 pages
- ICAI / NACAS not keen on adoption of IFRS for SMEs in India

IS ADOPTING IFRS DIFFICULT?

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- *ANSWER IS AN UNQUALIFIED YES !!*
- All the more in India, since **it is not adoption, but convergence**
- Challenges faced:
 - Can require extensive system changes for data collection
 - Unavailability of trained manpower
 - Commitment of top management
 - Too much subjectivity
 - Many other regulatory changes also coming up:
 - ✦ Direct Tax Code, GST
 - **IFRS are themselves undergoing a change !!**
- Whether FS prepared using converged IND-AS would be called IFRS compliant?

Thank you