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   INTRODUCTION

   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

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   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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# CONVERGENCE TO IFRS - AN INDIAN PERSPECTIVE

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## ABSTRACT
*Accountants felt the necessity that they should talk the same language which paved for a accounting innovation "IFRS". IFRS stands for International Financial Reporting Standards which are uniform set of accounting standards propounded to be used globally with the aim to furnish useful information to different users such as shareholders, creditors, lenders, management, investors, suppliers, competitors,researchers, regulatory bodies and society at large. This article focuses on convergence on Indian Accounting Standards to International Financial Reporting Standards (IFRS), its current status and challenges.*

## KEYWORDS
Convergence of Accounting Standards, International Financial Reporting Standards, Indian Accounting Standards, Generally Accepted Accounting Practices (GAAP)

## INTRODUCTION
The process of harmonization treats the global community a single entity. As the world is becoming a global village, the awareness of investor has increased and increasing geometrically. Harmonization of accounting standards has already bagged the status of the 'language of the business' that requires reporting of the affairs in a commonly understandable way.

In the statement of Harvey Pitt, US SEC Chairman at SEC Conference (2002) is worth mentioning, "High quality global accounting standards are needed to improve the ability of investors to make informed financial decisions. Companies must keep pace with this progress in order to promote and protect their business credibility in the international market place".

As part of the harmonization in India the Accounting Standard Board of the Institute of Chartered Accountants of India (ICAI) has prepared a concept paper of Convergence with IFRS in India. In precise terms convergence 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"

## REVIEW OF LITERATURE
Accounting numbers whether interpreted by the sellers and by buyers in the same way may be seen from the difference between 'bid" and "ask" prices. Thus with less differences between bid and ask prices give less possibilities for different interpretation and therefore seems to be superior. Luez and Verrecchia (2000) and Gassen and Sellhorn (2006) have shown that companies using IFRSs show smaller bid-ask spreads than those using German GAAP. Platikanova and Nobes (2006) have also shown that in Europe, on average, the bid-ask spread declines after IFRS-adoption. But in Switzerland, the effect is limited to small companies (Dumontier and Maghraoui, 2007).

Regarding the accuracy of analyst forecast, previous research show mixed results. Ashbaugh Pincus (2001) point out that analyst forecast improves after IFRS adoption. Hodgdon et al. (2008) show the compliance with IFRS s reduces analyst forecast errors. Ernstberger et al (2008) have also shown that, in Germany, forecast accuracy is higher for estimate based on IFRS or US GAAP data than for those based on German GAAP figures.

Dumontier and Maghraoui (2007) in Germany shows that compliance with IFRS does not reduce the dispersion of analyst forecast or forecast errors. Cuijpers and Buijink (2005) claim that, in Europe, dispersion of analyst forecast is higher for firms using IFRSs or US GAAP than those using local GAAPs.

According to Van Tendeloo and Vanstraelen (2005), IFRS adoptions do not present different earnings management behavior compared to companies reporting under German GAAP. Lin and Paananen (2007) points out that earnings management is higher in Germany in the post-IFRS adoption period. But Barth et al (2008) says that, in post adoption period, companies applying IFRSs show evidence of less earnings management. We noticed mixed findings in this case.

To the question of value relevance of accounting data there was mixed results. Firms applying IFRS exhibit more value relevant accounting figures than other companies (Barth et al. 2008). The value relevance of IFRS based earnings is higher than that of German GAAP based earnings (Germany: Bartov et al 2005).

IFRS adoption has no effect on the value relevance of book value and net income (Germany: Hung and Subramanyam, 2007). The value relevance of accounting figures is not affected by IFRS adoption (Sweden: Paananen, 2008)

To the question whether there is change in equity after IFRS adoption studies revealed both favorable and non favorable results. The cost of equity capital is lower for companies that adopted IFRS or US GAAP (Germany: Ernstberger and Vogler, 2008). The cost of equity capital is significantly lower for IFRS adopter (Kim and Shi, 2005).

No evidence of a lower cost of equity capital for IFRS adopters (Europe: Cuijpers and Buijink, 2005). Voluntary IFRS adopters do not exhibit lower cost of equity capital (Germany: Daske, 2006).

To the question of whether there is change in debt after IFRS adoption there is a sole study by Kim et al.2005 that IFRS adopters have lower interest rates, larger amount of loan facility, lesser restrictive loan covenants and they attract more foreign lenders. India is in the verge of convergence to IFRS, till date it is not mandated by our Government to follow IFRS, and so not many companies in India are following IFRS. With this background this article studies the possible impacts of following IFRS by the Indian Industries.

## OBJECTIVES
The objective of this article is to address upon the convergence of Indian Accounting Standards with International Financial Reporting Standards in the following areas:

1. Need for convergence
2. Impact of IFRS on accounting practices

3. Impact of IFRS on existing laws and regulations
4. Impact of IFRS - few key sectors
5. Impact of IFRS in functional areas of management

## THE NEED FOR CONVERGENCE

Convergence is needed due to the globalization of businesses and services and increase in cross-border investments and borrowings. Some of the benefits of harmonization are as under:

1. It ensures reliable and high quality financial reporting, in certain cases, it can prove to be crucial to the economic and financial development of a country.
2. It enables a systematic review and evaluation of the performance of a multinational company having subsidiaries and associates in various countries wherein each country has its own set of GAAP.
3. It makes the comparison of the performance of a company against its domestic and international peers easier and more meaningful.
4. It adds to the international credibility of a company
5. It is a precursor for accessing international capital markets which can, in turn, reduce the capital cost and consequently, improve the performance of a company
6. It provides a level playing field where no country is advantaged or disadvantaged by its GAAP and disclosures
7. Stock exchanges benefit from the growth in the listings and volume of securities transactions

## IMPACT OF CONVERGENCE ON FUNDAMENTAL ACCOUNTING PRACTICES

Harmonizing existing Indian accounting standards with IFRS will have an impact on some fundamental accounting practices followed in India. A few of these are enumerated below:

**USE OF FAIR VALUE CONCEPT**

Indian GAAP requires financial statements to be prepared on historical cost except for fixed assets which could be selectively revalued. Use of fair value is presently limited for testing of impairment of assets, measurement of retirement benefits and 'mark-to-market' accounting for derivatives. Under IFRS, there is a growing emphasis on fair value. In addition to the requirements under Indian GAAP, the carrying amounts of the following assets and liabilities are based on fair value under IFRS:

1. Initial recognition of all financial assets and financial liabilities is at fair value
2. Subsequent measurement of all derivatives, all financial assets and financial liabilities held for trading or designated at fair value through profit or loss, and all financial assets classified as needs to comply with all the accounting standards available-for-sale, are measured at fair value
3. Non-current provisions are measured at fair value which is derived by discounting estimated future cash flows
4. Share-based payments are measured at fair value.
5. Option available for measurement of property, plant and equipment at fair value, subject to certain conditions
6. Option available for measurement of intangible assets at fair value, subject to certain conditions
7. Option available for measurement of Investment property at fair value.

**SUBSTANCE OVER FORM**

Considering the overall theme of substance over form, IFRS mandates preparation of consolidated financial statements to reflect the true picture of the net worth to various stakeholders. Exceptions for preparation of consolidated financial statements are very limited. In India, currently consolidated financial statements are mandatory only for listed companies and that also only for the annual financial statements and not the interim financial statements.

Similarly, Indian accounting continues to be driven by the written contract and the form of the transaction as opposed to the substance. Consider, up front fees charged by a telecoms service provider.

Under Indian GAAP, several companies recognize such upfront fees as income because it is contractually non-refundable and is contractually received as fees for the activation process. Under IFRS, the fee is accounted for in accordance with the substance of the transaction. Under this approach, the customer pays the upfront activation fee not for any service received by the customer, but in anticipation of the future services from the telecoms company.

Thus, despite the non-refundable nature of the fees, revenue recognition would be deferred over the estimated period that telecoms services will be provided to the customer.

**PROVISION OF LAW SUPERSEDS ACCOUNTING STANDARDS**

As per the preface to the Indian accounting standards, if a particular accounting standard is found to be not in conformity with a law, the provisions of the said law will prevail and the financial statements shall be prepared in conformity with such law. However, under IFRS, the entity needs to comply with all the accounting standards and other authoritative literature issued by IASB in order to comply .with IFRS. If entities adopt accounting practice as approved by another regulatory authority or in conformity with a law, which is not in accordance with IFRS, the financial statement so prepared would not be considered to be in compliance with IFRS.

**DISCLOSURES**

In India, Schedule VI to the Companies Act, 1956, which prescribes a detailed format for preparation and disclosure of financial statements, lays great emphasis on quantitative information such as quantitative details of sales, amount of transactions with related parties, production capacities, CIF value of imports and income and expenditure in foreign currency, etc. Contrary to the same, IFRS is more focused on qualitative information for the stakeholders, such as terms of related party transactions, risk management policies, currency exposure for the entity with sensitivity analysis, etc. To more correctly report the liquidity position of the entity, IFRS also requires segregation of all assets/liabilities into current and non-current portions. Presently under Indian GAAP even long-term deposits and advances are disclosed under current assets, loans and advances, thereby not reflecting the true position.

**EXCEPTIONAL AND EXTRAORDINARY ITEMS**

Indian GAAP requires companies to disclose significant events which are not in the ordinary course of business as extraordinary items and material items as exceptional to facilitate the reader to consider the impact of these items on the reported performance. Under IFRS there is no concept of extraordinary or exceptional since all events/transactions are in the normal course of business and if an item is material, it can be disclosed separately, but cannot be termed as ‘extraordinary’ or 'exceptional'.

**RESTATEMENT OF FINANCIAL STATEMENTS**

Under Indian GAAP, changes in accounting policies or rectification of errors (prior period items) are recognized in the current year's profit and loss ac'count (for errors) and are generally recognized prospectively (for changes in accounting policies). Under IFRS, the prior period comparatives are restated in both cases. Indian GAAP does not have the concept of restatement of comparatives except in case of special-purpose financial statements prepared for public offering of securities.

**DETERMINATION OF FUNCTIONAL CURRENCY**

Entities in India prepare their general purpose financial statements in Indian rupees. However under IFRS, an entity measures its assets, liabilities, revenues and expenses in its functional currency, which is the currency that best reflects the economic substance of the underlying events and circumstances relevant to the entity *i.e.,* the currency of the primary economic environment in which the entity operates. Functional currency of an entity may be different from the local currency. For example, consider an Indian entity operating in the shipping industry. For such an entity it is possible that a significant portion of revenues may be derived in foreign currencies, pricing is determined by global factors, assets are routinely acquired from outside India and borrowings may be in foreign currencies. All these factors need to be considered to determine whether the Indian rupee is indeed the functional currency or whether another foreign currency better reflects the economic environment that most impacts the entity.

**OTHER SIGNIFICANT ASPECTS**

Under Indian GAAP, provision has to be made for proposed dividend, although it may be declared by the entity and approved by the shareholders after the balance sheet date. Under IFRS, dividends that are proposed or declared after the balance sheet date are not recognized as liability at the balance sheet date. Proposed dividend is a non-adjusting event and is recorded as a liability in the period in which it is declared and approved.

## IMPACT OF EXISTING LAWS AND REGULATIONS

Accounting standard-setting in India is subject to direct or indirect oversight by several regulators,such as the National Advisory Committee on Accounting Standards (NACAS) established by the Ministry of Corporate Affairs, the Reserve Bank of India (RBI),the Insurance Regulatory and Development Authority (IRDA) and the Securities and Exchange Board of India (SEBI). Further, the Indian Companies Act, 1956 (the Act) directly provides guidance on accounting and financial reporting matters. Courts in India also have the powers to endorse accounting for certain transactions – even if the proposed accounting treatment may not be consistent with Generally Accepted Accounting Principles.

**COMPANIES ACT**

The requirements of Schedule VI of the Act, which currently prescribes the format for presentation of financial statements for Indian companies, is substantially different from the presentation and disclosure requirements under IFRS. For example, the Act determines the classification for redeemable preference shares as equity of an entity, whereas these are to be considered as a liability under IFRS. Also, Schedule XIV of the Act provides minimum rates of depreciation - such minimum depreciation rates are also inconsistent with the provisions of IFRS.

**REGULATORY GUIDELINES**

The Reserve Bank of India (RBI) and Insurance Regulatory and Development Authority (IRDA) regulate the financial reporting for banks, financial institutions and insurance companies, respectively, including the presentation format and accounting treatment for certain types of transactions. For example, the RBI provides detailed guidance on provision relating to non-performing advances, classification and valuation of investments, etc. Several of these guidelines currently are not consistent with the requirements of IFRS.

The Securities and Exchange Board of India has also prescribed guidelines for listed companies with respect to presentation formats for quarterly and annual results and accounting for certain transactions, some of which are not in accordance with IFRS *e.g.,* Clause 41 of the Listing Agreement permits companies to publish and report only standalone quarterly financial results, however IFRS considers only consolidated financial statements as the primary financial statements for reporting purpose.

**COURT PROCEDURES**

Courts in India commonly approve accounting under amalgamation/restructuring schemes, which may not be in accordance with the accounting principles/standards. Under the current accounting/ legal framework such legally approved deviations from the accounting standards/principles are acceptable.

**INCOME TAX**

Computation of taxable income is governed by detailed provisions of the Indian Income Tax Act, 1961. Convergence with IFRS will require significant changes/ clarifications from the tax authorities on treatment of various accounting transactions. For example, consider unrealized losses and gains on derivatives that are required to be marked-to market under IFRS. Different taxation frameworks are possible for the tax treatment of such unrealized losses and gains. The treatment of unrealized gains and losses need to be addressed in line with the convergence time frame. It is imperative that the tax authorities are engaged sufficiently m .advance to decide on such critical aspects of taxation.

## SECTOR SPECIFIC IMPACT OF IFRS

The impact of IFRS on various industries on accounting point of view and the implications of the accounting standards are dealt with.

**TECHNOLOGY, MEDIA AND TELECOMMUNICATION**

The impact of IFRS mainly on technology, media and telecommunication mainly in the area of revenue recognition is going to be high. These industries usually have a high incidence of what is known as bundled transactions or multiple deliverable arrangements. A common example will be in the mobile segment where packages offered to end users include provision of handsets either at a subsidized rate or free of cost, pre-paid minutes, free SMS, discounts, special offers and other incentives. In these cases it may be necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. The decision to account for a transaction in its entirety or unbundled the product into its individual components can have a significant impact on an operator's financial statements. For instance, separating handset revenues from ongoing service may result in increased revenue upfront but there may also be instances where separating a contract into components may defer revenue recognition. The accounting treatment for indefeasible rights of use (IRU) in the telecoms sector will have to be determined by the commercial substance of each individual arrangement. When determining the appropriate accounting for Indefeasible Right of Use under IFRS, it will be necessary to first consider whether the arrangement is, or contains, a lease in the light of the provisions of IFRIC 4. If it is considered a lease, then the appropriate accounting will be determined in accordance with IAS 17. If not considered a lease, it will have to be ascertained whether the arrangement constitutes the sale of goods or the rendering of services. Accordingly the relevant part of IAS 18 will have to be applied to determine the appropriate accounting of revenue.

The media sector could be impacted by the application of SIC-31, Revenue - Barter Transactions Involving Advertising Services, which deals with the circumstances where an entity enters into a barter transaction to provide advertising services in exchange for receiving advertising services from its customer.

**REAL ESTATE SECTOR**

The realty sector would also be affected due to the provisions of IAS 40 which allow investment property to be measured at cost or using the fair value model with changes in fair value being recognized in profit or loss for the period. Accounting investment properties at fair values can lead to a great deal of volatility in the income statement as well as balance sheet.

Agreements for the construction of real estate take diverse forms – some agreements are for the provision of construction services, others are in substance for the delivery of goods (e.g. housing units) that are not complete at the time of entering into the agreement.

Thus, the percentage of completion method is appropriate for some agreements for the construction of real estate, but for others revenue should be recognized only at the point that the constructed real estate is delivered to the customer.

IFRIC 15 Agreements for the Construction of Real Estate addresses whether an agreement is within the scope of IAS 11 or IAS 18, and when revenue from the construction of real estate should be recognized.

An agreement for the construction of real estate will meet the definition of a construction contract when the buyer is able to specify the major structural elements of the design of the real estate before construction begins; and/or specify major structural changes once construction is in progress.

In contrast, if buyers have only limited ability to influence the design (for example, to select from a range of entity-specified options, or to specify only minor variations to the basic design), the agreement will be for the sale of goods, and be within the scope of IAS 18. Application of IFRIC 15 is expected to have an impact on the timing of revenue recognition for most realty firms.

**INFRASTRUCTURE SECTOR**

For infrastructure firms, the application of IFRIC 12, Service Concession Arrangements, could change the way revenues are accounted for. A typical arrangement is a 'build-operate-transfer' arrangement where an operator constructs the infrastructure to be used to provide a public service and operates and maintains that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement.

The infrastructure within the scope of IFRIC 12 is not recognized as property, plant and equipment of the operator. This is because the operator does not have the right to control the asset, but merely has access to the infrastructure in order to provide the public service in accordance with the terms specified in the contract.

It is also not treated as a lease as the operator does not have the right to control the use of the asset. Instead, the operator's right to consideration is recorded as a financial asset, an intangible asset or a combination of the two.

**BANKING SECTOR**

The banking industry will also be affected with an impact expected on the capital adequacy ratio. At the highest level, Indian banks, being subject to the RBI's rules-based accounting would require to move towards principles-based accounting of IFRS.

This distinction may prove more vexing than it initially appears, because most accounting and finance professionals in India have been used to the rules of the RBI. The overriding lesson from their years of study and work is this: If you have an issue, look up to the RBI. On the other hand, IFRS is a far shorter volume of principles-based standards, and consequently requires more judgment than Indian accountants are accustomed to.

## IMPACT OF IFRS IN FUNCTIONAL AREAS OF MANAGEMENT

From European experience in converting from one set of accounting standards to another, it has become clear that the switch to IFRS is not just an accounting issue. Adoption of IFRS is a major change management challenge for companies.

**PEOPLE AND CHANGE MANAGEMENT**

Adoption of IFRS is a major change management challenge for companies. And like many other major projects, it presents a broad range of challenges impacting people, systems and processes and each aspect must be carefully managed. Changing accounting policies often requires changes to processes, systems, procedures and controls. In turn, this requires changes to the substance of employees' roles and responsibilities and, potentially, to the governance and organization of the finance function. This calls for detailed project management and planning, the application of dedicated resources and talent, and a high level of senior management commitment to making the overall project a success. And each company's circumstances are different. Different structures, relationships with subsidiaries, consolidation processes and so on will require different treatment and present different challenges. Different parts of the group may currently be reporting on multiple bases of accounting. Ensuring the adoption of a comprehensive and consistent basis of accounts and consolidation throughout a global group will almost certainly involve varying degrees of systems, process and role re-engineering.

**STRATEGY AND PROJECT MANAGEMENT**

Large companies need to develop a clear strategy: for example, they should decide upon a fundamental approach as to whether to roll out fully IFRS-compatible systems and processes across the whole group all at once; or concentrate first on getting critical parts of the organization compliant, turning later to other areas. A further challenge is that IFRS standards are not static but rather they continue to change. Careful thought is essential in planning the implementation program and ensuring the new systems are sufficiently flexible and tailored to meet the requirements placed on them. As with any major change program, implementing IFRS has to be managed while at the same time keeping existing processes and systems running effectively. While the two can be kept reasonably separate during the planning stages, as implementation progresses, the challenges become greater. As real changes start to migrate into the organization, the same skills, expertise and resources are often needed, to ensure continuing reporting on the existing basis of accounting while introducing the new systems and processes. Even if external support is sought, eventually the new arrangements have to be handed off to in-house staff.

**HUMAN RESOURCE DEPARTMENT**

Compensation committees will need to work closely with accounting and management functions to understand the new processes' potential impact on remuneration. A shortage of trained IFRS resources is another significant challenge companies will face. Since comparative data will be required as early as possible, companies need to act now. Does the organization have enough manpower to handle IFRS conversion Numerous areas of the company, including information technology, may need additional people on hand, especially over the next few years. Human resources committees might also want to develop succession plans for key IFRS-trained technical resources, and revisit the company's compensation strategy. This could help reduce the risk of losing key finance people.

**INFORMATION TECHNOLOGY DEPARTMENT**

Although systems throughout the organization will be affected by the conversion to IFRS, by planning an upgrade to a system with a worldwide roll out starting in 2011, make sure the new system accommodates IFRS from the start. In a 2008 report titled "Effects of IFRS on Information Systems," KMPG said that IT expenses generally account for more than 50% of the cost of an IFRS conversion.

Areas what Organization should look in their Information Technology department are: Can current software support IFRS?; Can current IT systems support both GAAP and IFRS, in case they both need to be used during the transition?; Are our software vendors planning updates to handle IFRS? Is the company planning any major software upgrades in the next few years? If so, how will the new systems handle IFRS? The consequences for not being prepared could be pretty severe.

## CONCLUSION

Earlier research conducted in Europe on voluntary adoption of IFRS reveal that adopting high quality standards might be necessary condition for high quality information, but not a sufficient one (Ball et al.2003); Strong enforcement mechanisms are also necessary and the adoption of IFRS will probably not be sufficient to standardize the quality of earnings throughout Europe. India has decided to move towards IFRS but still the mandatory switch over is not finalized. But when once decided to move towards IFRS, there comes the question of the preparedness. Some ways are identified to it.

1) IFRS can be included as a subject and it should be a part of curriculum in Accounting Education; More workshops and certification courses should be added on to train existing accountants and Professionals in accounting.

2) Government and other Regulators should frame/revise regulations in consultation with NACAS to reflect the IFRSs.

3) Entities should prepare to implement IFRSs by identifying differences and addressing required financial reporting system changes. Entities should provide training to staff at all levels affected by the transition to IFRS.

4) Federation of Chambers of Commerce and Industry (FICCI), Associated Chambers of Commerce (Assocham) and Confederation of Indian Industry (CII) can also play important role in preparing their constituents for the adoption of IFRS by holding round-tables on Exposure Drafts of the IFRS, conducting seminars/workshops on IFRS for the industry participants to provide them appropriate training and provide industry specific forums to their constituents to discuss the industry specific issues in implementations of IFRSs.

5) To ensure consistency between various regulations and Accounting Standards converged with IFRSs, the regulators such as Reserve Bank of India (RBI), Insurance Regulatory and Development Agency(IRDA) and the Security Exchange Board of India(SEBI) has also to identify areas in their regulations which are not consistent with the Accounting Standards converged with IFRS and thereafter to amend the same and to create awareness among their stakeholders. At the same time to ensure that the Accounting Standards are as tax neutral as possible so that there are no adverse tax implications. Harmonization is a huge and daunting task by itself. But, it is the order of the day. However, suitable and adequate safeguards and safety nets, as listed above, also need to be built into national accounting and financial systems to achieve the objectives of harmonization.

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