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Research Paper Accountancy

Convergence of India Gaap with International GAAP / IFRS

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ABSTRACT

Accounting, being a man made system, should evolve and adjust itself to the changes needed by the mankind. As a result, accounting principles are not as exact and rigid as the laws of natural sciences. Therefore, the emphasis is on general instead of universal acceptability of accounting principles. The GAAP are not the building blocks of the accounting language. Rather, they are the pillars on which the structure of accounting is resting. If we remove these principles, the entire structure of accounting will come down. The GAAP should be understood by the makers and the users of accounting information before analyzing and interpreting financial statements. Accounting communicates the financial results of business to various parties by means of financial statements which have to exhibit a "true and fair" view of the state of affairs. Convergence with IFRS has gained momentum in recent years all over the world. 110+ countries including European Union, Australia, China, New Zealand, and Russia currently require or permit the use of IFRS. Apart from India, countries like Japan, Sri Lanka, Canada and Korea have also committed to adopt IFRS from 2011. United States of America has announced its intention to adopt IFRS from 2014 and it also permits foreign private filers in the U.S. Stock Exchanges to file IFRS complied Financial Statement, without requiring the presentation of Reconciliation statement.

Keywords : Accounting principles, Accounting concepts, Key divergences between India GAAP and IFRS

Introduction

Accounting aims to provide financial information about an enterprise to various interested groups for decision-making. As accounting communicates financial information for decision-making to many parties outside the reporting business entity, it is necessary that there is uniformity in the preparation of financial statements of different enterprises at a given point of time. It also requires consistency in the preparation of financial statements of an enterprise over a period of time. If every business could follow its own notion about the accounting terms like revenue, expenses, assets, liabilities, income etc., there will be complete chaos. To have uniformity and consistency in the preparation of financial statements, accounting operates within a framework of "Generally Accepted Accounting Principles" (GAAP), follows a conceptual framework and adheres to the "Accounting Standards" (AS) issued by the recognized regulatory body. This is referred to as the theory base of accounting.

Accounting principles are constantly evolving and are influenced by the following :

- Changes in the social, legal and economic environment
- Professional bodies like the Institute of Chartered Accountants of India, the American Institute of Certified Public Accountants, International Accounting Standards Board etc.
- Needs of the users of financial information

The GAAP includes the following concepts:

- **Accounting Entity**

Accountants treat a business as distinct from the persons who own it. Then, it becomes possible to record the transactions of the business without the proprietor also. The concept of separate business entity is applicable for all types of organizations like sole proprietorship, partnership etc. where the business affairs are free from the private affairs of the proprietor or partner.

- **Money Measurement**

Accounting records normally those transactions which are being expressed in monetary terms. Measurement of business events in monetary terms helps in understanding the state of affairs of the business in a much better way.

- **Going Concern Concept**

It is assumed that the business will exist for a ling time and transactions are recorded from this point of view. Based on this concept, the accountants, while valuing assets, will not consider the forced sale value of assets (market value), but the assets, normally, will be reflected at the cost of acquisition minus depreciation. Similarly, depreciation is provided based on the expected life of the assets.

- **Accounting Period Concept**

According to this concept, the life of a business is divided into appropriate segments of time, say 12 months, for studying the results. While the life of a business is considered to be indefinite, according to the going concern concept, the measurement of income and studying the financial position of the business after a very long time would not be helpful in taking corrective steps at the appropriate time.

- **Cost Concept**

Transactions are entered in the books of account at the amounts actually involved. An asset is ordinarily recorded at a price at which it has been acquired. For example, a plot of land purchased by a firm for Rs. 5,00,000 would be recorded at this value irrespective of its current market price. Cost concept has the advantage of bringing objectivity in the presentation of the financial statements.

Ø Realization Concept

Accounting is a historical record of transactions. It only records what has happened. It does not anticipate events, though anticipated adverse effects of events that have already occurred are usually recorded.

- **Expenses Recognition**

Cost is the total outlay or expenditure on acquiring resources required for the production of goods or rendering of services. Cost of resources utilized and lost during a particular period is termed as the expired cost or expense and is charged to the revenue of the period to obtain information about income. Costs of the resources remaining unutilized or unexpired at the end of the period are carried forward to the next accounting period and are termed as assets.

Ø Accrual Concept

The accrual system is a method whereby revenue and expenses are identified with specific period of time like a month, half year or a year. It implies recording of revenue and expenses of a particular accounting period whether they are received/paid in cash or not.

➢ **Disclosure**

Whether something should be disclosed or not will depend on whether it is material or not. Materiality depends on the amounts involved in relation to the assets group involved or profits. In the case of financial statements of a limited company, the practice followed is to append the notes to the accounts and disclose significant accounting policies. This is in pursuance of the convention of full disclosure.

➢ **Dual Aspect Concept**

Each transaction has two aspects. With every increase in the money owned to others, there should be an increase in assets or loss. Thus, at any time the accounting equations is as follows : Assets = Liabilities + Capital, or alternatively, Capital = Assets – Liabilities

➢ **Verifiable Objectivity**

According to this concept, all accounting transactions should be evidenced and supported by objective documents. These documents include invoices, contracts, correspondence, vouchers, bill, pass books, etc.

➢ **Materiality**

According to this convention, the accountant should attach importance to material details and ignore insignificant details. This is because otherwise accounting will be unnecessarily overburdened with minute details. The question “what constitutes material details” is left to the discretion of the accountant.

➢ **Consistency**

The accounting practices should remain the same from one year to another. For example, consistency in valuation of stock in trade or in method of charging depreciation. If the stock has been valued by adopting the principle of cost or market value, whichever is less, the same principle has to be consistently followed year after year.

➢ **Conservatism**

Financial statements are usually drawn up on a conservative basis, especially in the initial stages when the anticipated profits, which were accounted, did not materialize. This results in less acceptability of accounting figures by the end-users. Therefore, accountants follow the rule “anticipate no profits but provide for all possible losses.” Similarly, based on this convention, the inventory is valued at cost or market price whichever less is. Necessary provision for bad and doubtful debts is made in the books of account.

➢ **Timeliness**

Financial reports should be timely to have any usefulness for decision makers. Timeliness in financial reporting requires estimation of depreciation, provision for bad and doubtful debts, provision for discount etc. to prepare the financial statements of different accounting periods.

▪ Industry Practice Sometimes, practice prevailing in a particular industry is given precedence over generally accepted accounting principles. For example, valuation of gold on the basis of market price, agriculture products on the basis of minimum support price determined by the government etc.

▪ Substance over FormThe accounting treatment and presentation in the financial statements of transactions and events should be governed by their substance and not merely by their legal form. Hence, when goods are purchased on hire-purchase basis, the property in goods is transferred to the buyer on their payment of the last installment only.

❖ **Accounting Standard**

Accounting communicates the financial results of business to various parties by means of financial statements which have to exhibit a “true and fair” view of the state of affairs. However, these rules have to be used with a reasonable degree of flexibility in response to specific circumstances of the business.

The changes in the economic environment, social needs, legal requirement and technological developments. Accounting standards are defined as the policy documents issued by a recognized expert accounting body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events. In India, accounting standards are prepared by the Accounting Standard Board constituted by the Institute of Chartered Accountants of India.

❖ **Convergence of Indian GAAP with International GAAP /IFRS**

Convergence with IFRS has gained momentum in recent years all over the world. 110+ countries including European Union, Australia, China, New Zealand, and Russia currently require or permit the use of IFRS. Apart from India, countries like Japan, Sri Lanka, Canada and Korea have also committed to adopt IFRS from 2011. United States of America has announced its intention to adopt IFRS from 2014 and it also permits foreign private filers in the U.S. Stock Exchanges to file IFRS complied Financial Statement, without requiring the presentation of Reconciliation statement. In this scenario of globalization, India cannot insulate itself from the developments taking place worldwide. In India, so far as the ICAI is concerned, its aim has always been to comply with the IFRS to the extent possible with the objective to formulate sound financial reporting standards. The ICAI, being a member of the International Federation of Accountants (IFAC), considers the IFRS and tries to integrate them, to the extent possible, in the light of the laws, customs, practices and business environment prevailing in India. The Preface to the Statements of Accounting Standards, issued by the ICAI, categorically recognizes the same.

❖ **The key divergences between India GAAP and IFRS have arisen due to :**

1. Conceptual differences
2. Legal and regulatory requirements
3. Present economic conditions
4. Level of preparedness

❖ **Some of the divergences between Indian GAAP and IFRS are summarized as under:**

1. Special Purpose Entities (SPE) falling under the definition of ‘control’ as per IAS 27 on “Consolidated and Separate Financial Statements” shall be consolidated.

2. ‘Potential Voting Rights’ that are currently exercisable or convertible shall be considered to assess the existence of ‘control’.

3. All business combinations shall be accounted as per purchase method at fair values.

4. Negative goodwill arising on business combinations / consolidation shall be accounted as income instead of capital reserve

5. Goodwill shall not be amortized. It shall only be tested for impairment

6. PP&E and Intangible assets shall be measured either at cost or at revalued amount. Periodical valuation of entire classes of assets is required when revaluation option is chosen

7. Intangible assets can be revalued only when there is an active market for the same

8. Depreciation on revalued portion cannot be recouped out of revaluation reserve

9. Depreciation to be calculated based on useful life, which along with residual value and depreciation method shall be reviewed annually

10. Intangible assets may have an indefinite life e.g. Trademarks, Goodwill, Franchise

11. Investment property, i.e. land or building hale to earn rentals or for capital appreciation, shall be measured either at cost or fair value

12. If fair value model is adopted, changes in fair value, measured annually, shall be recognized in the income statement

13. No distinction shall be made between integral and non-integral foreign operations. All foreign operations to be consolidated using non-integral approach

14. Exchange differences shall not be capitalized except to the extent of that allowed by IAS 23 Borrowing Costs

15. Share Based Payments shall be measured at fair value

16. Deferred tax shall be created on temporary difference instead of timing differences

17. Liability portion of compound financial instruments, such as convertible debentures, shall be separately

18. Financial assets and liabilities shall be classified and measured accordingly as per the requirements of IAS 39

19. Financial Instruments : Recognition and Measurement

20. All derivative financial assets and liabilities including embedded derivatives shall be accounted for as on the balance sheet items

21. Derivatives classified as ‘hedge’ shall have to comply with various requirements of IAS 39 viz. documentation, hedge effectiveness testing and ineffectiveness measurement

22. Deracination of financial assets, as in the case of securitization, shall be based on risks and rewards, transfer of ‘control’ being a secondary test

23. Prior period errors shall be adjusted in the opening balances of assets, liabilities and equity of the earliest period presented i.e. the figures relating to prior years are restated