Overview of IFRS

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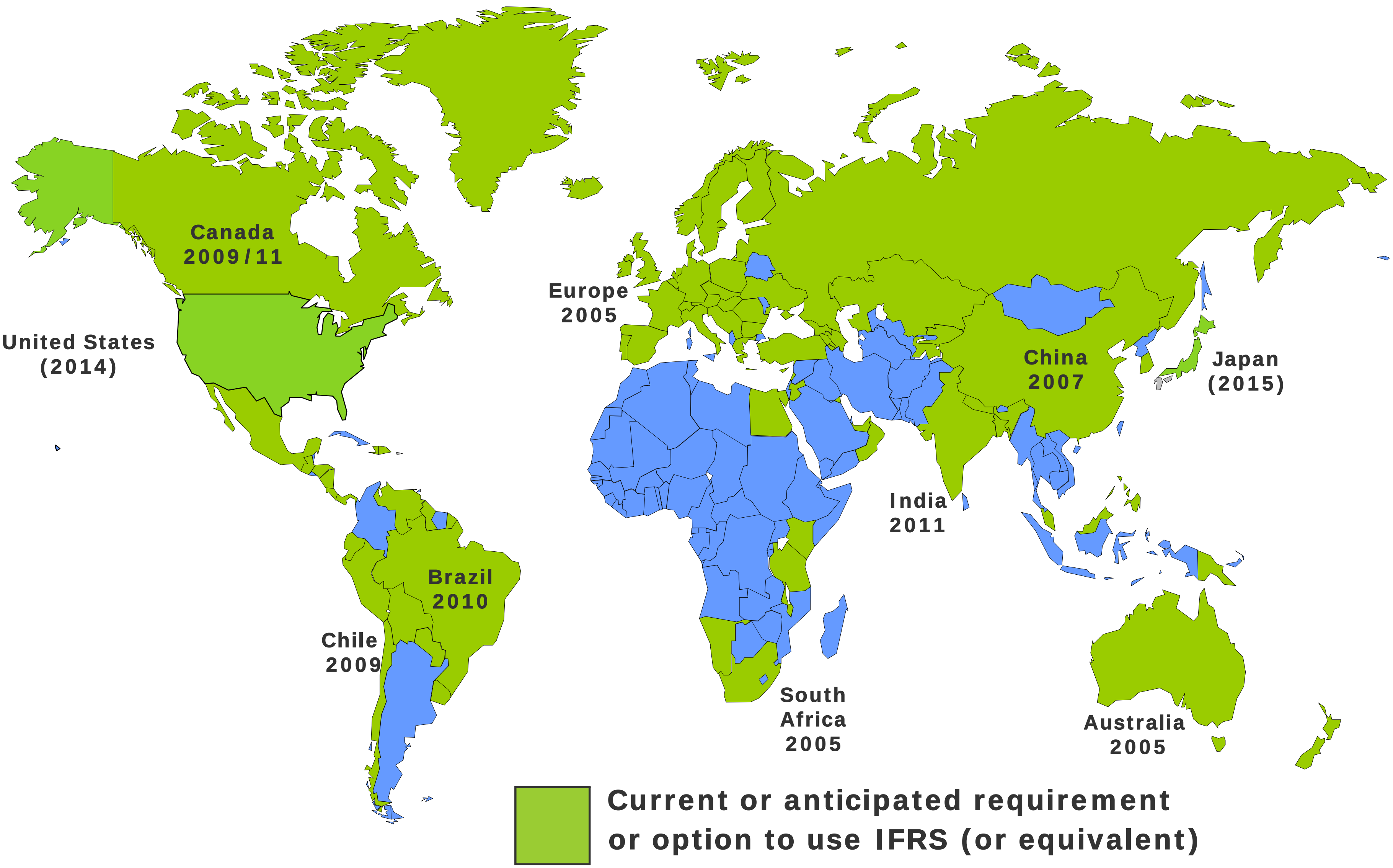
Who issue IFRS ?

The International Accounting Standard Board (IASB) based in London issues the IFRS.

IASB is funded by the IASC which receives financial support from major accounting firms private financial institutions and industrial companies throughout the world.

The global move towards IFRS



Basic Differences

- Cost Vs. Fair Value
- Relevance Vs. Reliability
- Accounting driven by Law

Fair Value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

- Active Market- Quoted price
- No Active Market
  - Valuation techniques
  - DCF, Option pricing model
- No Active Market – Equity investments less impairment loss

List of IAS and Corresponding AS

IAS No.	Title	Corresponding Indian GAAP
IAS-1	Presentation of Financial Statements	AS-1
IAS-2	Inventories	AS-2
IAS-7	Cash Flow Statements	AS-3
IAS-8	Accounting policies, change in accounting estimates and errors	AS-5
IAS-10	Events occurring after the Balance Sheet date	AS-4
IAS-11	Construction Contracts	AS-7
IAS-12	Income-tax	AS-22
IAS-16	Property, Plant and Equipment	AS-10 & AS-6
IAS-17	Leases	AS-19
IAS-18	Revenue	AS-9
IAS-19	Employee Benefits	AS-15
IAS-20	Accounting for Govt. grants and disclosure of Govt. assistance	AS-12

List of IAS and Corresponding AS

IAS-21	The effects of changes in Foreign Exchanges Rates	AS-11
IAS-23	Borrowing Costs	AS-16
IAS-24	Related Party Disclosures	AS-18
IAS-26	Accounting and reporting by retirement benefits plan	-
IAS-27	Consolidated and separate financial statements	AS-21
IAS-28	Investment in associates	AS-23
IAS-29	Financial Reporting in Hyper Inflationary Economies	-
IAS-31	Interest in Joint Venture	AS-27
IAS-32	Financial Instruments : Presentation	AS-31
IAS-33	Earnings Per Share	AS-20
IAS-34	Interim Financial Reporting	AS-25
IAS-36	Impairment Assets	AS-28
IAS-37	Provisions, Contingent liabilities and Contingent Assets	AS-29
IAS-38	Intangible Assets	AS-26
IAS-39	Financial Instrument: Recognition and Measurement	AS-30
IAS-40	Investment Property	AS-13
IAS-41	Agriculture	-

List of IAS and Corresponding AS

IAS No.	Title	Corresponding Indian GAAP
IFRS-1	First time adoption of IFRS	-
IFRS-2	Share based payment	Guidance note
IFRS-3	Business Combination	AS-14-
IFRS-4	Insurance Contracts	-
IFRS-5	Non-current assets held for sale and discontinued operation	AS-24
IFRS-6	Exploration for and evaluation of mineral resources	-
IFRS-7	Financial Instrument: Disclosures	AS-32
IFRS-8	Operating Segment	AS-17
IFRS-9	Financial Instrument – Recognition & Measurement	AS-30

India’s Approach on IFRS

- Convergence or adoption

- To develop Indian Accounting Standards equivalent to IAS/IFRS

Benefits If IFRS Adopted

- The Economy
- Investors
- The Industry
- The Accounting Professionals

IFRSs- Adoption Of Which Require Changes In Laws/ Regulations

- IAS 1, Presentation of Financial Statements
- IAS 8, Accounting Policies, Changes in Accounting and Estimates Errors
- IAS 10, Events after the Balance Sheet Date
- IAS 16, Property, Plant and Equipment
- IAS 32, Financial Instrument: Presentation
- IAS 34, Interim Financial Reporting
- IFRS 39, Financial Instrument: Reorganization and Measurement
- IFRS 4, Insurance Contacts
- IFRS 7, Financial Instruments: Disclosures

Complete Set of Financial Statements

- Statement of financial position
- Statement of comprehensive income –

  - Statement of income

  - Statement of recognised income & expense

- Statement of changes in equity
- Statement of cash flow
- Notes and accounting policies

Components of Other Comprehensive Income

- Revaluation surplus
- Actuarial gains and losses
- Gains & losses on translation of foreign subsidiary
- Gains & losses on AFS
- Gains & losses on effective portion of hedging instruments

Statement of Changes in Equity

On the face -

- Profit and loss for the period
- Effective retrospective application as per IAS-8
- Reconciliation of each component of equity

Expenses

- No extra ordinary item
- Separate disclosure of items of income and expense
- Analysis of expenses

  - Analysis by nature of expense

  - Analysis by function of expense

Major Changes for Banks due to IFRSs

- Assessment of provisions for credit losses
- Use of fair value for more financial instruments
- De-recognition of financial assets
- Derivatives and hedge accounting
- Recognition of interest income and interest expense
- Consolidation of entities.

Assessment of provisions for credit losses

An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired.

An account would be classified as impaired and impairment be measured on present value basis using the effective interest rate of the exposure as the discount rate. For group of loans that share homogenous characteristics (such as mortgage and credit card receivables), impairment can be assessed on a collective basis.

Assessment of provisions for credit losses

For investment, a similar analysis is conducted, the key differences being that the fair value of the investment is also considered as an input in addition to the financial / credit standing of the issuer etc.

RBI guidelines require a limited use of judgement and are mechanistic nature with prescribed loss/provision rates.

Use of fair value - Classification of Financial Asset

- Financial assets at fair value through profit or loss
- Held to maturity investments
- Loans and receivables
- Available for sale

IFRS-9

- Financial asset carried at fair value

- Financial asset carried at amortized value

Use of fair value - Classification of Financial Liability

- Financial liabilities at fair value through profit and loss
- Other financial liabilities

Use of fair value for more financial instrument

Under IFRS there may be a significant increase in the extent that fair value measurement needs to be used. For instance, all financial assets and liabilities will need to be initially measured at fair value.

There will be a number of instances where unrealized gains can/should be recognised. For example, trading instrument and those where the bank elects the fair value options.

Use of fair value for more financial instrument

Due to the stringent criteria prescribed under IFRS, a Held to Maturity (HTM) classification, (which currently results in an amortised cost valuation basis for a significant part of most Indian banks' investment portfolio), is unlikely to be available leading to fair value measurement for a substantial part of the portfolio.

Loan given to the staff of bank at concession interest rate to be recognised at fair value.

De-recognition of financial assets

Under IFRS, de-recognition of financial assets is a complex, multi-layered area with the de-recognition decision dependent largely on whether there has been a transfer of risks and rewards. If the assessment of the transfer of risks and rewards is not conclusive, an assessment of control and the extent of continuing involvement is required to be performed.

De-recognition of financial assets

A major area impacted would be securitization activity – most Indian securitisation vehicles are currently structured to meet Indian GAAP de-recognition norms. Substantially all those securitization vehicles would collapse into the transferor's balance sheet and assets would fail the de-recognition test under IFRS.

Derivatives and hedge accounting

Under IFRS, all derivatives are recognised on the balance sheet at fair values with changes in fair values being recognised generally in the income statement other than in the case of a qualifying cash flow hedge relationship. Application of hedge accounting does reduce the income statement volatility induced by the fair value measurement of derivatives.

At present there is no provision of hedge accounting under Indian GAAP.

Derivatives and hedge accounting

Conversion options embedded in a convertible debentures and preference shares requires to be separated from their host contracts and be accounted for separately.

Example

Induga Ltd has issued 5000 convertible debentures with a face value of Rs. 100 per debentures. The interest rate on the debentures is 5%. The debenture holders have the option of convening these debentures into ordinary shares at the end of four years. The prevailing market rate for a similar debt which does not have a conversion right is 7%

Present Value (PV) of principal :	Rs. 500,000.00
at end of 4 years discounted to PV	
(5,00,000 x 0.763)	381,500.00
PV of interest Rs. 25,000 annually in arrears	
for 4 years (25,000 x 3.387)	84,675.00
Liability Portion	466,175.00
Equity portion	**33,825.00**

Classification of Hedge Accounting

- A fair value hedge, which hedges the exposure to changes in the fair value of an item or transaction
- A cash flow hedge, which hedges the exposure to changes in the expected cash flows
- Hedges of a net investment in an overseas operation, which reduce the exposure of an entity to foreign operations.

Hedge Accounting

Hedge accounting (HA) is technique

That

Changes the normal basis for recognizing gains & losses

On

Associated hedging instruments and hedged items

So That

Both are recognized in profit and loss account in the same accounting period

Recognition of interest income and interest expense

Interest income and expense are recognised in the income statement using the effective interest method. Interest income on financial assets held for trading and on other financial instruments at fair value through profit or loss comprises coupon interest only.

Recognition of interest income and interest expense

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related direct costs, are deferred and amortised to the interest income over the estimated life of the financial instrument using the effective interest rate method.

Other fees, commission and other income and expense items are recognised when the corresponding services has been provided.

Consolidation of entities

- Consolidation may be required for more entities such as SPE as per SIC-12. As there are no such guidance under AS-21.
- Bargain purchase resulting in profit in business combination will be credited to income statement instead of capital reserve.

Other Changes – Not exhaustive

- Re-statement
- Provisions
- Fixed assets
- Investment property
- Dividend
- Preference shares
- Foreign Exchanges
- Share based payments
- Issue expenses
- Disclosure

Re-statement

IAS-8 requires re-statement of correction of errors and effect of change in accounting policies with retrospective effect

Provisions – Present value Vs. Face value

- A provision is recognised in the balance sheet when the Bank has a legal or **constructive obligation** as a result of a past event.
- If the effect is material, provisions are determined by discounting the expected future cash flow at a pre-tax rate that reflects current market assessments of the time value of money.
- Increase in provision as a result of passages of time

Fixed Assets

- Cost model vs. Revaluation model
- Costs of dismantling and removing the item
- Depreciation based on each part
- Depreciation method

Investment Property

Bank shall choose as its accounting policy either the fair value model or the cost model to all of its investment property

Dividend

If an entity declares dividends to holders of equity instruments after the reporting period, the entity shall not recognize those dividends as a liability at the end of the reporting period.

Preference Shares

Is it liability or equity

Component – Principal

- Dividend

Foreign Exchange

IAS-21 requires the entity should translate its results and financial position from its *functional currency* into a *presentation currency* (or currencies) using the method required for translating a foreign operation for inclusion in the reporting entity's financial statements.

Share based payment

The Standard identifies three types of share-based payment transactions:

- equity-settled share-based payment transactions;
- cash-settled share-based payment transactions; and
- share-based payment transactions with cash alternatives.

Issue Expenses

- Transaction costs for issuing own equity instruments are accounted for as deduction from equity net of any related income tax benefit.
- Transaction costs relating to the issue of a compound financial instrument are allocated to the liability and equity components in proportion to the allocation of proceeds.

Disclosure

The disclosure requirements under IFRS are substantially more than the Indian GAAP and therefore, the level of disclosure in the forms of notes and policies will substantially increase.

Thanks

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