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A STUDY ON THE IMPACT OF IFRS ON VARIOUS SECTORS IN INDIA

Dr. Hanuman Sahai Kumawat*

ABSTRACT

IFRS (International Financial Reporting Standards) are a set of accounting standards which has issued by IASB. In the present time of globalization, above 3900 multinational companies are establishing their businesses in the different sectors in India. The ICAI has discharged a concept paper on convergence with IFRS in India. India decided to converge with IFRS by developing standard called Indian Accounting Standards (Ind AS). Ministry of Corporate Affairs has announced a new road map for the implementation of Ind AS with effect from 1st April, 2016 as mandatorily. Being the paradigm change Ind AS would impact every facet of each sector. The purpose of this study is to analyze the impact of IFRS on various sectors like Indian banking industry, Auto, Real estate, Infrastructure, Telecommunication etc. Convergence of IFRS will have a huge impact on the financial reporting systems and compliance processes and also requires significant change into existing policies. According to IFRS 9 loans and receivable portfolio are recorded on amortized cost basis. Implementation of Ind AS will significantly change the revenue recognition, measurement and increase the disclosure requirements. Under Ind AS, it would require recognition of the non-current receivables at their present value. This would impact the revenue recognition on a year on year basis. Thus, the overall impact on the company's statement of profit and loss is in terms of additional depreciation and unwinding of discount. This research paper is a descriptive and basically conceptual in nature, based on secondary data. The conclusion of this study indicate that the convergence with IFRS more beneficial to attract the world capital market. Many Indian companies having businesses in a foreign country are preparing their financial statements using IFRS.

KEYWORDS*: Convergence of IFRS, Financial Reporting, Indian GAAP, Ind AS.*

Introduction

Meaning of IFRS and Convergence with IFRS

Foreign investments, merger and acquisition, franchising, business outsourcing are some example of international transaction. For the integrity of different country's business together in the world market it was necessary to adopt a common set of accounting standard. It has become mandatory to harmonize accounting standards and to follow a single language of financial reporting across the world. International Financial Accounting Standards (IFRS) are the standards and interpretations for the preparation and presentation of Financial Statements adopted by the International Accounting Standards Board (IASB). International Accounting Standards was issued by board of IASC in 1973 and 2001. On January 18, 2011, the Institute of Chartered Accountants of India (ICAI) announced their intention to converge with IFRS by issuing an exposure draft calling for the release of 35 Indian Accounting Standards (IFRS converged). The convergence to IFRS was going sluggish in India until the Parliament passed the new Companies Act, requiring the preparation of consolidated financial statements. Indian accounting standards converged with IFRS is known as Ind AS. 39 Indian Accounting Standards converged with IFRS were notified by the Ministry of Corporate Affairs (MCA) on 16th February, 2015. Ind-AS will be implemented in a phased manner.

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* Assistant Professor, Department of ABST, S.P.C. Government College, Ajmer, Rajasthan, India.

IFRS in India

The Ministry of Corporate Affairs (MCA) has issued a roadmap for convergence with IFRS in India in January 2010. ICAI has decided to fully converge with IFRSs from the accounting periods commencing on or after 1st April, 2011. After enactment of Companies Act, 2013 the MCA has focus to implement IFRS. From 1 April 2016, Ind AS converged with IFRS has become the new Generally Accepted Accounting Policies (GAAP) for many companies. As a result, commencing the June 2016 quarter, Phase I companies in India have reported their results under Ind AS. At present, Indian companies are preparing their financial statements as per converged IFRS i.e. Ind AS. However these principles were modified substantially as per Indian laws and practices.

Extent of IFRS application	Additional Information
IFRS Standards are required for domestic public companies	Indian Accounting Standards (Ind AS) are based on and substantially converged with IFRS Standards. Indian domestic companies have not adopted IFRS Standards for reporting.
IFRS Standards are necessary for listings by foreign companies	No
IFRS for SMEs Standard is required or permitted or under consideration.	No

Objectives of the Study

The objectives of this paper presentation can be listed below:

- To understand the concept of IFRS and Ind AS.
- To explore the current status of IFRS convergence in India.
- To discuss the benefits and challenges for Indian corporate in adopting IFRS.
- To study the impact of IFRS on various sectors in India
- To give suggestions towards successful implementation of IFRS.

Methodology of Research

The present paper is a descriptive and exploratory research, based on secondary data. The study is basically conceptual in nature and for the purpose of the study; an extensive review of literature has been studied and identified the critical challenges facing in India. The information and data have been collected from annual reports of companies and website of ICAI and IFRS, various journals and research papers, textbooks, newspaper articles, internet etc. The research methodology used to develop the paper contains only qualitative methods.

Literature Review

Sufficient number of studies has investigated the effects of adopting IFRS on corporate sector in India.

- **C.A. Mohammad Firoz, Prof. A Aziz Ansari and Kahkashan Akhtar (2011)** in their paper "IFRS- impact on Banking Industry" studied the impact of IFRS on Indian Banking Industry and their consequences on financial statements of the Banks.
- **Choudhary, Dr. Bhuvender, Hemant Chauhan and Rachit Gupta (2012)** in their research paper "Convergence of IFRS in India- Strategy, Benefits and Challenges for Infrastructure Industry" showing that adoption of IFRS will reproduce more exactly the revenues of Indian Real Estate developers. They also think that IFRS deals with the market risks.

Impact of Ind as (IFRS Converged) on Various Sectors in India

Ind AS would impact every facet of each sector in one way or the other. IFRS will boost the growth prospects for BPO/KPO segments in India. In phase I companies have started publishing their interim financial results starting June 2016 quarter. With effect from financial year beginning 1 April 2017 (FY 2017-18), phase II companies have to apply Ind AS. Most of the investors, financial statement preparers and auditors etc. agree that IFRS improves the quality of financial statements of the corporate sectors. This study was conducted to focus on the impact of IFRS on various key sectors like Banking, **Automobile**, Infrastructure, Real estate, Technology, media and telecommunication, SMEs etc.

- **Banking Sector**

The main impact of IFRS will be on the areas relating to loan loss provisioning, financial instruments and derivative accounting. The convergence process will have material impact on the financial statements and financial reporting systems (including IT systems) and compliance processes. Banks are regulated by RBI. Applicability of IFRS may increase in losses and impairment in loans which would finally affect the existing capital and capital adequacy ratios

- **Automobile Sector**

This sector is creating 19 million additional jobs in 2006-16. It amounted to 7.1% of the total GDP, contributing to 4.3% to exports and 13% to excise incomes in 2014-15. The Automotive Mission Plan (AMP) 2016-26 aims to encourage Indian automotive manufacturing. The government is also promoting The National Electric Mobility Mission (NEMM) Plan 2020 that aims to support hybrid and electric vehicles. IFRS would have an effect on some key areas like development costs, accounting for joint ventures, commodity hedging, tooling arrangements, segmental reporting, fixed assets accounting and impairment of assets, derivatives and financial instruments. Revenue recognition becomes a diverse area for consideration due to new revenue recognition requirements under Ind AS. Ind AS has wider concept of the term 'control', thereby would have significant effect on consolidation of entities.

- **Infrastructure Sector**

Roads, railways, ports, airports, power etc. are included in this sector. Infrastructure sector was allocated Rs. 3,96,135 crore in the union budget 2017-18. Ind AS will drastically change the recognition, measurement and disclosure aspects of revenue recognition for Public Private Partnership (PPP) agreement. New practice regarding discounting of long term payables and receivables (including retention money) is to replicate the current fair value. Revenue based amortization is not allowed relating to toll roads. Ind AS prescribes exclusive amortization method. Ind AS recognizes obligations related to maintenance expense and corresponding intangible asset at discounted value. Implementation of Ind AS in India will increase the disclosure requirements.

- **Real Estate Sector**

This sector includes of 4 sub-sectors such as Residential, Commercial, Retail and Hospitality. The housing sector contributes around 5-6% to the GDP. The **real estate** industry is probable to increase with a CAGR 9.8% to reach $180bn by 2020. On the basis of methodology as explained in Ind AS 11 (Construction Contracts), revenue is recognized by applying the percentage of completion method. Ind AS requires present value of the expected cost for the decommissioning of an asset. Thus, the overall impact would in terms of additional depreciation and unwinding of discount. According to the new guidance note by Ind AS on Real Estate companies states that, if development rights are acquired in exchange of an asset, its measurement is to be prepared as per the principles of exchange of assets enunciated under Ind AS 38 Intangible Assets. Under Ind AS, Classification and accounting for joint arrangements are governed by contractual rights and obligation. In Ind AS, this would require recognition of the non-current receivables at their present value. This would impact the revenue recognition on a year on year basis. Further, the unwinding of the discount would be treated as finance income instead of revenue from operations.

- **Technology, Media and Telecommunication Sectors**

The impact of IFRS mainly on the revenue recognition is expected to be high. The accounting treatment for indefeasible rights of use (IRSs) under IFRS, it will be essential to initial consider whether the arrangement is a lease or not lease (sale of goods or rendering of services). The media sector could be impacted by IFRS.

- **Small and Medium-Sized Entities (SMEs)**

Indian Government has decided that unlisted companies which have a net worth of not more than Rs. 5,000 Millions and whose securities are unlisted in Stock Exchanges outside India and also Small and Medium Companies (SMCs) will not be mandatory to follow the Ind AS.

- **Cement Industry**

Cement plants need wear parts, mechanical and electrical spares, resistance parts for their normal operations. As per Ind AS, all spare parts and servicing equipment modify as PPE (Property plant and equipment) if the company use these above 12 months. All foreign currency exchange difference has to be recognized in P&L. There is transition exemption allowed in Ind AS 101. As per Ind AS 18, revenue from sale of goods is recognized when transfers the significant risks and rewards of ownership and gives up managerial involvement. Ind-AS has changed the base and face of financial statements and reports and also changed the principle of recognition and measurement of financial transactions and records. Therefore, I can say the conversion or transition to Ind- AS is going to impact in both way qualitatively and quantitatively.

- **Fast Moving Consumer Goods (FMCG)**

Ind AS requires applying of fair value method to determine the employee costs over the vesting period. According to Ind AS, redemption premium are required to be calculated at effective interest rate through a charge in P&L account. As per Ind AS 18, revenue from sale of goods is recognized when transfers the significant risks and rewards of ownership and gives up managerial involvement. Under Ind AS, customer incentives are accounted for as a reduction from revenue instead of as expense. Key ratios e.g. gross margins, return on sales, etc. which are calculated from revenue would be affected.

- **Gem and Jewellery Sector**

Under Ind AS, a company has some choices regarding to PPE balances on the transition date. If company choose such a choice, the amounts so substituted are referred to as the ‘deemed cost’ of the PPE. One such choice is to revalue some or all items of PPE to their fair value as at the transition date with adjustment in the retained earnings/ reserves. Consequent depreciation charge is based on the fair valued asset base. Borrowings and investments in debt instruments are financial instruments under Ind AS and are accounted for at amortized cost as explained in effective interest method. For investments in equity shares, there is an irrevocable choice to measure at FVPL or FVOCI. According to Ind AS, financial guarantees issued in favor of bank on behalf of other company, are accounted for and are primarily recognized and calculated at fair value. Consequently, the measurement is at the higher of amount of loss allowance ascertained as per impairment requirements of Ind AS.

Benefits of IFRS Convergence to IND-AS

Indian corporate is likely to get some benefits from adopting IFRS. These are:

- With growing globalization and liberalization, a globally accepted financial reporting system with uniformity, comparability, transparency and adaptability in itself helps the users know only one set of accounting standard to analyze any corporate in the world.
- IFRS helps for better access to global capital markets, also availability of funds at lower cost. Indian companies are also receiving listed in European and American Capital Markets through raising funds. Main pre-requisites of getting listed on European Markets is preparation of accounts as per IFRS requirements.
- Convergence with IFRS the Investors, Bankers and Lenders also find it easy to compare the two financial statements. Improvement in international comparability of financial information and financial performance is benefiting to the industry and capital markets. It will result in more transparent financial reporting of a company’s activities.
- Corporate would have to guarantee that the present business report model is amended to suit the reporting requirements of IFRS regarding to fixed assets, related party transactions, segment disclosures etc.
- Indian corporate will have to make awareness between investors and analysts to explain the performance measures e.g. EPS and P/E ratios.
- IFRS expects enhance in merger and acquisition opportunities because the major challenge of conversion of financial statements to a uniform standard will be removed by reason of IFRS.

Challenges and Problems in Convergence with IFRS

The challenges faced during adoption and implementation of IFRS in India as follows:

- It would be a challenge to bring regarding awareness of IFRS and its effect on users of financial statements.
- Lack of facilities of training and academic courses on IFRS will challenge in India. It is observed that there is shortage of trained IFRS staff.
- In India, accounting practices are governed mainly by Companies Act, 2013 and GAAP. Existing laws such as SEBI regulations, Indian Banking Laws & Regulations, FEMA also provide some guidelines on preparation of Financial Statements in India. IFRS doesn’t identify the existence of these laws and the accountants will have to follow the IFRS fully with no overruling provisions from these laws.
- Tax laws are the main challenge faced by the Indian law makers immediately. In addition to the direct tax implications, the regulators would also need to indirect taxes under consideration (especially towards GST).

- Financial Statements has been preparing on historical cost by Indian corporate. Thus, historical cost basis will have tough time while shifting to Fair Value Accounting.

Phases of the Revised Roadmap (Mandatory)

Ind-AS (the converged IFRS standards) in India may significantly affect a company's day-to-day operations. From 1st April, 2015 IFRS applied as voluntarily basis but from 1st April, 2016 as mandatorily. ICAI has issued 39 accounting standards converged with IFRS**.**

Table 1: Revised Schedule set by the MCA for Converging with IFRS

(A) Phase-I of the revised roadmap which is mandatory for accounting periods beginning from or after 1st April, 2016	**(B) Phase-II of the revised roadmap which is mandatory for accounting periods beginning from or after 1st April, 2017**	**(C)** Phase-III **Mandatory applicability of Ind AS to all Banks, Insurance companies and NBFCs, w.e.f. 1st April 2018, whose:**	(D) Phase-IV Mandatorily applicable of Ind AS to all **NBFCs w.e.f. 1st April 2019 whose:**
• Companies listed or in process of listing on Stock Exchanges inside or Outside of India having net worth greater than or equal to Rs. 5 Billion • Unlisted Companies having net worth above INR 5 Billion • (c) Parent, Subsidiary, Associate and J.V. of above.	• Every company which is listed or in process of listing on Stock Exchanges inside or outside of India not covered in Phase-I (other than companies listed on SME Exchanges) • Unlisted companies having net worth greater than or equal to Rs. 250 crore but less than Rs. 500 crore. • (c) Parent, Subsidiary, Associate and J.V. of above	Net worth is above or equal to Rs. 500 crore w.e.f. 1st April 2018. IRDA of India shall notify the separate set of Ind AS for Banks & Insurance Companies w.e.f. 1st April 2018. NBFCs include stock brokers, core investment companies, venture capitalists etc. Net Worth shall be checked regarding the previous three financial years (2015-16, 2016-17, and 2017-18).	Net worth is above or equal to Rs. 250 crore but below Rs. 500 crore.

- Ind AS not applies on companies listed on SME exchange.
- Once Ind ASs is applicable, it shall be required to follow the Ind AS for all the succeeding financial statements.
- Ind AS is apply on both consolidated and Individual Financial Statements.

As per SEBI Clarification

- Up to March 31, 2017, all of the financial statements filed by them can be under Indian GAAP.
- From April 1, 2017 to March 31, 2018, disclosures in the last three financial years immediately previous the relevant financial year will have to be made under the Ind AS principles, whereas disclosures for the remaining two financial years may be as per Indian GAAP.
- Between 1st April, 2018 to 31st March, 2019, disclosures in the previous 3 financial years immediately preceding the relevant financial year will have to be made under the IND-AS principles, whereas disclosures for the remaining 2 financial years may be as per Indian GAAP.
- From April 1, 2019 to March 31, 2020, disclosures in the last four financial years just previous the relevant financial year will have to be made under the Ind AS principles, while disclosures for the remaining one financial year may be as per Indian GAAP.
- On and after April 1, 2020, disclosures in all the previous five financial years will have to be made as per the Ind AS principles.

Findings, Conclusion and Recommendations

Findings

Based on the data analysis, I concluded that it is the need of the time for Indian corporate to comply with global reporting practices. In this ever changing and globalized era, company must adopt international financial reporting practices so as to make itself competent enough. The various findings are as follows:

- Around 50% to 70% Chartered Accountants believe that convergence with IFRS will have some impact on business operations.

- Around 60% to 70% Chartered Accountants believe that convergence with IFRS will have an effect on performance measurement management of an organization which includes planning, budgeting, new performance requirements, decision making, goal setting, business performance management ecosystem, earnings management, tax management, FDI inflows, investor oriented information.
- IFRS Convergence is moving in positive directions and overall IFRS convergence will be creating win-win situation in the long-run.

Conclusion

Financial Statements are preparing on the basis of historical cost by Indian corporate, will have hard time as shifting to fair value accounting. All regulators i.e. Ministry of Corporate affairs, Ministry of Finance (Tax), SEBI, ICAI, RBI, IRDA, International Accounting Standard Board have to closely work jointly to execute IFRS. This study concludes that adoption of Ind AS has enhanced the comparability and benchmarking of the financials of Indian Companies with International Peers. Sectors like pharmaceuticals, life sciences and healthcare, industrial manufacturing, automotive were positively impacted, while telecom, metals and capital projects and infrastructure were negatively impacted. Taxes, financial instruments (including derivatives) and revenue recognition continue to be the major areas of adjustment due to Ind AS adoption.

Recommendations

On the basis of above analysis a summary of recommendations on IFRS are as follows:

- Government should bring all the regulatory bodies like SEBI, MCA, FEMA, RBI, IRDA, ICAI, NFRA, CBDT and CBEC at single platform to sort out all the problems which they will face on convergence.
- More guidance notes are required to provide immediate guidance on accounting related issues.
- Tax authorities should reflect on IFRS implications on direct and indirect taxes. IFRS should provide clear and appropriate guidelines from a tax perspective.
- The IASB has a separate IFRS for SME’s, which reduce some of the disclosure requirements of IFRS for SME’s.

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