NACAS and Convergence in India—Journey So Far and Road Ahead

The Institute of Chartered Accountants of India (ICAI) had issued a concept paper in 2007, focusing on achieving the convergence with IFRS and proposed that India should converge (rather than adopt) with the IFRS. ICAI took it as its responsibility to bring out the standards converged with the IFRS. While converging, the ICAI took IFRS as the starting point and made the required changes in view of existing accounting principles and practices and economic conditions of India. As per a roadmap issued by the MCA, about 300 to 400 entities were likely to be covered by Ind AS in the first phase. National Advisory Committee on Accounting Standards (NACAS) was constituted by the Central Government under Section 210A of the Companies Act, 1956, to advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies. In this article, the author, NACAS President h himself, provides an authoritative account of the NACAS journey so far vis-à-vis the convergence of Ind AS with the IFRS. Read on…

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Under Section 210A of the Companies Act, 1956, National Advisory Committee on Accounting Standards (NACAS) was constituted by the Central Government to advise the Central Government on the formulation and laying down of accounting policies and Accounting Standards for the adoption by companies.

Union Finance Minister Shri Arun Jaitley, in his Union Budget 2014-15 speech, stated that corporate India would implement the Ind AS on voluntary basis effective from 1st April, 2015, and on compulsory basis effective from 1st April, 2016.

Beginning of India's Journey to Converge with IFRS

The Institute of Chartered Accountants of India (ICAI) had issued a concept paper in 2007, which focused on achieving the convergence with IFRS. The concept paper also proposed that India should converge (rather than adopt) with the IFRS. Further, a group headed by the then Prime Minister of India, Dr. Manmohan Singh, committed to the converge with IFRS by April 2011 at the G-20 summit held in 2009. ICAI took it as its responsibility to bring out the standards converged with the IFRS. While converging, the ICAI took the IFRS as starting point and made the required changes keeping in view the accounting principles and practices and economic conditions prevailing in India.

Afterwards, the Ministry of Corporate Affairs (MCA) issued a press release no. 2/2010 on 22nd January, 2010, specifying a roadmap of Ind AS implementation for companies other than banking, insurance and non-banking finance companies. The roadmap specified the phased manner in which companies other than banking, insurance and non-banking finance companies were required to apply the converged Accounting Standards.

A press release no. 3/2010 related to the roadmap for application of the converged Indian Accounting Standards by the banking companies, insurance companies and non-banking finance companies was issued on 31st March, 2010. As per the roadmap issued by the MCA, in the first phase, about 300 to 400 entities were likely to be covered by the Ind AS (the converged standards). It may be mentioned here that some of these companies were already preparing their financial statements based on the IFRS for the purpose of raising money from abroad.

Significant Role of NACAS

In respect of the converged Accounting Standards, the ICAI submitted the converged version of Accounting Standards to the NACAS from time to time for recommendations and onward submission to the Ministry. NACAS played an important role in evaluating and approving all the Ind AS for notification by the MCA. It duly considered the India-specific circumstances and made carve-outs from the IFRS issued by the IASB. It also restricted multiple options that are permitted by the IFRS in several standards to enhance the uniformity. The process of convergence was completed by December 2010. At this juncture, industry started resisting the implementation of Ind AS mainly due to taxation issues involved.

Union Finance Minister Shri Arun Jaitley, in his Union Budget 2014-15 speech, stated that corporate India would implement the Ind AS on voluntary basis effective from 1st April, 2015, and on compulsory basis effective from 1st April, 2016. With a view to achieve the desired objective, the NACAS has recently been reconstituted to ensure the completion of this task in time.

Carve-Outs

In February 2011, the MCA hosted 35 Ind AS on its website, which differ from the IFRS issued by the IASB in certain respects. These have been discussed below along with the current thinking on the same:

I. Ind ASs Deferred by MCA

1. Ind AS 11, *Construction Contracts*

IFRIC 12 and SIC 29, *Service Concession Arrangements and Service Concession Arrangements: Disclosures*, respectively, which are included as Appendices A and B to Ind AS 11, *Construction Contracts*, respectively, were deferred.

Reasons: MCA received feedback regarding the adverse consequences which may ensue to the Indian companies in the event of immediate adoption of the IFRIC 12 and SIC 29. Hence, the MCA decided to defer these.

Present Situation: In case it is decided to adopt the IFRS 15 early, these carve-outs may not be required.

2. Ind AS 17, *Leases*

IFRIC 4 *Determining Whether an Arrangement contains a Lease*, which is included as Appendix C to Ind AS 17, Leases would not be notified along with the other standards and its application has been deferred.

Reasons: MCA received feedback regarding the adverse consequences which may ensue to the Indian

companies in the event of immediate adoption of the Appendix C to Ind AS 17, corresponding to the IFRIC 4. Hence, the MCA decided to defer these.

Present Situation: In view of the better preparedness of the industry and the profession, this deferment may not be required now.

3. Ind AS 106, *Exploration for and Evaluation of Mineral Resources*
Ind AS 106 corresponding to IFRS 6, *Exploration for and Evaluation of Mineral Resources*, would not be notified immediately as it is under consideration of the Government.

Reasons: MCA was of the view that the standard is open-ended offering freedom to companies to follow virtually any policy they like. The Standard does not prescribe any standardisation. This may even be counterproductive from a regulatory point of view. Hence, this Ind AS was deferred.

Present Situation: In view of the fact that the revised IFRS 6 may take a significant time before it is finally implemented, India may adopt the Ind AS 106 with suitable modifications based on the Guidance Note on *Accounting for Oil and Gas Producing Activities*.

4. Indian Accounting Standard corresponding to IAS 26, *Accounting and Reporting by Retirement Benefit Plans*, is not being notified as this Standard is not applicable to companies.

5. IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments* is not issued as it is not relevant for the companies as the Ind ASs are to be notified under the Companies Act and are applicable to companies incorporated under the Act.

II. Significant Carve-outs

A. Carve-outs which are due to differences in application of accounting principles and practices and economic conditions prevailing in India.

1. Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*

As per IFRS

IAS 21 requires recognition of exchange differences arising on translation of monetary items from foreign currency to functional currency directly in profit or loss.

Carve-Out: Ind AS 21 permits an option to recognise exchange differences arising on translation nf certain long-term monetary items from foreign currency to functional currency directly in equity. In this situation, Ind AS 21 requires the accumulated exchange differences to be amortised to profit or loss in an appropriate manner. IAS 21 does not permit such a treatment.

Reasons

(i) There is significant fluctuation in the value of US dollar *vis-à-vis* rupee. India plans for a large expenditure on infrastructure. This may need a very large inflow in the foreign borrowings. These borrowings are denominated in foreign currencies unlike developed countries where borrowings are denominated in local currencies.
(ii) Unlike currencies of many advanced countries, rupee is not fully convertible.
(iii) Indian companies are not permitted to prepay the foreign currency loans.
(iv) Other countries such as South Korea have also been raising these issues.
(v) It is not appropriate to recognise the exchange differences immediately which arise as a result of items which are to be paid/realised in foreign currency, after a long-term nature.

Present situation: ASB has submitted its recommendations to the NACAS and the NACAS is evaluating the same.

2. Ind AS 32, *Financial Instruments: Presentation*
Carve-Out: An exception has been included to the definition of *financial liability* in paragraph11 (b) (ii), Ind AS 32 to consider the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments as an equity instrument if the exercise price is fixed in any currency. This exception is not provided in IAS 32.

An exception has been included to the definition of *financial liability* in paragraph11 (b) (ii), Ind AS 32 to consider the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments as an equity instrument if the exercise price is fixed in any currency.

Reasons: This position is not appropriate in instruments such as FCCBs since the number of shares convertible on the exercise of the option remains fixed and the amount at which the option is to be exercised in terms of foreign currency is also fixed; merely the difference in the currency should not affect the nature of derivative, *i.e.*, the option.

Present Situation: ASB has submitted its recommendations to the NACAS and the NACAS is evaluating the same.

3. Ind AS 39, *Financial Instruments: Recognition and Measurement*

As per IFRS: IAS 39 requires all changes in fair values in case of financial liabilities designated at fair value through Profit and Loss at initial recognition shall be recognised in profit or loss. IFRS 9 which replaces IAS 39 requires these to be recognised in 'other comprehensive income'

Carve-Out: A *proviso* has been added to paragraph 48 of Ind AS 39 that in determining the fair value of the financial liabilities which upon initial recognition are designated at fair value through profit or loss, any change in fair value consequent to changes in the entity's own credit risk shall be ignored.

Reasons: It is felt that recognition of gain in profit or loss or in 'other comprehensive income' on deterioration of own credit risk is not proper because such deterioration ordinarily occurs when an entity is incurring losses. Thus, if an entity is allowed to recognise gain on deterioration of its own credit risk, it will book gains when its performance is not upto the mark. In the recent financial crisis in USA, it was noted that some banks booked gains while they were incurring losses due to the crisis.

Present Situation: Due to a subsequent amendment in IAS 39, this carve-out may need to be reevaluated.

4. Ind AS 103, *Business Combinations*

As per IFRS: IFRS 3 requires bargain purchase gain arising on business combination to be recognised in profit or loss.

Carve-Out: Ind AS 103 requires the same to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve.

Ind AS 101 provides that the financial instruments carried at amortised cost should be measured in accordance with the Ind AS 39 from the date of recognition of financial instruments unless it is impracticable (as defined the in Ind AS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements of the Ind AS 39.

Reasons: It is felt that recognition of such gains in profit or loss would result into recognition of unrealised gains as the value of net assets is determined on the basis of fair value of net assets acquired.

Present situation: The carve-out may continue.

5. Ind AS 101, *First-time Adoption of Indian Accounting Standards*

(i) Presentation of comparatives in the *First-time Adoption of Indian Accounting Standards* (Ind AS) 101 (corresponding to IFRS 1)

As per IFRS: IFRS 1 defines transitional date as beginning of the earliest period for which an entity presents full comparative information under the IFRS. It is this date which is the starting point for the IFRS and it is on this date the cumulative impact of transition is recorded based on the assessment of conditions at that date by applying the standards retrospectively except to the extent specifically provided in this standard as optional exemptions and mandatory exceptions. Accordingly, the comparatives, *i.e.*, the previous year figures, are also presented in the first financial statements prepared under the IFRS on the basis of IFRS.

Carve-Out: Ind AS 101 requires an entity to provide comparatives as per the existing notified Accounting Standards. It is provided that, in addition to aforesaid comparatives, an entity may also provide comparatives as per the Ind AS on a memorandum basis.

Reason: This would facilitate smooth convergence with the IFRS as comparatives are not required to

be in accordance with the Ind ASs. It is also felt that since the Ind AS 101would not be considered to be in existence for the comparative period, requiring comparatives to be prepared on the basis of Ind AS may not be legally defensible.

Present Situation: In view of the better preparedness of the industry and the profession, this carve-out may not be required now.

(ii) Foreign currency gains/losses on translation of long term monetary items

Carve-Out: Ind AS 101 provides that on the date of transition, if there are long-term monetary assets or long-term monetary liabilities mentioned in paragraph 29A of Ind AS 21, anentity may exercise the option mentioned in that paragraph regarding spreading over the unrealised Gains/ Losses over the life of Assets/Liabilities either retrospectively or prospectively. If this option is exercised prospectively, the accumulated exchange differences in respect of those items are deemed to be zero on the date of transition.

Reason: Exemption given as a consequence of optional treatment prescribed in Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, in context of exchange difference sarising on account of certain long-term monetary assets or long-term monetary liabilities.

Present Situation: ASB has submitted its recommendations to the NACAS and the NACAS is evaluating the same.

(iii) Financial instruments existing on transition date

Carve-Out: Ind AS 101 provides that the financial instruments carried at amortised cost should be measured in accordance with the Ind AS 39 from the date of recognition of financial instruments unless it is impracticable (as defined the in Ind AS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements of the Ind AS 39. If it is impracticable to do so then the fair value of the financial asset at the date of transition to Ind ASs shall be the new amortised cost of that financial asset at the date of transition to the Ind ASs. Ind AS 101 provides another exemption that financial instruments measured at fair value shall be measured at fair value as on the date of transition to the Ind AS.

Reason: This exemption would facilitate smooth convergence with the IFRS.

Present Situation: ASB has submitted its recommendations to the NACAS and the NACAS is evaluating the same.

(iv) Definition of previous GAAP under Ind AS 101 *First-time Adoption of Indian Accounting Standards*

As per IFRS: IFRS 1 defines the previous GAAP as basis of accounting that a first-time adopter used immediately before the adopting IFRS.

Carve-Out: Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used immediately before adopting Ind ASs for its reporting requirements in India. For instance, for companies preparing their financial statements in accordance with the existing Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 shall consider those financial statements as the previous GAAP financial statements.

Reason: The change makes it mandatory for the Indian companies to consider the financial statements prepared in accordance with existing notified Indian accounting standards as was applicable to them as under the Companies (Accounting Standards) Rule, 2006 as the previous GAAP, when it transitions to the Ind AS as the law prevailing in India does not recognise the financial statements prepared in accordance with Accounting Standards other than those prescribed under the Companies Act.

Present Situation: ASB has submitted its recommendations to the NACAS and the NACAS is evaluating the same.

Ind AS 101 provides an entity an option to use carrying values of all assets as on the date of transition in accordance with the previous GAAP as an acceptable starting point under the Ind AS.

In view of this, the MCA has reconstituted the National Advisory Committee on Accounting Standards (NACAS) vide the notification dated 19th September, 2014, the NACAS has appointed CA. Amarjit Chopra as its Chairman and 12 other members as specified in the notification.

(v) Cost of Property, Plant and Equipment (PPE), Intangible Assets, Investment Property, on the date of transition of First-time Adoption of Indian Accounting Standards.

Ind AS 101 provides an entity an option to use carrying values of all assets as on the date of transition in accordance with the previous GAAP as an acceptable starting point under the Ind AS.

Reasons: The existing Indian notified Accounting Standards are not significantly different from IFRS as all the standards have been based on IFRS. It will minimise the cost of convergence.

Present Situation: The carve-out may continue.

B. Carve-outs for specific industries

1. Ind AS 18, Revenue

As per IFRS: On the basis of principles of the IAS 18, IFRIC 15 *on Agreement for Construction of Real Estate, prescribes* that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and has retained neither continuing managerial involvement nor effective control.

Carve-Out: IFRIC 15 has not been included in the Ind AS 18, *Revenue*. Such agreements have been scoped out from the Ind AS 18 and have been included in the Ind AS 11, *Construction Contracts*.

Reasons

(i) IFRIC 15, would have required the real estate developers to recognise there venue in their financial statements based on the completion method, *i.e.*, only in the last year of the completion of the project. In that case, the profit and loss account of the developers will not truly reflect the performance of the business, as during the years the real estate project continues, no revenue will be recognised. In other words, profit and loss account will not reflect proper measure of performance of business.

(ii) Some countries such as Malaysia have also decided not to apply IFRIC 15 for the time being. Similarly, while Singapore has decided to issue IFRIC 15, it has provided specific guidance in the context of legal situations prevailing in that country.

Present Situation: ASB has submitted its recommendation to early converge with the IFRS 15 and the NACSA is evaluating the same.

2. Ind AS 18, *Revenue*

Carve-Out: A footnote has been added in paragraph 1 to the Ind AS 18, *Revenue*, that for rate regulated entities, this standard shall stand modified, where and to the extent the recognition and measurement of revenue of such entities is affected by recognition and measurement of regulatory assets/liabilities as per the Guidance Note on the subject being issued by the ICAI.

Reason: Rate regulated entities such as electricity companies are subject to tariff fixation by the relevant authorities. Tariff is fixed on the basis of certain costs which are different from the expenses recognised in financial statements. Such differences may result into certain regulatory assets and regulatory liabilities which are presently not recognised as per the IFRS. Such entities feel that such assets and liabilities exist and, therefore, should be recognised in financial statements. IASB has taken up a project on this subject on its Agenda. ICAI has issued a Guidance Note on the subject.

Present Situation: ASB has submitted its recommendation to the NACAS and the same is being evaluated.

3. Indian Accounting Standard on *Agriculture* (Corresponding to IAS 41)

As per IFRS: IAS 41, *Agriculture*, requires measurement of biological assets, *viz.*, living animals and plants at fair value and recognising gains and losses arising on such measurement in profit or loss, unless ascertainment of fair value is unreliable.

Carve-Out: It has been decided to revise the Standard and not to issue the standard as it is. IASB has taken up a limited scope amendment project on its Agenda to require necessary Bearer Biological Assets using cost model.

Reasons:

(i) There is difficulty in identifying the attributes of biological assets, the cost offair valuation, and high volatility of significant qualitative factors (not within the control of the entity) leads to greater subjectivity in estimating fair value.

(ii) The quoted market price for bearer biological assets (*e.g.*, long-term assets that produce each year such as tea, coffee, rubber and palm oil trees) is not easily available, since these are not traded in the open market.

(iii) Present Value (PV) method is to be adopted for estimating fair value of biological assets such as forests. Making appropriate estimates of future price and costs levels are key factors for a reliable fair value measurement of standing forests. Due to the long-term nature of the period of cash flows, small fluctuations in the assumptions may have a significant effect on the calculated fair value.

(iv) Fair value of biological assets may not be relevant because most plantations are rarely sold. Fair valuation may give the impression that the value of the company increases when in reality nothing has changed.

(v) Considering the high volatility of prices for the end products, the fair value adopted as cost as per IAS 41, may result in very significant impact on the profitability of the companies.

Present Situation: ASB has submitted the revised converged standard on Agriculture and the NACAS is evaluating the same.

Ind-AS Implementation Regaining Momentum

Union Finance Minister Shri Arun Jaitley, in his Union Budget 2014-15 speech, highlighted the need and urgency for India to move to the Ind AS. According to his announcement, adoption of Ind AS will be compulsory from 2016-17 and voluntary from 2015-16.

In view of this, the MCA has reconstituted the National Advisory Committee on Accounting Standards (NACAS) *vide* the notification dated 19th September, 2014, the NACAS has appointed CA. Amarjit Chopra as its Chairman and 12 other members as specified in the notification. Besides at present, it has seven special invitees as well.

Challenges for NACAS

Since the Ind AS were hosted by the MCA on its website in 2011, several developments have taken place. IASB has issued the following new IFRS/IAS/IFRIC:

a) IFRS 9 *(Financial Instruments)*,
b) IFRS 10 *(Consolidated Financial Statements)*,
c) IFRS 11 *(Joint Arrangements)*,
d) IFRS 12 *(Disclosures of Interests in Other Entities)*
e) IFRS 13*(Fair Value Measurement)*
f) IFRS 14 *(Regulatory Deferral Accounts)*
g) IFRS 15 *(Revenue from Contracts with Customers)*
h) IAS 27 *(Separate Financial Statements) and IAS 28 (Investments in Associates and Joint Ventures)*

Besides, the IASB has made amendments to several existing standards such as the IAS 12 *(Income Taxes)*, the IAS 19 *(Employee Benefits)*, the IAS 1 *(Presentation of financial statements)*, and the IAS 36 *(Impairment)*, *etc.*

ASB of the ICAI and the NACAS are working overtime to evaluate these new standards and changes in the existing standards. Further, it is also evaluating whether India should converge with the IFRS 9 on *Financial Instruments* and IFRS 15 on *Revenue from Contracts with Customers* at this stage.

Besides, the NACAS is also considering the areas, where there may be a need for additional carve-outs. Let us briefly address those areas. Readers may note that those areas are under consideration of the NACAS and the final decision on the same will be based on national requirements, appropriate accounting principles and practices being followed and the industry requirements.

Areas for Consideration of Additional Carve-Outs or Guidance

A.* Ind AS 1 on *'Presentation of Financial Statements'

In the Indian context, banks generally do not demand repayment of loans on minor defaults of debt covenants. Ind AS 1 may need to be amended in the context that defaults in compliance with minor procedural loan covenants to which lenders do not exercise their rights to recall the loan, would not result in classification of liability as a current liability.

B. Definition of *'Close members of the family of a person'* under Ind AS 24 on *'Related Party Disclosures'*

There may be a need for guidance for evaluating as to how the influence in the dealings with the entity can be assessed to address the issue of subjectivity in assessing whether a particular family member is expected to influence or be influenced in their dealings with the entity.

C. Ind AS 111 on *'Joint Arrangements'*

As per the exposure draft of Ind AS 111 submitted by the ASB to the NACAS, the accounting for joint ventures will be done using equity method, *i.e.* proportionate consolidation method will not be permitted. The same is being examined by the NACAS.

D. Ind AS 40 on *'Investment Property'*

Rebuttable presumption of investment property to be measured at fair value is removed in the Ind AS 40, *i.e.*, only the cost option for valuation of investment property is there. However, the requirement in the Ind AS 40 to disclose the fair value despite the fact that fair value option is not given for valuation of investment property still exists. There may be a case for reexamining this requirement.

E. Ind AS 19 on *'Employee Benefits'*

As per para 83 of the revised Ind AS 19, the rate used to discount post-employment benefit obligations (both funded and unfunded) should be determined by reference to market yields at the end of the reporting period on government bonds whereas as per the IAS 19, discount rate should be determined by reference to market yields at the end of the reporting period on high-quality corporate bonds. Further as per the IAS 19, in countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used. The government bond rate in India would not be relevant for subsidiaries, associates and joint ventures of companies in other countries for preparing consolidated financial statements. Therefore, it may not be appropriate to require such companies to use government bond rate in India as the rate of discount for post-employment benefit plans outside India.

Thus, there may be a need to change the requirement in paragraph 83 of the revised Ind AS 19 to permit use of discount rate for subsidiaries, *etc.*, of companies in other countries based on the requirement contained in the IAS 19.

F. Ind AS 113 on *'Fair Value Measurement'*

Ind AS 113 uses the concept of highest and best use. Besides, it contains many areas which will require India specific implementation guidance. In particular, implementation guidance may be required in the following areas under the Ind AS 113:

- Terms used in the definition of *Fair Value*, *viz.*, orderly transaction; market participants and measurement date;
- Determination of principal market and the most advantageous market;
- Valuation of a non-financial assets particularly the *Highest and Best Use* principle, *etc.*

Statement of Union Finance Minister in his Union Budget 2014-15 speech has revived the process of implementation of the Ind AS in India. Reconstitution of the NACAS has given it the much-desired momentum. Despite certain challenges faced on this way, target would certainly be achieved and accountancy profession in the country would touch new heights. This would also facilitate recognition of Indian chartered accountants as international accountants. ■