ACCOUNTING AND AUDITING IN INDIA – THE PAST, PRESENT AND FUTURE

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EVOLUTION OF ACCOUNTING

1 Introduction

1.1 Financial accounting and reporting remains the core tool of entities for communication with its stakeholders. It is the semantics for such communication. Accounting standards are the grammar of such language used by entities in such communication. The separation of ownership and management in the growing businesses and modern day complexities added the importance of timely and accurate communications. The grammar (i.e. Accounting Standards) blends uniformity in reporting and facilitation of unambiguous communication with the variety of stakeholders including but not limited to owners/shareholders, employees, regulators, trade/business relations, revenue authorities *etc*.

1.2 The subject of accountancy and its importance has a long history in India e.g. a treatise on economics and political science titled 'Kautilya's (also known as Chanakya) Arthshasthra', has elaborate prescriptions on accounting (and accountability) aspects for a treasury and government which have features of universal utility. In line with the evolution and changes in the scale and texture of economies and society, financial reporting and accounting standards have also evolved and witnessed path-breaking changes.

1.3 The earliest treatise on accounting is generally thought to be Pacioli's Summar of 1494. However, Bahi-khata (a double-entry system of bookkeeping) predates the 'Italian' method by many centuries. Its existence in India prior to the Greek and Roman empires suggests that Indian traders took it with them to Italy, and from there the double-entry system spread through Europe, which then evolved itself to accrual from cash and gradually to present day modern reporting.

2 Evolution of accountancy in major jurisdictions

2.1 America:

After the U.S. stock market crash in 1929, many investors and market participants felt that insufficient and misleading accounting and reporting had inflated stock prices that eventually crashed the stock market followed by the Great Depression. Whether that perception was true or not is a separate debate, but those feelings made accounting world more alert and agile about its role and the continuing pressures on the accounting profession to establish accounting standards prompted the American Institute of Accountants (now known as the AICPA) and the New York Stock Exchange to review financial reporting requirements.

2.2 A few years later, the Securities Act of 1933 and the Securities Exchange Act of 1934 were passed into law to restore investor confidence, which set forth the accounting and disclosure requirements for the initial offering of stocks and bonds and for secondary market offerings respectively.

2.3 The 1934 Act also created the U.S. Securities and Exchange Commission (SEC), which was mandated with standard setting of financial accounting and reporting for publicly-traded companies. However, the SEC while keeping the power to set standards chose to delegate its rule-making responsibilities to the private sector. This means that if the SEC did not conform to a specific standard issued by the private sector, it had the authority to change that standard. Despite delegating its rule-making responsibility, the SEC issued its own accounting pronouncements called Financial Reporting Releases (FRRs).

2.4 The Committee on Accounting Procedure (CAP) and American Institute of Accountants (now AICPA) were the very first private-sector standard setting bodies. During 1938 to 1959, the CAP issued 51 Accounting Research Bulletins (ARBs). Since, it had not established a financial accounting conceptual framework, its rule-making approach of dealing with accounting and reporting problems and issues was subjected to severe criticism.

2.5 The CAP was then replaced by the Accounting Principles Board (APB) set up under the recommendation of a special committee appointed by AICPA which issued 31 Accounting Principles Board Opinions (APBOs), 4 Statements and several interpretations during its tenure from 1959 to 1973. In contrast to its predecessor, it attempted to establish a conceptual framework with its APB Statement No. 4 but failed. In addition to its unsuccessful efforts to create a framework, it was also under fire for its apparent lack of independence because its board members were supported by the AICPA and other interest groups or stakeholders were not represented in its rule-making process.

2.6 Emphasizing the significance of an independent standard-setting structure, the APB was reorganized in 1973 into a new body called the Financial Accounting Standards Board (FASB). As compared to APB's 18-21 part-time members who mostly represented public accounting firms, the FASB has 7 full-time members representing the accounting profession, industry and other various interest groups/stakeholders such as the government and accounting educators.

2.7 In 1984, FASB formed the Emerging Issues Task Force (EITF) with members of the FASB, auditing firms and industries with the role of responding to emerging accounting and financial reporting issues and publish its pronouncements in the form of EITF Issues – considered to form part of US GAAP. The function of the EITF is important because it makes the standard-setting process more efficient and allows the FASB to concentrate on much broader and long-term problems.

3 UK/ Europe

3.1 Meanwhile, efforts in the UK and Europe to create an international body to establish international accounting standards were also gaining widespread support, which led to the creation of the International Accounting Standards Committee (IASC) in mid-1973. Just like the FASB's EITF, the IASC established the Standing Interpretations Committee (SIC) in 1997 to study accounting issues and problems that required authoritative guidance.

3.2 In 1977, the International Federation of Accountants (IFAC) came into existence as a result of an agreement signed by 63 accounting bodies representing 49 countries. The main objective of IFAC is *'the development and enhancement of a co-ordinated worldwide accountancy profession with harmonized standards'*. ICAI is a member of the IFAC since its inception.

3.3 In 2001, the IASC reorganized itself to act as an umbrella organisation to a new standard-setting body – the International Accounting Standards Board (IASB). The accounting standards issued by the IASB were designated as International Financial Reporting Standards (IFRS). The IASB continued to adopt the 41 International Accounting Standards (IAS) issued by the IASC between 1973 and 2002. It also adopted all SIC Interpretations which were renamed as International Financial Reporting Interpretations Committee (IFRIC).

3.4 IASB has no authority to enforce compliance with IFRS and its adoption is entirely voluntary. In 2001, the International Organization of Securities Commission (IOSCO) approved the use of IAS/IFRS for cross-border offerings and listings and IFRS/IAS was also adopted in 2005 by listed companies in the European Union. This adoption of IFRS/IAS by EU companies gave a big filip for them to become gradually being adopted and accepted across other jurisdictions.

3.5 Since October 2002, the IASB and FASB have been working to remove differences between IFRS/IAS and US GAAP towards a common set of high quality global accounting standards. Their commitment to the convergence effort was embodied in a memorandum known as the Norwalk Agreement.

3.6 After 10 years of working together, some notable convergence projects have been successfully completed.

Major joint projects completed include converged standards on Business Combinations, Consolidation, Fair Value Measurement, Revenue Recognition and Leases.

3.7 Other projects were discontinued because the two boards could not agree on some issues such as standards on de-recognition, financial statement presentation, insurance contracts, liabilities and equity, and post-employment benefits.

3.8 The major prevalent Accounting Practices in the world today can be bifurcated to two broad categories:

i. International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB), which are prevalent in more than 100 countries including European Union, Australia, Canada *etc*.;

ii. US GAAP i.e. Generally Accepted Accounting Principle followed in United States of America.

4 History & Evolution of Accounting and Auditing in modern India

4.1 The evolution of India's present-day accounting system can be traced back to as early as the sixteenth century with India's trade links to Europe and central Asia through the historic silk route. Earlier Indian accounting practices reflect its diversity as India has many official languages and scores of dialects spread over numerous states.

1857: The first ever Companies Act in India legislated.

1866: Law relating to maintenance of accounts and audit thereof introduced. Formal qualification as auditor was now required.

1913: New Companies Act enacted. Books of accounts required to be maintained specified. Formal qualifications to act as auditor were named and a Certificate from the local government was required to act as an auditor – An unrestricted Certificate to act as auditor throughout British India and a restricted Certificate to act as auditor only within the Province concerned and in the languages specified in the certificate.

1918: Government Diploma in Accounting **(GDA)** was launched in Mumbai. On completion of articleship of 3 years under an approved accountant and passing of the Qualifying examination, the candidate would become eligible for the grant of an Unrestricted Certificate.

1920: The issue of Restricted Certificates discontinued.

1930: Register of Accountants to be maintained by the Government of India to exercise control over the members in practice. Those whose names found entry here were called Registered Accountants (RA).

The Governor General in Council replaced the local government as the statutory authority to grant certificates to persons entitling them to act as auditors. Auditors were allowed to practice throughout India.

1932: First Accountancy Board was formed. The Board was to advise the Governor General in Council on matters relating to accountancy and to assist him in maintaining standards of qualification and conduct required of auditors.

1933: First examination held by the Indian Accountancy Board. GDAs were exempted from taking the test.

1935: The first Final examination was held. GDAs were exempted from taking the test.

1943: GDA was abolished.

1948: Expert Committee formed to examine the scheme of an autonomous association of accountants in India.

1949: The Chartered Accountants Act, 1949 passed on 1st May. The term Chartered Accountant came to be used in place of Indian Registered Accountants. The Chartered Accountants Act was brought into effect on 1st July and The Institute of Chartered Accountants of India (ICAI) was born on 1st July 1949.

4.2 The ICAI, being the premier standard-setting body in India, constituted Accounting Standard Board (the 'ASB') on April 21, 1977, with the objective to formulate Accounting Standards to enable the Council of ICAI to establish a sound and robust financial reporting standards framework in India.

The ASB takes into consideration the Accounting Standards at the International Level (IFRS/IAS) and sets National Standards based on those so that National Standards are broadly aligned to Global Accounting Principles. ASB is represented not merely by members of ICAI but also representatives from Government including Revenue Departments, RBI, IRDA, MCA, Chambers of Commerce.

From 1977 to 1988, ICAI notified 11 Accounting Standards ('AS'), made in consultative manner by ASB, but these notified AS lacked statutory recognition.

4.3 The statutory recognition and legal force was provided to Accounting Standards by amendment made in 1999 to the Companies Act, 1956. New sub-sections (3A), (3B) and (3C) were inserted in section 211, which required that every balance sheet and profit & loss account of the Company complied with the accounting standards, prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards (NACAS).

The accrual method of accounting in India also gradually evolved with growth and evolvement of the 'Company' form of business organisation and mandatory requirement prescribed under the law [Section 209(3) of 1956 Act] for the Companies to follow 'accrual' basis and according to double entry system of accounting.

5 Accounting Standards

5.1 Accounting Standards are "*written documents, policies, procedures issued by expert accounting body or government or other regulatory body covering the aspects of recognition, measurement, treatment, presentation and disclosure of accounting transactions in the financial statement".*

5.2 Objective of Accounting Standards:

- Standardise the diverse accounting policies.
- To eliminate non-comparability of financial statements to the possible extent.
- Add to the reliability to the financial statements.
- Help understand Accounting Treatment in financial statements.

5.3 Advantages of Accounting Standards:

- Reduce or eliminate confusing variations in the accounting treatments used to prepare the financial statements.
- Disclosures beyond that required by law.
- Facilitating comparison of financial statements of across different companies.
- Uniformity of accounting treatment of identical transactions

5.4 Procedure for issuing Accounting Standards by ICAI:

The following procedure is adopted for formulating the accounting standards:

- ASB constitutes Study Group to formulate preliminary draft.
- ASB considers the preliminary draft and issues Exposure draft (ED) for public comments. ED is also specifically sent for comments to specified bodies such as industry associations, regulators, stock exchanges and others.
- ASB considers comments received on ED and finalises the draft AS for consideration of Council.
- Draft approved by council is recommended to NACAS.
- NACAS recommends the Standard to the Government of India (MCA) after its review and modifications, if any, in consultation with ICAI.
- Government of India (MCA) notifies the AS on acceptance of recommendations made by NACAS.

6 Important Milestones of Accounting Standards in India

- 1979 - Preface to Statements of AS & AS 1 issued.
- 1987 - Mandatory status of AS 4 & AS 5.
- 1991 - Mandatory status of AS 1, AS 7, AS 8, AS 9, AS 10 and AS 11 (Corporate Entities)

- 1993 - Mandatory status of AS 1, AS 7, AS 8, AS 9, AS 10 and AS 11 (Non Corporate Entities)

- 1999 Legal recognition to ASs issued by ICAI under Companies Act, 1956.

- 2000-2003 - 12 AS were issued based on IASs-major step towards convergence with IASs.

- 2002 - Insurance Regulatory and Development Authority (IRDA) required Insurance Companies to comply with the Accounting Standards issued by the ICAI.

- 2003 - Reserve Bank of India (RBI) issued Guidelines on compliance with Accounting Standards (ASs) advising banks to ensure strict compliance with the Accounting Standards issued by the ICAI.

- 2006 - MCA notified separate AS under Companies (AS) Rules, 2006 which was based on work done by ASB of ICAI and approved by NACAS. ASB decided to constitute a task force to develop a concept paper on convergence with IFRS.

- 2007 - ASB and Council accepted recommendations of Task Force for convergence with IFRS.

- 2010-11 Ind AS (IFRS Converged Standards) prepared by ICAI, approved by NACAS and notified by MCA (Date not notified)

- 2015 - MCA issued the roadmap (dates of implementation) for converged IFRS in phased manner & notified 39 Ind AS formulated by ICAI and approved by NACAS.

- 2016 - MCA notified revised AS 2, AS 4, AS 10, AS 13, AS 14, AS 21, and AS 29 and Ind AS 11.

- 2018 - MCA notified Ind AS 115 replacing Ind AS 11 and Ind AS 18.

7 Applicability of Accounting Standards to Small and Medium Sized Enterprises (SMEs) and Small and Medium-sized Companies (SMCs)

7.1 Under the Companies Act, 1956 Small and Medium-Sized Company as defined in Clause 2(f) of the Companies (Accounting Standards) Rules, 2006 were exempted from compliance of the Accounting Standards AS 3 – Cash Flow Statement and AS 17 - Segment Reporting. Also AS 21 – Consolidated Financial Statements, AS 23 – Accounting for Investments in Associates in Consolidated Financial Statements and AS 27 – Financial Reporting of Interests in Joint Ventures (to the extent of requirements relating to Consolidated Financial Statements were not applicable to SMCs since the relevant Regulations did not require compliance with them. Relaxations in respect to disclosures under certain Accounting Standards were also granted to SMCs.

7.2 As per 'Applicability of Accounting Standards', issued by the ICAI (published in 'The Chartered Accountant', November 2003), there are three levels of entities. Level II entities and Level III entities are considered to be the small and medium enterprises (SMEs). On the other hand, as per the Accounting Standards notified by the Government, there are two levels, namely, SMCs as defined in the Rules and companies other than SMCs. Non-SMCs are required to comply with all the Accounting Standards in their entirety, while certain exemptions/ relaxations have been given to SMCs. Certain differences in the criteria for classification of the levels were also noted.

GLOBALISATION OF ACCOUNTING STANDARDS

8.1 Globalisation of economies and evolution of a highly interconnected world has had far reaching changes impact on economy and the 'accounting' world also cannot remain unaffected there from. Since the beginning 21st century, there was renewed demand for global harmonisation of accounting standards and to converge or adopt single set of high quality standards that require transparent and comparable information in the financial statements. There is also a significant transformation in the fundamental accounting principles and concepts fair value measurements, prominence to fair and faithful presentation, new components in financial statements and so on gained acceptance.

8.2 Further, the direction of accounting standard setting has shifted towards '*Principles*' based standards rather than '*Prescriptive Rule*' based ones. There are two other major developments also impacting standard-setting viz., the unprecedented global financial crisis starting in 2007-08 and birth of integrated reporting framework in 2010 having core objective of more effective communication with stakeholders. Policy makers and Regulators are following the developments in standard-setting area with keen interest. Therefore, accounting standard-setting role has assumed greater responsibility and accountability.

8.3 International Financial Reporting Standards (IFRS) area set of high quality principle-based standards and has become the global financial reporting language with more than hundred countries accepting or requiring IFRS based financial reporting. The U.S. Securities and Exchange Commission has also allowed Foreign Private Issuers to file financials statements prepared under IFRS without reconciliation to the US GAAP.

8.4 It is the primary duty of any company irrespective of Indian company or foreign company to prepare financial statements at the end of accounting period. While preparing financial statements some accounting standards needs to be followed that is laid down by Accounting Standard Board of the respective country. Subsidiary/Joint Venture/Associate of a company located in another country need to prepare its financial statements according to accounting standards of the country where it is located, which leads to variation in profits. This variation in profits is due to difference in accounting standards, which differs from country to country. In order to remove these variation/difference in profits, International Accounting Standard Board introduced International Financial Reporting Standards called as IFRS. IFRS are the common accounting standards followed by member countries of IASB in preparing their financial statements. IFRS helps in arriving at similar profits regardless of the location of an entity. Before any new IFRS are issued or amendments are made in IFRS, IASB issues exposure drafts, discussion papers and conducts out-reach events.

9 Advantages of convergence to IFRS

- *Easy Comparison*: Companies always would like to compare their performance with other companies' performance. IFRS make this work easier because most companies are / will follow same accounting standards in preparing their financial statements.

- *One Accounting language company-wide*: Company with subsidiaries in foreign countries can use IFRS as common business language in preparing its financial statements as most of the countries are adopting / converging with IFRS.

- *IFRS facilitates Cross border movement* of capital and cross border acquisitions, enables partnerships & alliance with foreign entities.

- Availability of professionals internationally: IFRS enhances the mobility of professionals internationally.

- *IFRS provides more compatibility*: IFRS provide more compatibility among sectors, industry, & companies. This would improve relationship with investors, suppliers, customers and other stakeholders across the globe.

- *Increased investment opportunities*: Common accounting standards help investors to understand available investment opportunities better as opposed to financial statements prepared under different set of national accounting standards.

- *Lower cost of capital*: Greater willingness on the part of investors to invest across borders will enable entities to have access to global capital markets which lowers the cost of capital.

- *Higher economic growth*: Increased investment opportunities lead to attraction of more investments which result in higher economic growth.

- *Better quality of financial reporting*: Convergence will place better quality of financial reporting due to consistent application of accounting principles and reliability of financial statements.

10 Road to Indian Accounting Standards (Ind-AS i.e. IFRS Converged Standards in India)

10.1 The Leaders' Statement at G-20 Summit held in September 2009 attended by our Prime Minister Dr. Manmohan Singh at Pittsburgh contained a commitment by the G-20 nations for convergence of accounting standards globally.

10.2 In 2010-11, the ASB of ICAI after a tirelessly effort came out with 35 Ind AS which, after NACAS consultation were notified by Ministry of Corporate Affairs (MCA) in February 2011. However the date of implementation which was scheduled to be 1st April, 2011 was not notified by the Government possibly, amongst other reasons, due to tax-related concerns by corporates.

10.3 The current government in its very first budget in July 2014 announced its intention of implementing Ind AS from 2015 onwards. On 2nd January 2015, the Ministry of Corporate Affairs (MCA) issued a press release which laid down a roadmap for adoption of Ind AS in India. 16th February 2015 marked the dawn of new era in accounting standards in India when MCA notified the final roadmap for adoption of new generation accounting standards, "Indian Accounting Standards – Ind AS" based on the size of the companies and sectors like Banking, NBFC & Insurance.

10.4 Between 2011, when MCA deferred the implementation of Ind ASs and this notification, the International Financial Reporting Standards (IFRSs) had gone through a significant rejig – the biggest ones being the new accounting standards on Consolidation (IFRS 10, 11 and 12), Fair Value Measurement (IFRS 13), Revenue (IFRS 15) and Financial Instruments (IFRS 9). These developments have been incorporated in the standards notified by the MCA based on the updation by ICAI with consultation of NACAS.

11 Indian Accounting Standards (Ind AS)

11.1 The key features of Ind-AS which are principle-based IFRS converged standards include fair value measurement, use of time value of money and reliance on robust disclosures. These Standards are applicable for separate as well as consolidated financial statements.

11.2 The implementation of Ind-AS has led to enhanced qualitative reporting due to additional information requirements and more transparency. This will help the investors to better understand the risks and rewards associated with the investment in an entity and, therefore, it would make investment decisions easier.

11.3 Ind AS also require greater use of judgements and estimates. Therefore, greater disclosure requirements are prescribed under these Standards.

- For estimates: focus on the most difficult, subjective and complex estimates including details of how the estimate was derived, key assumptions involved, the process for reviewing and a sensitivity analysis.

- For judgements: provide sufficient background information on the judgement, explain how the judgement was made and the conclusion reached.

- There is emphasis on substance over form under these standards as they require us to look into the economic reality of a transaction. Therefore, the substance of a financial instrument needs to be looked into, rather that its legal form to determine its classification in the balance sheet. For example, a compulsorily redeemable preference share is to be classified as a financial liability under Ind AS while under Indian GAAP it was classified as per its form i.e., it was classified as a part of equity.

11.4 Ind-AS thus, leads to more truthful representation of transactions, e.g.

- Where goods are sold on extended credit terms, i.e., extending the term beyond the normal credit period; then the financing element built into the price is segregated and considered as 'interest' income. For example, goods that are normally sold at price of Rs. 100 for a credit period of 3 months. If, however, they are sold for Rs. 110 for 15 months credit then Rs. 10 will be considered as 'interest' (say @10%) income under Ind AS. Similarly, fixed assets or inventories purchased on deferred credit terms having financing element, namely 'interest' is also to be segregated from the 'purchase price'.

- Derivatives and hedge accounting was earlier done on settlement-based approach rather than deferral approach. Ind-AS requires fair value approach in case of these instruments.

- Accounting for time value of money, the true position of financials closer to reality is depicted. There are many instances where Ind-AS requires discounting of future amounts to arrive at the present value. Some of these instances are discounting of long term provisions, measurement of asset retirement obligations, measurement of liability in defined benefit plans etc.

11.5 There are several fundamental changes that the new standards bring in when compared to the earlier Standards. One key fundamental change is the significant increase in focus on fair value accounting. Ind AS requires application of fair value principles, which is resulting in significant differences from financial information being presented earlier. Complying with fair value principles of Ind AS will also require assistance from professionals with valuation skills to arrive at reliable fair value estimates.

The following four Ind AS will have substantial impact with significant operational and procedural changes specially for Banks, NBFCs and Insurance Companies:

- Ind AS 109, Financial Instruments which provides the accounting and reporting norms for Financial Instruments.

Presently, companies follow a provisioning matrix for impairment losses of financial assets which is based on 'incurred loss' model wherein impairment losses were recognised on occurrence of a credit risk trigger or event indicating objective evidence of impairment. This could include a past due or default, significant financial difficulty and so on.

After Ind AS comes into place, the 'expected loss' model will be followed which is based on estimating Credit Risk since initial recognition. Ind AS 109 requires entities to recognise and measure a credit loss allowance or provision based on an expected credit loss model.

The new impairment model based on the expected credit losses as compared to current percentage-based provisioning requirements will have a significant impact on the entities' estimation of the probabilities of default.

- Ind AS 32, Financial Instruments: Presentation which will change the presentation by the issuer of a financial instrument as liability or equity based on principles of classification.

- Ind AS 113, Fair Value Measurement which defines how fair value will be measured.

- Ind AS 115, Revenue from Contracts with Customers which is effective from 1st April 2018, replacing Ind AS 11, Construction Contracts and Ind AS 18, Revenue.

11.6 Carve-Outs from IFRS: The Ind AS contain some carve-outs as compared to IFRS as mentioned below. These carve-outs have been made either due to conceptual issues or considering Indian economic conditions and existing accounting practices being followed in the country.

- Events after the Reporting Period - Ind AS 10 *vis-à-vis* IAS 10As per IFRS, Rectification of any breach of a loan agreement after the end of Reporting period is a non-adjusting event. Whereas, as per Ind AS, if the lender, before the approval of Financials Statements for issue, agrees to waive the breach, it shall be considered as an adjusting event.

- Leases - Ind AS 17 *vis-à-vis* IAS 17: As per IFRS, all leases rentals to be charged to statement of profit and loss on straight-line basis. Whereas, as per Ind AS, no straight-lining for escalation of lease rentals is to be done in line with expected general inflation.

- Employee Benefit - Ind AS 19 *vis-à-vis* IAS 19: As per IFRS, corporate bond rates are to be used as discount rate for determining Actuarial Liabilities. Whereas, as per Ind AS, mandatory use of government securities yields rate is to be done.

- The Effects of changes in Foreign Exchange rates - Ind AS 21 *vis-à-vis* IAS 21: As per IFRS, recognition of exchange rate fluctuations on long-term foreign currency monetary items is to be done in the statement of profit and loss. Whereas, as per Ind AS, there is an Option to defer exchange rate fluctuations on long-term foreign currency monetary items existing as at the transition date.

- Investment in Associates and Joint Ventures - Ind AS 28 *vis-à-vis* IAS 28: As per IFRS, for the purpose of applying equity method of accounting in the preparation of investor's financial statements, uniform accounting policies should be used. In other words, if the associate's accounting policies are different from those of the investor, the investor should change the financial statements of the associate by using same accounting policies. Whereas, as per Ind AS, the phrase, 'unless impracticable to do so' has been added in the relevant requirements.

- Financial Instruments: Presentation - Ind AS 32 *vis-à-vis* IAS 32: As per IFRS, equity conversion option in case of foreign currency denominated convertible bonds is considered a derivative liability, which is embedded in the bond. Gains or losses arising on account of change in fair value of the derivative need to be recognised in the statement of profit and loss as per IAS 32. Whereas, as per Ind AS, an exception has been included to the definition of financial liability, whereby conversion option in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments is classified as an equity instrument if the exercise price is fixed in any currency.

- First time Adoption - Ind AS 101 *vis-à-vis* IFRS 1: As per

IFRS, on the date of transition, either the items of Property, Plant and Equipment shall be determined by applying IAS 16 'Property, Plant and Equipment' retrospectively or the same should be recorded at fair value. Whereas, as per Ind AS, an additional option is given to use carrying values of all items of property, plant and equipment on the date of transition in accordance with previous GAAP as an acceptable starting point under Ind AS.

- Business Combinations - Ind AS 103 *vis-à-vis* IFRS 3:

As per IFRS, bargain purchase gain arising on business combination is to be recognised in Statement of profit or loss as income, whereas, as per Ind AS, it is to be recognised in Capital Reserve.

It is proposed to minimise carve-outs in the future in course of time. In order to minimise the carve-outs which are due to conceptual issues, ICAI is continuously in dialogue with IASB and raising concerns at appropriate international forums.

The objective of carve-outs made due to Indian economic conditions and existing accounting practices was to smoothen the transition to Ind AS and are proposed to be removed over a period of time when Ind AS get stabilised in India and an environment compatible with the requirements under IFRS is developed.

12 The way forward

12.1 Changes in Accountancy, due to change in Technology: Globalization of national economies and their interdependence had been strengthened by the internet, which brings people living across the globe together in no time. This had an impact on the working of the different professions and the profession of accounting has not been left unaffected by this global revolution of networking. New technologies spawn new applications and possibilities, which in turn inspire changes to accounting methods and methodologies. The advent of cloud-enabled computing has brought improvements to mobility and connectivity for accountants. As a result, one is able to work with clients across the globe from the comfort of one's home, remotely access one's data from a variety of devices regardless of one's location or the time, perform advanced computations on the fly and retrieve real-time analytics. Technological changes to accounting have automated many of the inputs and calculations that accountants once had to perform manually. This allows one to play a more analytical and consultative role in one's interactions with clients. Of course, these advances also require one to remain flexible, adaptable and perpetually learning in order to keep up with the rapid pace. The evolving Block Chain technology and Artificial Intelligence will also impact the way accounting is done, in times to come. These are interesting times in the Accounting arena.

12.2 India has come a long way through evolving the accounting rules towards better governance and globalization of its rapidly growing economy. The couple of years of experience by several hundred Indian companies ushering in IFRS converged accounting, to the say the least, is encouraging. The existing Standards for SME/SMCs are also being upgraded to make them compatible with Ind AS except for the complexities of Fair Value, time value of money, *etc.* and this could be next era of big changes in Indian context.

ORIGIN AND EVOLUTION OF AUDITING

13. Origin of Audit

13.1 The word audit comes from the word "Audire" (means to hear). In general, it is a synonym to control, check, inspect, and revise. In early days an auditor used to listen to the accounts read over by an accountant in order to check them. Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Greece, Egypt, Rome, U.K. and India. The Vedas contain reference to accounts and auditing. Arthasashthra by Kautilya also detailed rules for accounting and auditing of public finances.

13.2 In general, it is a synonym to control, check, inspect, and revise. Auditing existed primarily as a method to maintain governmental accountancy, and record-keeping was its mainstay. It wasn't until the advent of the Industrial Revolution, from 1750 to 1850, that auditing began its evolution into a field of financial accountability. Checking clerks were appointed in those days to check the public accounts and to find out whether the receipts and payments are properly recorded by the person responsible.

13.3 As trade and commerce grew extensively globally, the involvement of public money therein also increased manifold. This in turn created a demand from the investors to have the accounts of the business ventures examined by a person independent of the owners and management of the business to ensure that they were correct and reliable. Such a demand laid down the foundation for the profession of auditing.

13.4 Over the years, the extent of reliance placed by the public on the auditors has increased so much with time that it is, unreasonably, felt by the public that nothing can go wrong with an organisation which has been audited. Though the fact that an audit has been carried out is not a guarantee as to the future viability of an enterprise, it is extremely important that the auditors carry out their assignments with utmost professional care and sincerity, to uphold the faith posed by the public in them.

13.5 Over the years, auditing has undergone some critical developments. A change in audit approach from "verifying transaction in the books" to "relying on system" also evolved due to the increase in the number of transactions which resulted from the continued growth in size and complexity of companies where it was unlikely for auditors to play the role of verifying transactions. As a result, auditors started placing much higher reliance on companies' internal controls in their audit procedures. Furthermore, auditors were required to ascertain and document the accounting system with particular consideration to information flows and identification of internal controls. When internal control of the company was effective, auditors reduced the level of detailed testing.

13.6 There was also a readjustment in auditors' approaches where the assessment of internal control systems was found to be an expensive process and so auditors began to cut back their systems work and make greater use of analytical procedures. An extension of this was the development during the mid-1980s of Risk-Based Auditing (RBA). RBA is an audit approach where an auditor will focus on those areas which are more likely to contain errors. To adopt the use of RBA, auditors are required to gain a thorough understanding of their audit clients in term of the organisation, key personnel, policies, and their industries. The use of RBA places strong emphasis on examining audit evidence derived from a wide variety of sources that is both internal and external information for the audit client.This period also involved Introduction of Computer Assisted Audit Techniques (CAATs) that facilitated data extraction, sorting, and analysis procedures.

14. Advent of computerization and auditing

14.1 Before the advent of the computer, bookkeeping was done by actual bookkeepers. The bookkeeper would record every financial transaction the company made in a journal, the then book of primary entry. The transaction didn't just need to be entered into the journal but also copied to other ledgers, for example, the company's general ledger.

14.2 Prior to the advent of computers, to ensure accounts were in balance, a 'Trial Balance' was used. If this internal document revealed that the accounts were not balanced then the bookkeeper had to undertake the arduous task of going through each transaction, check the castings, carry-forwards, *etc*. until the root cause of the disparity was located and rectified so that the accounts again balanced.

14.3 The advent of computerisation dramatically changed the manner in which the business was conducted. It had significant effect on organization control, flow of document information processing and so on. Auditing in a Computerised environment however did not change the fundamental nature of auditing, though it caused substantial change in the method of evidence collection and evaluation. This also required auditors to gain knowledge about computer environment (hardware, software, *etc*.) and keep pace with rapidly changing technology, even to the extent of using sophisticated Audit software.

14.4 Auditors generally followed an "*auditing around the computer*" approach by comparing the machine's input with its output (parallel processing), just as he/she had compared the voucher files with the ledger books in the early 1900s.

14.5 With the introduction of computers, conventional accounting systems and methods using papers, pens, etc. underwent drastic changes, therefore exerting a great impact on internal control and audit trails in following audit procedures. Auditors could no longer depend on visible records but only check the existence of adequate internal control system to ensure accuracy of operations; the number of records which could be read only when processed by computers increased while intermediary and legible records which existed in conventional manual accounting processes decreased and there were many cases in which audit trails were not available. Therefore, audit procedures had to be revised to cope with these problems.

14.6 With rapid changes in the business world, auditors only slowly realised they needed to be technologically proficient and, perhaps, adopt new approaches. The 21st Century forced auditors to rather "*work through the computer*" in performing their functions as virtually all business transactions were conducted via the information technology. Computer Assisted Audit Techniques (CAATs) were developed for using technology to assist in the completion of an audit. CAATs automated working papers and auditors used software to perform audits. CAATs were very useful when large amounts of data were involved or complex relationships of related data were needed to be reviewed to gather appropriate audit evidence from the aggregated data. It also increased the efficiency of the conclusions about data analysis. Several CAATs were developed like Generalized Audit Software, Data analysis software; Network security evaluation software/ utilities; OS and DBMS security evaluation software/ utilities; Software and code testing tools", Interactive Data Extraction and Analysis, and Audit Command Language.

15. Auditing in future and use of technology for audit

15.1 For the past two decades, auditors have been seeking less and less audit evidence from detailed substantive testing. Better accounting systems and the greater use of IT by clients has meant that very few material transaction errors are being discovered by external auditors. Therefore, audit emphasis is increasingly shifting from the detailed examination of the routine transactions to the internal controls and the potential of risk. These developments have to be viewed in terms of a change from audit efficiency to audit effectiveness. There has been resurgence in the emphasis on judgement regarding the assessment of risks and controls, judgement regarding the interpretation of analytical reviews, and judgement in relation to any testing (albeit on limited basis). The focus, by some firms, on the high-level risks and controls, together with the justification of very limited amounts of detailed substantive testing based on their risk analyses and analytical reviews, has completely altered previous conceptions of the external audit.

15.2 The functions of auditors have changed over the years unlike its antecedent "accounting". Much later in history, this duty changed since auditors are not guarantors and there is no way they can ascertain 100% that the financial statements prepared and presented are free from fraud, therefore, the auditors were expected to give reasonable skill and care in giving their opinion on whether the financial statements faithfully represent the financial situation of the business. The roles of auditors were seen to be changing due to changes in the world at large. Due to this, the assertion in an audit report has changed from "True and correct" in the past to the present concept of "True and Fair".

15.3 Given the recent advances in business technologies, the continuing emphasis on the backward-looking or historical audit is now being seen as an outdated philosophy. Instead, the thought is that real-time solutions are needed. As such, it is felt that auditing firms that successfully experimented with the CAATs should give eventual consideration to more advanced programs which contain functionalities resembling the audit of the future and provide a higher level of assurance. Furthermore, these programs may assist in optimizing the audit function by analyzing all financial transactions as they occur. This has also resulted in the evolution of different fields of audit viz., Statutory Audit, Internal Audit, Management Audit, Systems Audit, Forensic Audit and so on. Clearly, within the overall audit function, the scope and end result or the reporting is different in the different types of audit.

15.4 The extent to which data, controls, and processes are automated must be considered and discussed with the client, for example a company that is overburdened by manual audit processes will need to confront this issue at some point if the objective is to yield optimal benefits from the audit. An enterprise that moves toward greater automation relative to data, processes, controls, and monitoring tools begins to naturally structure itself for the coming of the future audit. There are a variety of methodologies like Embedded Audit Modules (EAM), Monitoring and Control Layer (MCL), Audit Data Warehouse (ADW), and Audit Applications Approach that will need to progressively adopted and used to meet the users' expectations.

15.5 New technological tools have the potential to enable the auditor to mine and analyze large volumes of structured and unstructured data related to a company's financial information. This capability may allow auditors to test 100% of a company's transactions instead of only a sample of the population. Major accounting firms have asserted that the use of these tools will enhance the audit by automating time-consuming tasks, which are more manual and rote in nature. For example, through the use of artificial intelligence, robotic systems could interface with a client's systems to transfer and compile data automatically, something previously done manually by a junior auditor. Other areas where such technologies may introduce efficiencies include processing of confirmation responses or using drones for physical inventory observations.

15.6 As a result, the auditor should have more time to carefully examine the more complex and higher risk areas that require increased auditor judgement and contain high levels of estimation uncertainty. Such tools, will also enable auditors to perform advanced analytics which will provide them with greater awareness and deeper insights into the company's operations. Data analytics may also allow auditors to better track and analyze their client's trends and risks against industry or geographical datasets, allowing them to make more informed decisions and assessments throughout the audit process.

15.7 Further, through the power of big data, auditors will be able to correlate disparate data information to develop predictive indicators to better identify areas of higher risk, which in turn could lead to early identification of fraud and operational risks. For example, firms will have the ability to develop predictive models to forecast financial distress in order to better assess the future financial viability of a company or improve fraud detection by helping auditors assess the risk of fraud as part of their risk assessment.

15.8 The use of these technological tools and methods also raise certain challenges. For example, it is important that the data being used is reliable, complete and accurate. That is true for general ledger data, other financial and operating data, and data from outside the company. Data security and quality control over these tools, whether developed in-house or by vendors, are also factors for firms to consider. And ensuring consistency of approaches across group audits may become difficult if such tools are not readily available to, or used by, affiliate offices. Also, auditors should take care that they are not over relying on data analytics. As powerful as these tools are, or are expected to become, they nonetheless are not substitutes for the auditor's knowledge, judgement, and exercise of professional scepticism.

16. Changing role of Auditors

In the last two decades, rapid and vast development in corporate governance has consolidated the auditor’s position as a watchdog. The perpetual accounting and auditing failures like Enron, WorldCom, Paramalt, and more recently Satyam has exposed serious lacuna in the auditing. India’s largest accounting fraud “Satyam” has dented auditing profession and surfaced the inherent conflicting position of auditors in the Indian business scenario. The recent ‘PNB’ scam and the more recent resignation of auditors in several listed entities just before the financial statements were to be adopted has also put the auditors; and their role in the limelight.

16.1 According to IFAC, objective of an audit is to enable the auditor to express an opinion on whether the financial statement is prepared in all material respects, in accordance with an identified financial reporting framework. The auditor’s opinion helps to determine the true and fair financial position and operating results of an enterprise. This is considered as most accepted role of the auditorsand mandated so by the corporate laws of most countries of the world. In India also, the auditor is cast with the responsibility of ensuring this aspect.

16.2 With development of stricter corporate governance codes and new reporting standards both in accounting and auditing, the auditor’s role has implicitly enhanced to a great extent as against the traditional role of merely assessing the true and fair value of a corporation. With financial reporting standards now focusing on concepts of ‘fair value’, ‘impairment’ and ‘going concern’, which involve a high level of judgement, the role of auditors is becoming much more relevant than ever.

16.3 External auditors are the oldest watchdogs, to protect the interest of the shareholders by verifying the financial accounts and presenting their opinion on it. In India, in the recent decade, capital markets have grown tremendously, open access of market has been given to foreign nationals / investors, numerous corporate frauds (including Satyam, Ricoh, and PNB) happened, and vast developments in the field of corporate governance have taken place. All these increase theauditor’s responsibilities and make them an integral part of corporate governance framework. They are now professed to play different roles and responsibilities, other than their statutory responsibilities in this contemporary business environment. The corporate governancereforms by SEBI in the form of Clause 49 and the more recent LODR has improved the status of auditing and given much needed significance to the role of auditors.

17. Standards on Auditing in India

17.1 In simplest possible terms, auditing standards represent a codification of the best practices of the profession, which already exists. Auditing standards help the members in proper and optimum discharge of their profession duties. Auditing standards also promote uniformity in practice as also comparability. Standards on Auditing help to:

- compensate for the lack of observability of the audit outcome by focusing on the audit process;
- partially mitigate the information advantage possessed by the auditor as a professional expert that might motivate the auditor to under-audit;
- counter balance the diversity of demand across multiple stakeholders that might drive the audit to the lowest common denominator and create a market based on adverse selection; and
- provide a benchmark that facilitates the calibration of an auditor's legal liability in the event of a substandard audit.

17.2 However, the Standards does not:

- discourage the use of judgement by auditors;
- limit the potential demand for alternative levels of assurance;
- lead to excessive procedural routine or standardisation in the conduct of the audit; or
- be set based on an enforcement agenda.

17.3 Since its establishment, the ICAI has taken numerous steps to ensure that its members discharge their duties with due professional care, competence and sincerity. One of the steps is the establishment of the **Auditing Practices Committee (APC)** in September 1982. Representatives from the Reserve Bank of India, the Securities and Exchange Board of India (SEBI) and industry were part of APC and had their say before the ICAI formulated its guidance and statements on `Standard Auditing Practices'. APC issued Statements on Standard Auditing Practices (SAPs) and guidance notes without involving the public in the entire process.

17.4 In July 2002, the central council of ICAI renamed the existing APC as Auditing and Assurance Standards Board (AASB) to reflect the activities being undertaken by the committee. To bring about more transparency in the auditing standards setting process, the council also stipulated that the AASB would have four special invitees.. Further, all exposure drafts issued by AASB are sent to specific bodies such as the stock exchanges, Insurance Regulatory & Development Authority (IRDA) and the Indian Banks' Association (IBA) for their views and comments.

17.5 The Standards on Auditing (SAs) issued by ICAI are based on International Standards on Auditing (ISAs) issued by IFAC.Since, ICAIis one of the founder members of IFAC, the Standards issued by the AASB under the authority of the council of the ICAI are in conformity with the corresponding International Standards issued by the International Auditing and Assurance Standards Board (IAASB) established by the IFAC. The only exception to this is SA 600 'Using the work of another auditor' which, looking to the Indian scenario where auditors can rely on branch auditors or subsidiary auditors, is not converged with ISA 600.

Currently, the Standards on Auditing issued by the ICAI are:

	Title
SQC-1	Quality control for Firms that perform audits and reviews of historical financial information and other assurance and related services engagement
Standards on Auditing (SA)	
SA 100-199	Introductory Matters
SA 200-299	General Principles and Responsibilities
SA 300-499	Risk Assessment and Response to Assessed Risks
SA 500-599	Audit Evidence
SA 600-699	Using Work of Others
SA 700-799	Audit Conclusions and Reporting
800-899	Specialized Areas

	Title
Standards on Review Engagements (SREs)	
SRE 2000 -2699	
Standards on Assurance Engagements (SAEs)	
SAE 3000-3699	Applicable to All Assurance Engagements
SAE3400-3699	Subject Specific Standards
Standards on Related Services (SRSs)	
4000-4699	Standards on Related Services

18. Revised Audit Reporting (*Effective for periods beginning on or after 1st April 2018*)

18.1 The ICAI has issued revised standards on audit reporting. The same are based on the ISAs issued by IFAC in 2016. The reason stated by IFAC for issue of the revised ISAs is as under:

- Continued **relevance** of audit
- Improve **audit quality** and professional scepticism
- **Enhance preparer focus** on key financial statement risk areas and disclosures
- Enhance **communicative value** to users
- Stimulate more robust **auditor interactions and user engagement**
- **Improve users' understanding** of what an audit is and what the auditor does.

18.2 Key Audit Matters (KAM):

Mentioning KAM in an audit report is one of the major changes brought about in audit reporting from financial year 2018-19 onwards. KAM are defined as those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. KAM are selected from matters communicated with TCWG. KAM are required to be communicated for audits of financial statements of all listed entities – however an auditor may also voluntarily, or at the request of management communicate KAM. The following considerations are used in determining matters of most significance:

- Importance to intended users' understanding of the FS
- Nature and extent of audit effort needed to address
- Nature of the underlying accounting policy, its complexity or subjectivity
- Nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error (if any)
- Severity of any control deficiencies identified relevant to the matter (if any)
- Nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence

18.3 It is felt that the introduction of KAM in the audit reports will usher in more transparency in disclosures and improvement in audit quality.

CONCLUSION

19. Over the last decade, the users' expectations from financial statements and audit report thereon have undergone a sea-change. From a time where concise financial statements and crispaudit reports were favoured, the trend now is clearly towards more disclosures and transparency in financial statements and audit reports with more details. An attempt has been in this article to discuss the evolution of accounting and auditing to meet these ever-growing expectations. ■

Tax payer is your partner, not your adversary. You have a policy and regulatory role, but you are principally a service provider. Please be sensitive to the demands and dignity of the person – the honest tax payer – who is coming to you for a service. — **Hon. Ram Nath Kovind , President of India addressing the 71st batch of IRS Officer-Trainees on 23rd March, 2018**