

International Financial Reporting Standards: The Roadmap Ahead

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Abstract

Trust and transparency led to a discussion of the fundamental purpose of financial reporting. Consistent, comparable and understandable financial information is the lifeblood of commerce and making investment. In India the Institute of Chartered Accountants of India (ICAI) has decided to adapt IFRS for accounting periods commencing on or after April 1, 2011. This paper deals with the issues and Challenges faced in the process of convergence in Indian perspective and measures taken to address the challenges.

Introduction

International Financial Reporting Standards (IFRS) are a set of accounting standards developed by the International Accounting Standards Board (IASB) that is becoming the global standard for the preparation financial statements of public companies. The mission of IASB is to develop, in the public interest, understandability, reliability, relevance, comparability and International Financial Reporting Standards (IFRS) for general purpose financial statements. The present era of globalization and liberalization has shrunk the geographical barriers of commerce. The whole world has literally become flat. One can see the cross-border economic activities happening in a swift way. The entities are listed on major stock exchanges of the world. Capital markets have also spread their wings across the globe, leading to free flow of domestic and foreign direct investments to different parts of the world.

Given these scenarios, a common and uniformly accepted Financial Reporting System, supported by strong governance practices and a firm regularity framework, strengthens the economic development of any country. As investors have also become global, financial statements of entities of different countries should be comparable on prescribed common parameters. A common set of financial statement help investors better understand investment opportunities worldwide as against statement of different standards unique to each country.

Objectives of the Study

- To study the Problems and Challenges faced by Indian Companies in the process of Convergence to IFRS.
- To focus on the Measures taken to address the Challenges.

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Methodology

For the purpose of the present study, mainly literature survey and secondary data has been used. The required secondary data was collected from the authorized Annual Reports and Official Website of ICAI and IFRS, various Journals and Research Papers, diagnostic study reports and newspaper articles have been surveyed in making this study.

IFRS – Indian Context

The paradigm shift in the economic environment in India during last few years has led to increasing attention being devoted to accounting standards as means towards ensuring potent and transparent financial reporting by any corporate.

ICAI, being a premier accounting body in the country, took upon itself the leadership role by establishing ASB, more than twenty five years back, to fall in line with the international and national expectations. Today, accounting standards issued by the Institute have come a long way. The ICAI as the accounting standard-setting body in the country has always made efforts to formulate high quality Accounting Standards and has been successful in doing so. Indian Accounting Standards have withstood the test of time. As the world continues to globalize, discussion on convergence of national accounting standards with International Financial Reporting Standards (IFRS) has increased significantly. At present, the ASB of ICAI formulates the AS based on IFRS. However, these standards remain sensitive to local conditions, including the legal and economic environment. Accordingly, AS issued by ICAI depart from corresponding IFRS in order to ensure consistency with legal, regulatory and economic environment of India. As the world continues to globalize, discussion on convergence of Indian GAAP with IFRS has increased significantly. A few developments are set forth here under

- Formation of IFRS Task Force by the Council of ICAI
- Recommendation of the IFRS Task Force submitted to the Council

- Full adoption of IFRS from accounting period commencing on or after 1st April, 2011
- Proposed to be applicable to listed entities and public interest entities such as banks, insurance companies and large sized entities
- Involvement of various regulators (MCA, RBI, IRDA, Tax authorities and SEBI)
- Draft Schedule VI and Accounting Standard I (Exposure Draft) consistent with IFRSs
- Convergence Strategy presented by Technical Directorate of ICAI on 02.02.2009.
- ICAI has begun the process of issuing IFRS equivalent AS with following proposed changes:
 1. Removal of alternative treatments
 2. Additional disclosures, where required
 3. As number will continue but IFRS number will be given in parenthesis
 4. IFRICs will be issued as appendices – ICAI has constituted a Group in liaison with government & regulatory authorities and this group has constituted separate core groups to identify inconsistencies between IFRS and various relevant acts.

Role of Indian Government

The central government of India prescribes accounting standards in consultation with the National Advisory Committee on Accounting Standards (NACAS) established under the Company Act 1956. NACAS is a separate body of expert including representative of various regulatory bodies and government agencies, has been engaged in the exercise of examining Accounting standards prepared by ICAI. In this exercise it has adapted the International norms established by the IFRS is-used by International Accounting Standards Board. The central government notified 28 accounting standards (as 1 to 7 and as 9 to 29) in Dec. 2006, after receiving recommendation of NACAS. In notifying the Accounting Standards, the government has adopted a policy of enabling disclosure of company accounts in transparent manner at par with widely accepted international practices, though a process of convergence with the International Financial

Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The initiative for harmonization of the Indian Accounting Standards with IFRS, taken up by NACAS in 2001 and implemented through notification of accounting standard by the central government in 2006. The process would be continued by the government with the intention harmonization with IFRS by 2011. Indian Ministry of corporate Affairs has also set up a high powered group comprising various stakeholder under the chairmanship of Shri Anurag Goel, Secretary of Ministry of Corporate Affairs, to discuss and resolve implementation challenges with regards to convergence of Indian Accounting Standards with IFRS by April, 201

Rationale behind Adopting IFRS

Policy makers all over the world are focusing their attention towards the implementation of IFRS and are also looking for the answers to the question as to why they should implement it when they are successfully following GAAP for so many years. Major reasons advanced for implementing IFRS are enumerated as:

Globalization of finance

The key benefit of implementing IFRS is a common accounting system and framework which is perceived as stable, transparent and fair to the local and foreign investors which in turn lead to increased compatibility and comparability among different financial statements across the globe. This will eliminate multiple reporting at the entity level and also at the consolidated level. Indian firms need to globalize, and for this they need funds at cheaper cost which is available in American, European and Japanese Capital Markets. To meet the regulatory requirements of these markets, Indian Companies are now mandated to report their financials as per IFRS. This will lead to cross border listing of shares and securities in other parts of the world and in turn cause globalization of finance.

Competitive advantage

Indian entities will be able to initiate new relationships with investors, customers and suppliers internationally as IFRS provides a globally accepted reporting platform which will ultimately raise the reputation and relationship of the Indian corporate and give them competitive advantage. Companies are also in a race to gain an edge over their competitors by trying to adopt IFRS at the earliest and also listing securities on stock exchanges world-wide to build their Brand image. Convergence with IFRS improves the risk rating and makes the corporate world more competitive globally as their comparability with the international competitors' increases.

Professionalism

Service sector will get a boost as the implementation of IFRS in the corporate would require trained accountants, auditors, values and actuaries. Moreover, a single set of accounting standards worldwide would ensure that auditing firms standardize their training and quality of work is maintained globally which will move India towards accounting services hub.

Statutory obligation

After the opening up of countries and removal of tariff barriers, it has been made mandatory and obligatory to report using IFRS as majority of stock exchanges require financial information presented according to the IFRS. In case of joint ventures with a venture partner operating in countries requiring IFRS, they need to follow the same accounting standards as their venture partner. The multinationals seeking to enter new markets and expand operations to a foreign country may need to report using IFRS in order to obtain an operating license or to raise capital.

Economic growth

It has been observed from the above literature review that the number of countries across the world where

IFRS is a recognized reporting framework continues to grow by exploiting opportunities to generate process and cost efficiencies. It will potentially open up opportunities to standardize, simplify and centralize financial reporting processes and functions as the use of a single global standard enhances the efficiency of capital allocation on a global basis and help reduce the cost of capital.

Benefits of adopting IFRS

The adoption of IFRS is expected to have a significant impact on all stakeholders, such as regulators, professionals, prepares of financial statements, analysts, users of financial information and so on.

- **The Economy:** The convergence with IFRS benefits the economy as a whole by accelerating growth of international business. It strengthens the economy with a strong and efficient capital market, where cost of capital becomes cheaper, leading to inflow of international investment into the country.
- **The Investors:** Convergence with IFRS facilitates those investors who want to expand their cross-border business operations. For this purpose, investors want information that is relevant, reliable, timely and comparable across locations. Convergence with international standards will mean a clear understanding of financial statements by investors.
- **The industry:** Entities can raise capital from foreign markets at lower cost only if they can create trust and confidence in the minds of the foreign investors through “True and Fair” presentation of their financial statements by adopting globally acceptable standards.
- **The Accounting Professionals:** Convergence benefits accounting professionals who can offer their services to different parts of the world. It offers diverse opportunities to accounting professionals in any part of the globe, as the same accounting practices prevail throughout the world.

Challenges in adopting IFRS

By now we are clear as to the advantage of universally accepted accounting principles but its complete and fair adoption is not free from challenges. Major challenges that Indian corporate might face;

Awareness of international practices

The entire set of financial reporting practices needs to undergo a drastic change after the adoption of IFRS to overcome the number of differences between the two GAAP's. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.

Training

The biggest hurdle for the professionals in implementing IFRS is the lack of training facilities and academic courses on IFRS in India. IFRS has been implemented with effect from 2011; but it is observed that there is acute shortage of trained IFRS staff. The Institute of Chartered Accountants of India (ICAI) has started IFRS Training programmes for its members and other interested parties. Yet there exists a large gap between Trained Professionals required and trained professionals available.

Amendments to the existing law

A number of inconsistencies with the existing laws are other major challenges which are observed in the Companies Act 1956, SEBI regulations, banking laws and regulations and the insurance laws and regulations. Currently, the reporting requirements are governed by various regulators in India and their provisions override other laws. IFRS does not recognize such overriding laws.

Taxation

Currently, Indian Tax Laws do not recognize the Accounting Standards. Therefore, a complete overhaul of Tax laws is the major challenge faced by the Indian Law Makers immediately. In July 2009,

a committee was formed by Ministry of Corporate Affairs of Government of India, with a view to identify the various legal and regulatory changes required for convergence and to prepare a roadmap for achieving the same.

Fair value

IFRS which uses fair value as a measurement base for valuing most of the items of financial statements can bring a lot of volatility and subjectivity to the financial statements. It also involves a lot of hard work in arriving at the fair value and services of valuation experts have to be used. Moreover, adjustments to fair value result in gains or losses which are reflected in the income statements. Whether this can be included in computing distributable profit is also debated.

Management compensation plan

This is because the financial results under IFRS are likely to be very different from those under the Indian GAAP. The contracts would have to be renegotiated by changing terms and conditions relating to management compensation plans.

Reporting systems

The disclosure and reporting requirements under IFRS are completely different from the Indian reporting requirements. Companies would have to ensure that the existing business reporting model is amended to suit the reporting requirements of IFRS. The information systems should be designed to capture new requirements related to fixed assets, segment disclosures, related party transactions, etc. Existence of proper internal control and minimizing the risk of business disruption should be taken care of while modifying or changing the information systems.

Complexity in adoption

The researchers feel that the biggest risk in converging Indian GAAP with IFRS is the fact that the accounting entities underestimate the complexity involved in the process. Instead it should be recognized well in advance that teething

problems would definitely creep in. Converting to IFRS will increase the complexity with the introduction of concepts such as present value and fair value. In IFRS framework, treatment of expenses like premium payable on redemption of debentures, discount allowed on issue of debentures, underwriting commission paid on issue of debentures etc is different than the present method used. This would bring about a change in income statement leading to enormous confusion and complexities.

Risk in adoption

Implementing IFRS has increased financial reporting risk due to technical complexities, manual workarounds and management time taken up with implementation. Another risk involved is that the IFRS do not recognize the adjustments that are prescribed through court schemes and consequently all such items will be recorded through income statement.

Time

95% of companies in Australia and in the European Union took more than a year to the complete IFRS transition, with 40% taking more than two years. Looking at the Indian scenario, we have already delayed the process from the very beginning. In other countries, regulators released final interpretations two to three years in advance of IFRS deadline and provided step-by-step transition road maps for companies. In India, ICAI took so long to finalize the standard—increasing the confusion around standard interpretation.

Cost

The IFRS transition is expected to cost Indian firms between Rs. 30 lakh and 1 crore, with an average of 16 internal and three external full-time staff dedicated to the transition. Fifty percent of adopters had to implement entirely new IT systems to accommodate IFRS; only 20% of companies did not implement systems changes. Costs such as auditor fees, systems changes, and reporting costs tend to overrun at the last minute.

Key Divergences

The key divergences between Indian GAAP and IFRS have arisen due to: -

- Conceptual differences
- Legal and regulatory requirements
- Present economic conditions
- Level of preparedness

Implementation Phase in India

The applicability of International Financial Reporting Standards for convergence of Indian entities would be in several phases as the issues involved in one-shot adoption are complex. For example, there are issues to be addressed, which may impact tax revenue collection in the Indian scenario. Also to be sorted is the applicability of IFRS to Small and Medium Scale Enterprises, pending deliberation by various authorities. Hence, in the first phase, ICAI has submitted a suggested list of companies listed with BSE/NSE Sensex, insurance companies, mutual funds, entities with a capital base of over 50 million dollars outside India, companies that are publicly accountable with an aggregate borrowing of over Rs. 1,000 crores and such others.

Measures Taken to Address the Challenges

- For changes required in rules and regulations of various regulatory bodies, draft recommendations have been placed before Accounting Standard Board.
- The ICAI issued 30 interpretations of accounting standards, with a view to resolve various intricate interpretational issues arising in the implementation of new accounting standards.
- Guidance notes have been issued by ICAI for providing immediate guidance on accounting issues.
- To facilitate discussions at seminar, workshops, etc., ICAI has issued background material on newly issued accounting standards.
- For the purpose of assisting its members, the ICAI council has formed an expert advisory committee to answer queries from its members

Training of IFRS

India has a large number of accounting

professionals. ICAI has already taken the initiatives for a comprehensive capacity building programme to prepare the CA profession for this transition. A large number of professionals have already undergone training and this process is being accelerated by the ICAI. To summarize, convergence is inevitable. The timeline is tight. The need of the hour is co-ordinate and continuous efforts by all concerned to make the process a grand success.

Suggestions to beat Challenges

The solution to the problem of professionalization of finance is that all stakeholders in the organization should be trained and IFRS should be introduced as a full time subject in the universities. Timely steps should be taken to ensure amendments in the existing laws to the extent they are inconsistent with the provisions of IFRS.

Conclusion

From the above discussion it is very much clear that transition from Indian GAAP to IFRS will face many difficulties but at the same time looking at the advantages that this adoption will confer, the convergence with IFRS is strongly recommended. We have also seen that this transition is not without difficulties as to the proper implementation process which would require a complete change in formats of accounts, accounting policies and more extensive disclosure requirements. Therefore, all parties concerned with financial reporting also need to share the responsibility of international harmonization and convergence. Keeping in mind the fact that IFRS is more a principle based approach with limited implementation and application guidance and moves away from prescribing specific accounting treatment, all accountants whether practicing or non-practicing have to participate and contribute effectively to the convergence process. This would lead to subsequent revisions from time to time arising from its global implementation and would help in formulation of future international accounting standards. A continuous research is in fact needed to harmonize and converge with the international standards and this in fact can be

achieved only through mutual international understanding both of corporate objectives and rankings attached to it. Though difficult, it is not impossible for the Indian corporate to implement IFRS in the prevailing conditions since the fundamentals are strong and will feel the impact of the new rules the most as its operations involve multiple financial instruments that face the brunt of the changeover. Critical third-party contracts, debt covenants, and key leadership metrics will change with the change in accounting policies. Senior management at many companies views IFRS as a Finance priority because of the required changes in accounting practices. However, the impact of IFRS is truly cross-functional, spanning divisions and business units. Indian Corporate World which has been preparing its Financial Statements on Historical Cost Basis will have tough time while shifting to Fair Value Accounting. The measures taken by ICAI and the other regulatory bodies to facilitate the smooth convergence to IFRS are commendable and give the positive idea that the country is ready for convergence. The need is to have a systematic approach to make the organization and the investors ready for the change and the standards ready for renovation. Corporates need to gear themselves for constant updation and not only for the first time adoption. Adopting of IFRS by Indian corporate is going to be very challenging but at the same time could also be rewarding. Indian Corporates are likely to reap significant benefits from adopting IFRS. Since the cost of compliance with IFRS would be very high for medium size industry. There are some challenges in implementing IFRS like non-compatible legal and regulatory environment, concern over SMEs, economic environment, level of preparedness, alternative treatments, education needs of auditors, frequent change to the IFRS and translation issues. However, several important matters need to be addressed urgently if India hopes to achieve the planned convergence.

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