Indian Accounting Standards and IFRS

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Abstract: Globalization of financial markets has meant an increased focus on international standards in accounting and has intensified efforts towards a single set of high quality, globally acceptable set of accounting standards. Financial statements prepared in different countries according to different set of rules, mean numerous national sets of standards, each with its own set of interpretation about a similar transaction, making it difficult to compare, analyse and interpret financial statements across nations. A financial reporting system supported by strong governance, high quality standards, and firm regulatory framework is the key to economic development. Indeed, sound financial reporting standards underline the trust that investors place in financial reporting information and thus play an important role in contributing to the economic development of a country. Internationally accepted accounting standards play a major role in this entire process. Converging to global accounting standards i.e. IFRS facilitates comparability between enterprises operating in different jurisdictions. Thus, global accounting standards would remove a frictional element to capital flows and lead to wider and deeper investment in markets. Convergence with IFRS is also in the interest of the industry since compliance with them would be able to create greater confidence in the mind of investors and reduce the cost of raising foreign capital. It is also burdensome and costly for enterprises operating across several countries to comply with a multitude of national accounting standards and convert them to a single standard for group reporting purposes. Convergence would thus help reduce both the cost of capital and cost of compliance for industry. This paper deals with the Problems and challenges faced in the process of convergence in Indian perspective and measures taken to address the challenges.

Introduction:

The International Accounting Standards Board (IASB) is a standalone privately funded accounting standard setting body established to develop global standards of financial reporting. It is the successor to the International Accounting Standard Committee (IASC), which was created in seventies to develop International Accounting Standards (IAS). In 2001, IASB assumed the responsibility of setting accounting standards from IASC. Since then, the accounting standards that the IASB develops and approves have been known as International Financial Reporting Standards (IFRS).

IFRS, with world-wide acceptance of principles based reporting standards, has become the new *'principle'* management mantra. Management defines success as being nonconformist and, that is, what IFRS focuses on. IFRS implementing body is also clear that there are multiple ways of challenging the status quo. Thus, different countries who have adopted IFRS in different ways often embed local cultures. Therefore, there are no standard rules; only broad principles which define the outer boundary of accounting.

However, the way companies and accounting firms work to overcome the issues that will surface with time is a matter of concern. This will portray the adaptability rate and convenience in adoption of IFRS in India. A lot of ground is yet to be covered to align and harmonize legislative changes with various enactments. Hence, the pace of regulatory changes has to gain momentum to address these challenges, and move ahead with a phased implementation of IFRS and convergence. In an era of globalization, wherever companies operate globally, the expectations of the capital providers are multiple and faceted. They increasingly expect financial information to be presented in a comprehensive, transparent and commonly understood format. However, the expectation is far away from the satisfaction level and it enhances and multiplies the conflicting situation among the various nations worldwide.

Objectives of the Study:

1) To study the adoption of IFR system in India in comparison to other countries.

2) The Problems and Challenges faced by Indian Companies in the process of Convergence to IFRS.

3) To focus the Measures initiated by GOI and other countries to address the Challenges.

4) Suggestions for better implementation of IFRs.

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 more effective.

Literature Review:

We have analyzed approximately ten academic articles for the documentation (literature review) and comparative analysis. Ball (2005) showed concern about substantial differences among the countries' implementation of IFRS, which may have risk uniformity. The researcher also feels that simply having uniform standards may not produce the required impact of uniform financial reporting if the approach and objectives of accounting differ. De Jong, Rosellón Cifuentes, and Verwijmeren (2006) stated one of the economic implications of international standards in which they concluded that IFRS does not only lead to a decrease in the use of financial instruments that otherwise would have added to the capital structure diversity, but also changes firm's real capital structure. Covrig et al. (2007) documented that foreign mutual fund ownership is significantly higher for IFRS adopters compared to local GAAP firms, particularly for firms from poorer information environments and with lower visibility. Carmona and Trombetta (2008) evaluated the logic and implications of the principles-based system and suggested that the principles-based approach to the standards and its inner flexibility enables the application of IAS/IFRS to countries with diverse accounting traditions and varying institutional conditions. Callao et al. (2009) found that first application of IFRS has had different effects on the financial reporting among countries.

Ramanna and Sletten (2009) find no evidence that levels of and expected changes in foreign trade and investment flows in a country whether affect its adoption decision. Thus, it cannot be confirmed that IFRS lowers information costs in more globalized economies. They further concluded that a country likely to adopt IFRS if its trade partners or countries within in its geographical region are IFRS adopters. A. Skotarczyk, (2011) contended that the main goals of IFRS (International Financial Reporting Standard) are to create quality and relevant standards that are also comparable, for the promotion of these standards and to apply the standards in maintaining the quality.

In sum, the literature documents various economic consequences around voluntary or mandatory IFRS adoptions and, in many cases, firms reporting under IFRS appear to enjoy substantial benefits. The adoption of IFRS has had a greater impact on the financial statements of Code versus Common Law countries. Also, for Code Law countries, IFRS increases equity and earnings.

IFRS and Its Implementation:

The need for a global set of high-quality financial reporting standards has long been apparent. The process of international convergence towards a global set of standards started in 1973, when 16 professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and the United States of America agreed to form the International Accounting Standards Committee (IASC), which in 2001 was reorganized into the International Accounting Standards Board (IASB). The IASB develops global standards and related interpretations that are collectively known as International Financial Reporting Standards (IFRS). The process gained momentum when the International Organization of Securities

Commissions (IOSCO) endorsed the IASC standards for international listings in May 2000. It was further facilitated by a regulation approved in the European Union in 2002, requiring the preparation of consolidated (group) accounts of listed companies domiciled in the European Union in accordance with endorsed IFRS. Since then, many more countries have announced their plans to transition to IFRS, in some instances, extending the scope of application beyond group accounts to legal entities, and incorporating IFRS into their national regulatory frameworks.

India's Roadmap to Convergence:

Convergence with IFRS implies to achieve harmony with IFRSs and to design and maintain national accounting standards in a way that they comply with the International Accounting Standards. The transition would enable Indian entities to be fully IFRS compliant and give an "unreserved and explicit statement of compliance with IFRS" in their financial statements. In the new format core accounting principles will still apply and simply is an additional piece of accounting equation. The new IFRS are nothing but the new International Accounting Rules. Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). IAS was issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). On 1 April 2001, the new IASB took over the responsibility for setting International Accounting Standards from the IASC. During its first meeting the new Board adopted existing IAS and SICs. The IASB has continued to develop standards calling the new standards IFRS. It is simply an addition to the existing accounting rules.

In line with the global trend, the Institute of Chartered Accountants of India (ICAI) has plans for convergence with IFRS of certain entities (listed companies, banks and insurance companies and certain large-sized organizations) with effect from the accounting period commencing on or after April 1, 2011 (currently deferred vide press release dated February 25,2011). Small and medium-sized entities (SMEs) still have some relaxations. The proposed standards by ICAI represent a simplified set of standards for SMEs with disclosure requirements reduced, methods for recognition and measurement simplified and topics not relevant to SMEs eliminated. The setting of accounting standards is directly or indirectly influenced by various regulatory bodies like National Advisory Committee on Accounting Standards (NACAS), Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) and Insurance Regulatory and Development Authority (IRDA). An overview of IFRS roadmap exhibits that there will be two separate sets of Accounting Standards under Section 211(3C) of the Companies Act, 1956, which are as follows:

- ❖ The first set would comprise of the Indian Accounting Standards, which are fully convergent with IFRS and, which are to be applied by specified companies.

- ❖ The second set would comprise of the existing Indian Accounting Standards, which are not fully convergent with IFRS and would be applicable to other companies, including small and medium-sized companies (SMC). As per the roadmap, to achieve the convergence in a time-bound manner, it was agreed that the convergence of all the accounting standards with IFRS will be completed by the ICAI by March 31st, 2010. National Advisory Committee on Accounting Standards (NACAS) was to submit its final recommendations to the MCA by April 30, 2010. Consequently, ICAI issued 25 exposure drafts of converged accounting standards.

As a part of its convergence strategy, the ICAI has classified IFRS into four broad categories which are described in below.

Broad Categories of IFRS According To ICAI

Category 1: IFRS which can be adopted immediately or in the immediate future in view of no or minor differences. The examples are construction contracts, borrowing costs, inventories etc.

Category II: IFRS which may require some time to reach a level of technical preparedness by the industry and professionals, keeping in view the existing economic environment and other factors. For example, share based payments, retirement benefits.

Category III: IFRS which have conceptual differences with the corresponding Indian Accounting Standards, and where further dialogue and discussions with the IASE may be required. For example, consolidation, associates, joint ventures, provisions and contingent liabilities.

Category IV: IFRS, the adoption of which would require changes in laws/ regulations because compliance with such IFRS is not possible until the regulations/laws are amended.

IFRS Conversion Challenges:

The Institute of Chartered Accountants of India (ICAI) had proposed a plan for the large-sized entities (entities with a turnover of more than Rs. 1 billion or borrowings more than Rs. 250 million) and certain other defined entities through the issue of a concept paper on *"Convergence with IFRS in India"* in late 2007, to be followed with effect from 1st April 2011.

United Nations Conference on Trade and Development (UNCTAD) has an Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (1SAR), that had recognized the growing number of member States that are introducing International Financial Reporting Standards (IFRS) as the basis for the preparation of corporate financial reports by enterprises in their respective jurisdictions. According to the UNCTAD Report published in 2008, the practical challenges faced by the developing countries can be grouped into three:

- **Institutional Challenges:** When IFRS are introduced in a given jurisdiction, they form a part of the pre-existing laws and regulations in the country guiding the governance of business entities. Often, the laws and regulations overlap or become inconsistent with each other, especially when the roles and responsibilities of different institutions are not clearly defined, and coordination mechanisms are not in place. Lack of coherence in the regulatory system becomes a cause for serious misunderstandings and inefficiency in the implementation of IFRS. Most of the laws and regulations pertaining to corporate reporting were enacted several decades before the introduction of IFRS. ICAI may restrict the available accounting alternatives because the alternative accounting choices that are permitted in IFRS may be incompatible with the local requirements within specific sectors or industries, for example, when the ICAI issued an accounting standard on leasing, based on the equivalent IAS, the Association of Leasing Companies approached the courts to seek relief from the standard, arguing that it was onerous for the leasing companies.

- **Enforcement Challenges:** A rigorous and systematic enforcement of the IFRS standards is of paramount importance for its successful implementation. The responsibility of enforcing IFRS rests with a number of parties. Institutions such as SEBI, RBI and IRDA play important roles in enforcing financial reporting requirements like IFRS. The lack of clarity on the status of authoritative and non-authoritative accounting guidance, for example, the guidance notes issued by ICAI, subsequent to the stated convergence is another enforcement challenge. In cases where the Indian Accounting Standard are in full conformity with the equivalent IFRS, the interpretive guidance provided in India may be inconsistent with the interpretive guidance in other countries that are fully compliant with IFRS.

- **Technical Challenges:** Practical implementation of IFRS necessitates adequate capacity among preparers, users, auditors and regulatory bodies. Companies in UK, Ireland and Italy that have already converted to IFRS, faced the biggest challenge in understanding IFRS, in training, in assimilating requirements, and also faced major challenges in IT (Brown & Pike, 2011). A variety of capacity challenges are faced by most of the countries that implement IFRS, which are as follows:

i. Shortage of accountants and auditors, who are technically competent in implementing IFRS.

ii. Limited availability of training materials and experts on IFRS at an affordable cost.

iii. Difficulty in coping with the rapid frequency and volume of changes made by the IASB to existing IFRS, as well as keeping pace with new standards. For Example: In India, IASB decided to amend 13 standards, as part of its improvement project, and as a result, more than 20 standards were affected because of the consequential amendments that were made. Repeated amendments on IFRS place a strain on available technical capacity, which in many cases was already insufficient.

iv. Fair-value measurement requirements in IFRS pose yet another significant technical implementation challenge. For Example: In India, where trading volume is low and capital markets are not sufficiently liquid, obtaining reliable fair value for IFRS measurement purposes becomes difficult.

Is India Ready for IFRS?

India, in recent years, has experienced strong economic growth, rising foreign exchange reserves and global acceptance of its technological competence. As the largest democracy in the world, India is well respected around the globe and the commitment to the G20 and the European Union to adopt IFRS with effect from April 1, 2011 shows India's determination towards being a part of those countries availing the global benefits of implementing IFRS.

India follows the accounting standards issued by the Institute of Chartered Accountants of India (ICAI) based on International Financial Reporting Standards (IFRS). Departures from IFRS are made with a view to the prevailing legal position and customs and usages in the country. The Companies Act was introduced in nineties, giving the accounting profession a start in India. Substantial efforts have been made since then to align the Indian standards to the internationally accepted standards. The regulatory framework of India, with respect to enforcement of accounting and reporting standards can be discussed as follows:

1) Accounting Standards Issued By ICAI Under The Companies Act (1956): The basic requirements for financial reporting of all the companies in India are provided by the Companies Act (1956). The Act requires the preparation, presentation, publication, and disclosure of financial statements, as well as an audit of all companies by a member-in- practice certified by the Institute of Chartered Accountants of India (ICAI). Under the Act, the Central Government has the power, by notification in the Official Gazette, to constitute the National Advisory Committee on Accounting Standards to advise the Central Government on the formulation and lying down of the accounting standards for adoption by companies or class of companies. For this purpose, the Act requires the committee to consider accounting standards issued by ICAI when recommending accounting standards to the Government. ICAI generally deviates from the corresponding IAS/IFRS because of the following factors:

- Economic environment within the country;
- Legal and regulatory environment prevailing in the country;
- Alternatives permitted in IFRS would lead to incomparable financial information;
- Level of preparedness of the industry.

2) Accounting Standards by Other Regulators:

- **Securities and Exchange Board of India (SEBI):** The Securities and Exchange Board of India acts as a regulator of the securities' market and the listed companies of India are required to comply with the requirements prescribed in the 1992 Act of the Board and the Securities Contracts (Regulation) Act of 1956. To protect investor interests, the board has issued a listing agreement, which specifies disclosures applicable to listed companies, in addition to other applicable auditing and accounting requirements. In particular, it requires compliance with the accounting standards issued by JCAI.

- **Reserve Bank of India:** The Reserve Bank of India (RBI) is empowered by the Banking Regulation Act (1949) to regulate financial reporting of the financial sector, including banks and financial institutions. One of the schedules to the Banking Regulation Act prescribes formats for general-purpose financial statements (e.g. balance sheets and profit and loss accounts) and other disclosure requirements. Banks are also required to comply with the requirements of the Companies Act (1956), provided that they are consistent with the Banking Regulation Act. The Reserve Bank has issued circulars requiring banks to comply with the accounting standards issued by ICAI.

- **Insurance Regulatory and Development Authority:** The Insurance Regulatory and Development Authority regulate the financial reporting practices of insurance companies under the Insurance Regulatory and Development Authority Act (1999). The authority's regulations require compliance with the accounting standards issued by ICAI.

- **The Institute of Chartered Accountants of India as a Regulator:** ICAI requires its members to ensure compliance with all the accounting standards that it issues while discharging their attesting function. Recently, extensive changes have been introduced into the Act through the Chartered Accountants (Amendment) Act (2006), which has made the ICAI's disciplinary mechanism more stringent. ICAI, with a view to further improve and strengthen the financial reporting practices in India, has also constituted the Financial Reporting Review Board. The board reviews general-purpose financial statements of certain selected enterprises, with a view to ensuring compliance with, inter alia, the accounting standards. In cases, where non-compliance is observed, appropriate action is taken by ICAI and/or the case is referred to an appropriate authority for the action. This step definitely helps to improve the quality of financial reporting in the country.

Challenges and implementation issues involved in adoption of IFRs in India:

India faces several challenges in the path towards convergence to IFRS, which can be discussed as follows:

i. **Legal And Regulatory Considerations:** The first and most would be from the differences between Indian GAAP and IFRS. The differences are wide and very deep routed, to say a few - financial instruments accounting, effects of changes in foreign exchange rates, both being not dealt under the Indian GAAR The lack of clarity on issues such as whether the financial statements have to be prepared as per the IFRS model or Schedule VI of the Companies Act, FICCI had raised questions on the ability of Indian companies to incur substantial IT and manpower training cost required to initiate the change to the present IFRS (FICCI Press Release, December 2010). A more rational approach, for this issue raised by FICCI, was already answered in the roadmap as with effect from April 1, 2011; only the large entities are required for the compliance with complete convergence, which would provide guidance and direction for the other companies.

ii. **Economic Environment:** The economic environment and trade customs and practices existing in India, in a few cases, may not be conducive for adoption of an approach prescribed in an IFRS. For example, in a country whose markets do not have adequate depth and breadth for reliable determination of fair values, such as India, it may not be advisable to follow a fair value-based approach prescribed in certain IFRS. Certain IAS/IFRS assume an economic environment with mature markets.

iii. **Level of Preparedness:** Adopting IFRS, in certain cases, may cause hardship to certain industries. There are also a few conceptual differences between Indian Accounting Standards and IFRS, for example, IAS 37 deals with constructive obligation in the context of creation of a provision. The effect of recognizing the provision on the basis of constructive obligation is that, in some cases, the provision will need to be recognized at an early stage. Majority of the companies rely heavily on their auditors to advise them, but even the audit firms should agree on the treatment of certain items to ease out the complications.

iv. **Capacity and Training Issues:** Convergence to IFRS requires India to be equipped with adequate technical capacity in terms of training of employees, trained professionals and chartered accountants, number of actuaries available, and modification of the IT system. The impact of IFRS on IT and financial systems can vary depending on the firm's size, complexity, capabilities, internal control structure and other attributes (Brown & Pike, 2011).

Measures Taken to Address the Challenges:

1. **Measures for Institutional Challenges:**

- For changes required on IRDA rules and regulations, draft recommendations have been placed before Accounting Standard Board (ASB).

- For changes required in The Companies Act 1956, draft recommendations had been sent to the Ministry in May 2009.

- For changes required in RBl/Banking Regulations Act, draft recommendations have been placed before the ASB,

2. **Measures To Build Capacity and Improve Preparedness:**

- 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 that have already been issued.

- Guidance notes have been issued by ICAI for providing immediate guidance on accounting issues arising as a result of the issuance of new accounting standards, and to provide immediate guidance on new accounting issues arising because of changes in legal or economic environment and/or other developments.

- To facilitate discussions at seminars, workshops, etc., ICAI has issued background material on newly issued accounting standards.

- ICAI is often presented with certain delicate situations while performing attesting functions, where an authentic view is required. For the purpose of assisting its members, the ICAI council has formed an expert advisory committee to answer queries from its members.

Conclusion:

India holds the reputation of being a potential global leader among the various countries, and its commitment to G20 and the European Union regarding the convergence to 1FRS - portrays its dedication to make the country's accounting system consistent with the global standards to improve investors' confidence, better governance, capital flows and the rate of economic growth. The measures taken by the Institute of Chartered Accountants of India and the other regulatory bodies to facilitate the smooth convergence to IFRS is commendable and gives the positive idea that the country is ready for convergence.

Looking at the present scenario of the world economy and the position of India convergence with IFRS can be strongly recommended. But at the same time it can also be said that this transition to IFRS will not be a swift and painless process. Implementing IFRS would rather require change in formats of accounts, change in different 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.

This is the high time to have a systematic approach to make the organizations and the investors ready for the change and the standards ready for renovation. Undoubtedly, the convergence is an arduous task, but what is required for India is to accept the change and then try to fix it by the process of gradual improvement. If India wants a real leadership role, the way is to get in the IFRS system, be ready for the system and stay in the system. 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.

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