

“Tribulations for implementing IFRS in India”

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Abstract

Every country has its own rules and regulations for maintaining books of Accounts followed since number of years. In India, ICAI decides such uniform rules, widely known as Accounting Standards. Majority countries of the world have such Accounting Standards which are followed within the country. Unfortunately, Accounting Standards of different countries differ from each other and creates hassle in transactions as world now has become global village due to enhancement in Transportation and Communication.

IFRS stands for International Financial Reporting Standards which reflects uniform accounting standards for all the countries of the Globe for transparency and clarity in concepts. IFRS is an accounting framework that establishes recognition, measurement, presentation and disclosure requirements relating to transactions and events that are reflected in the financial statements. IFRS was developed in the year 2001 by the International Accounting Standards board (IASB) in the public interest to provide a single set of high quality, understandable and uniform accounting standards.

The globalization of the business world and the attendant structures and the regulations, which support it, as well as the development e-commerce make it imperative to have a single globally accepted financial reporting system. A number of multinational companies are establishing their business in various countries with emerging economies and vice versa. The entities in emerging economies are increasingly accessing the global markets to fulfill their capital needs by getting their securities listed on the stock exchanges outside their country. Capital markets are, thus, becoming integrated consistent with this World-wide trend.

In the study, the researcher has collected data about conceptual clarity and inclination for acceptance of IFRS from Chartered Accountants mainly located at Mumbai. A detailed research is made by applying statistical tools about their acceptance level for IFRS.

Key word:- IFRS, IASB, IND AS, IASC, GAAP, SIC, etc.

1 Introduction

International Financial Reporting Standards (IFRS) adopted by International Accounting Standards Board (IASB) is a standardized format of financial reporting that is gaining momentum world wide and is a single consistent accounting framework and is likely to become predominant GAAP in times to come. In this world of globalization in which Indian economy has also flourished, adopting IFRS would not only make Indian companies at par with other global companies but shall also increase India's marketability globally in terms of foreign investments. The present paper makes an attempt to understand the various beneficiaries by adopting IFRS, the challenges faced by India in adopting the same and the likely risks in introducing IFRS. The paper also makes an attempt to analyze the requirements for successful implementation of IFRS in India.

1.1 Conceptual Framework

International Financial Accounting Standards (IFRS), formerly known as International Accounting Standards (IAS) are the Standards, Interpretations and Framework for the Preparation and Presentation of Financial statements adopted by the International Accounting Standards Board (IASB). IAS was issued in 1973 and 2001 by the board of the International Accounting Standards Committee (IASC). On April 1 2001 the new IASB took over the responsibility

of setting International Accounting Standards from IASC. It has since then continued to develop standards called as the new standards IFRS.

1.21 Structure of IFRS

IFRS are as principles based set of standards that establish broad rules and also dictate specific treatments. International Financial Reporting Standards comprises of

- International Financial Reporting Standards (IFRS) - standards issued after 2001
- International Accounting Standards (IAS) - standards issued before 2001
- Interpretations originated from the International Financial Reporting Interpretations Committee (IFRIC) - issued after 2001
- Standing Interpretations Committee (SIC) - issued before 2001

2 Framework for the Preparation and Presentation of Financial Statements

There is also a Framework for the Preparation and Presentation of Financial Statements which describes of the principles underlying IFRS. A framework is nothing but the foundation of accounting standards. The framework states that the objectives of financial statements is to provide information about the financial position, performance and changes in the financial position of an entity that is useful to a wide range of users in making economic decisions, and to provide the current financial status of the entity to its shareholders and public in general.

2.1 Meaning of Convergence with IFRS

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.

3 Review of Literature

De Jong, Rosellón Cifuentes, and Verwijmeren (2006) demonstrated one of the economic implications of international standards. The study revealed that 71% of the firms that are affected by IAS buy back their preference shares or alter the specifications of the preference shares in such a way that the classification as equity can be maintained. The paper 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.

Hboxma (2008) pointed out that the most significant discrepancy between the two sets of standards in accounting treatment of business combination, provisions financial instruments and business assets with reference to both net income and share holder's equity while the individual accounting differences in property, plant and equipment show a significant difference only on share holders' equity.

Daske et al. (2008) asserted that on average, market liquidity increases around the time of the introduction of IFRS. A decrease in firms' cost of capital and an increase in equity valuations was also observed, but only if it is accounted for the possibility that the effects occur prior to the official adoption date. On partitioning of sample, the researchers found that the capital-market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong.

Callao et al. (2009) found that first application of IFRS has had different effects on the financial reporting among countries. The cluster analysis identifies four groups which show that the impact of IFRS on financial statements of European firms is not related to traditional accounting systems.

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. Furthermore, he said that "the principles-based approach involves major changes in the expertise held by accountants and, hence, in their educational background, training programs and in the organizational and business models of accounting firms".

Ramanna and Sletten (2009) studied a sample of 102 non-European Union countries and found the variations in the decision to adopt International Financial Reporting Standards (IFRS) and revealed that more powerful countries are less likely to adopt IFRS, consistent with more powerful countries being less willing to surrender standard-setting authority to an international body. They also 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 its geographical region are IFRS adopters.

Lanto and Sahlström (2009) studied the impact of International Financial Reporting Standard adoption on key financial ratios and revealed increase profitability ratios and decrease in price to earning ratio; decrease in liquidity ratio; increase in gearing ratio and decrease in equity ratios. The results of the study indicated that the adoption of IFRS changes the magnitudes of the key accounting ratios of Finnish companies by considerably increasing the profitability ratios and gearing ratio moderately, and considerably decreasing the PE ratio and equity and quick ratios slightly.

Armstrong et al. (2009) examined European stock market reactions to 16 events associated with the adoption of International Financial Reporting Standards (IFRS) in Europe and found an incrementally positive reaction for firms with lower quality pre-adoption information, which is more pronounced in banks, and with higher pre-adoption information asymmetry, consistent with investors expecting net information quality benefits from IFRS adoption. They finally concluded a positive reaction to IFRS adoption events for firms with high quality pre-adoption information, consistent with investors expecting net convergence benefits from IFRS adoption.

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.

4 Challenges in the Convergence with IFRS faced by India

Looking at the various benefits, the policy makers in India have now realized the need to follow IFRS and it is expected that a large number of Indian companies would be required to follow IFRS from 2011. There are a number of challenges that India is likely to face while dealing with convergence with IFRS. In fact convergence with IFRS is not just a technical exercise but also involves an overall change in not only the perspective but also the very objective of accounting in the country. The researcher points out certain key areas that require close attention while dealing with conversion from Indian GAAP to IFRS.

It has to be realized that this conversion is not just the any technical exercise. Even after the later gets introduced, the preparers, users and auditors will continue to encounter practical implementation challenges. This is because the consequences of the same would have far wider financial reporting issues and extend to various

significant business and regulatory matters like, structuring of ESOP schemes, training of employees, tax planning, modification of IT system, compliance with debt covenants and so on. Another important challenge is to ensure that their investors understand the shift from Indian GAAP to IFRS.

It is a common belief that there are only a few differences between Indian GAAP and IFRS as the former is inspired by the later. Although it is true but this does not mean that the efforts required for conversion would get minimal. This is because the areas where the differences lie are deep rooted for example, fixed assets accounting, presentation of financial statements, accounting of financial instruments and foreign exchange, group accounts etc. Indian GAAP is still a long way behind IFRS.

Moreover in spite of any number of arguments in favor of convergence with IFRS deviations are bound to exist due to various conceptual, practical, legal and implementation challenges that cause unavoidable reasons for departures from IFRS.

The first and foremost challenge is that of maintaining consistency with the legal and the regulatory requirements prevalent in India. For example, Accounting Standard (AS) 25 (Interim financial Reporting), does not require disclosure and presentation of interim financial statements in India because here at present Clause 41 of the Listing Agreement prescribes a format of presentation of quarterly and/or half yearly financial results and also requires various disclosure to be made therein. Similarly, (AS) 21 defines 'control' as ownership of more than half of the voting power of an enterprise or control over the composition of the governing body of an enterprise. This definition of control is based on definitions of holding company and subsidiary company as per Companies Act 1956. However, IAS 27 defines control as "the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities".

Another important reason for departure from IFRS may be the macro environment of the country where it is applied. For example in view of the fact that various markets in the country are not supposed to possess the necessary depth and breadth, there has been reluctance in India to adopt FAIR VALUE approach in measurement of various assets and liabilities where as IFRS is based on the fair value approach.

It is predicted by the think tanks of the country that a sudden convergence with IFRS may cause hardships to the Indian industry. The industry therefore requires to be prepared for adoption of IFRS for which modifications are required to be made in the Accounting Standards. For example the revised version of AS 15 permits deferment of expenditure incurred on account of termination of services arising in a voluntary retirement scheme for transitional period in view of the fact that the Indian industry was undergoing structural changes at the time when this standard was introduced. As against this, IAS 19 does not allow the deferment of such expenditure even as a transitional measure.

The conceptual differences are also likely exist that may cause departure from IFRS. For example AS 29 does not specifically deal with constructive obligation whereas IAS 37 deals specifically with this in the context of creation of a provision. The effect of this is that in some cases provisions will be required to be recognized at an early stage.

5 Risks involved in Introducing IFRS in India

- 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. Similarly there are some recognition and measurement issues that would create quite a lot of controversy
- 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

- 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.
- IFRS will introduce changes in the very concepts and definitions of in a few areas like change in the definition of 'equity'. This would result in tax benefits of hybrid instruments where 'interest' is treated as receiving a dividend.
- At the ground level, it will be difficult for the small firms and the accounting companies to keep pace with the process of convergence with IFRS and it will be more challenging for them. Basically the idea is that it should be made mandatory for the companies to prepare consolidated financial statements which would require them to provide information about their unlisted companies as well under IFRS. This may however result in increased challenges to the small and medium firms in the country.
- IFRS financial statements are significantly more complex than financial statements based on Indian GAAP. This complexity threatens to undermine the usefulness of IFRS financial statements in making decisions. The risk is that the preparation of financial reports will become just a technical compliance exercise rather than a mechanism for communicating performance and the financial position of companies.
- Laws and pronouncements are always country specific and no country can abandon its own laws altogether. It will always be checked to see if the IFRS pronouncements fit for application in a particular country and its environment.

In fact it is not yet very clear whether IFRS would be directly adopted or will they converge into Indian GAAP. This also shows our unpreparedness towards the convergence process.

6 Successful implementation

Looking at the risks we cannot escape or avoid from converging or accepting IFRS. There is a strong case for convergence and harmonizing accounting principles and standards at the international level. This goes more strongly with India as we have witnessed a good growth with globalization and it has helped Indian companies to raise funds from offshore capital market. Therefore, the researchers feel that instead of adopting an escapist path India should go along and face the challenges, study the likely risks and accordingly get prepared for IFRS. The researchers point out some suggestions for successful implementation of IFRS.

If India does not have an active role in standard setting process internationally, converging to IFRS using an endorsement process and possibly accepting temporary carve outs and quirks seems to be a safer route to take. In view of various challenges and difficulties it seems to be more appropriate to adopt all IFRSs from a specified future date as it is. This method has been successfully adopted by many countries. ICAI has also decided to adopt IFRS for public interest entities from accounting periods commencing on or after April 1 2011.

Tax authorities should consider IFRS implications on direct and indirect taxes and provide appropriate guidance from a tax perspective. The Institute of Chartered Accountants of India should make an all out effort to train and upgrade the profession in IFRS.

Successful implementation of IFRS would require companies to fully use IFRS as their basis of daily primary financial reporting as well as for performance tracking in the form of budgets, forecast and management accounts. IFRS requires industry specialization. But due to lack of industry specific guidance in IFRS and general reliance on Indian GAAP there are no industry specific themes in IFRS. Implementation in other countries has not revealed any visible pattern in industry wise adoption of these standards. There is need to improve upon the disclosures which may help to view financial statements not only from compliance perspective but also as a way of communicating and explaining performance. It should be made compulsory for the companies to prepare IFRS compliant statements along with Indian GAAP compliant statements so that the likely problems can be traced in advance and corrected as far as possible.

7 Suggestions for increased convergence

The researchers put forward certain suggestions to enable harmonization in published company annual reports at the international level

1. Political pressure on International Accounting Standards Board (IASB) should be avoided from various interest groups like private sector and government agencies.
2. IASB should publicize standards developed by it and get support from the accounting profession, member countries and corporate management all over the world.
3. IASB should encourage member bodies to adopt IFRS and formulate and reformulate their rules that they are in line with IFRS
4. Legislation should be passed to the effect that in case of any changes or amendments in IASB, the local standards, if any, should be brought in line with these.
5. Local stock exchange can be used for cooperating in taking action against companies that fail to comply with the IFRS.
6. Governing bodies of the various accounting profession can also be used to apply disciplinary procedures in case of non-convergence with IFRS.

8 CONCLUSION

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. 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.

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