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HARMONIZATION OF ACCOUNTING STANDARDS: INDIA'S EXPEREINCE IN INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

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Abstract

Many countries have been using International Financial Reporting Standards (IFRS) and many more are still planning to come on the main stream. India is one among those nations which has committed itself to the convergence of IFRS. With the growing international consensus on IFRS, the convergence could help Indian business gain more credibility and grow in the international arena. In this background, this paper examines India's experience in converging national accounting standards with IFRS. The paper makes a case for harmonization of accounting standards, presents a framework of IFRS, narrates the saga of India's efforts of convergence, outlines the challenges on the way and offers a summary of suggestions to address the challenges on the way of implementation of these accounting standards.

Keywords: *IFRS, Indian GAAP, Harmonisation of Accounting Standards, Fair-market value.*

Introduction

Globalization has led to free flow of capital, technology, information, manpower etc. across countries world over. Themulti-national companies (MNCs) in particular, are the major actors in the globalized economy. They are actively engaged in international investing and financing on a higher scale. The benefits of these international financial operations in the form of interest rates, exchange rates, and international diversification have made the international financial markets increasingly vibrant and active over the years. The international investing and financing decisions are however, more complex and challenging. An MNC, for instance, intending to raise finance internationally has to convince its credentials in raising funds globally in a way that appeals the global investors and prompts them to invest their funds. In this context, the financial statements of the MNCs through which they intend to win overthe investors assume greater significance. It is not enough that the financial statements are true and fair; there has to be convergence between the intended message of the MNCs to raise finance internationally and the perceived signal to the global investors to invest their funds in these companies. It calls for sharing of consistent, comparable, reliable and understandable financial information among the business entities which are spread across the globe. In this background, this paper traces the imminent pressure on enhancing the quality of financial reporting in the contemporary globalized economy and makes a case for harmonization of accounting standards. As part of developing a single accepted accounting language for the preparation of financial statements, the paper narrates the efforts of International Accounting Standards Board in prescribing International Financial Reporting Standards (IFRS). The major focus of this paper is to examine the experience of India in converging with IFRS. It describes at length India's efforts of convergence, outlines the challenges of convergence and offers suggestions for addressing these challenges. These issues are discussed in the following paragraphs.

Harmonization of Accounting Standards

There is a need for a body of broad concepts, and detailed practices to guide business enterprises in preparing financial statements. The set of conventions, rules, and procedures which define accepted accounting practice, constitute Generally Accepted Accounting Principles (GAAPs). It is interesting to note that different countries adopt different accounting treatments and disclosure patterns. The financial reporting standards currently followed in India, for instance, are a combination of the standards notified by the Ministry of Corporate Affairs, guidance issued by the Securities Exchange Board of India (SEBI), guidance from the Institute of Chartered Accountants of India (ICAI), and industry-specific guidance from the regulators. But the Indian GAAPs, at times, have not been able to provide high quality financial information that is comparable, consistent and transparent to serve the needs of the global investors. Among others, they have failed to keep pace with changing international standards of accounting and disclosure.Increasing cross border investing and proliferation of financial products have posed challenges to companies as they face multiple standards. Thus the pressure to enhance the quality of financial reporting is addressed through global harmonization of accounting standards throughout the world. This goes a long way in building a global financial reporting infrastructure. Financial statements that are based on a single, universally accepted GAAP will enable the free flow of financial resources internationally.

Conceptual Framework of IFRS

As part of developing a single accepted accounting language for the preparation of financial statements, the International Accounting Standards Board (IASB) based in London, is committed to developing a single set of accounting standards. In this regard, International Financial Reporting Standards (IFRS) have come into being. International Financial Reporting Standards broadly comprise 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. In addition to the above, there is a "Framework for the Preparation and Presentation of Financial Statements", which describes the principles underlying the IFRS. Majority of the standards which form part of IFRS were issued between 1973 and 2001 by the board of the International Accounting Standards Committee (IASC). The standards issued by IASC were known as IAS. In 2000, IASC Member Bodies approved the restructuring of the IASC's foundation and in March 2001, the new IASB took over the responsibility of setting the International Accounting Standards from the IASC. IASB adopted the standards set by IASC and continued to develop new standards and called the new standards - IFRS. Fifteen IFRS have been issued so far (till 1 July 2014). The details relating to number and name of each standard along with their effective dates are listed hereunder:

IFRS 1: *First-time Adoption of International Financial Reporting Standards*, 1 July 2009

IFRS 2:*Share-based Payment*,1 January 2005

IFRS 3:*Business Combinations*,1 July 2009

IFRS 4:*Insurance Contracts*,1 January 2005

IFRS 5:*Non-current Assets Held for Sale and Discontinued Operations*,1 January 2005

IFRS 6:*Exploration for and Evaluation of Mineral Resources*,1 January 2006

IFRS 7:*Financial Instruments – Disclosures*,1 January 2007

IFRS 8:*Operating Segments*,1 January 2009

IFRS 9:*Financial Instruments*,1 January 2015

IFRS 10:*Consolidated Financial Statements*,1 January 2013

IFRS 11:*Joint Arrangements*,1 January 2013

IFRS 12:*Disclosure of Interests in Other Entities*,1 January 2013

IFRS 13:*Fair Value Measurement*,1 January 2013

IFRS 14:*Regulatory Deferral Accounts*,1 January 2016

IFRS 15:*Revenue from Contracts with Customers*,1 January 2017

The aforesaid list contains IFRS (new standards) issued since the establishment of IASB. In developing IFRS (including Interpretations), the IASB follows a comprehensive, open and due process. The due process requirements are built on the principles of transparency, full and fair consultation and accountability. A final standard or Interpretation must be approved by at least ten of the sixteen members of the IASB. Practically there is no difference between IFRS and IAS and both are equally enforceable.

The highlights of IFRS

- IFRS are developed and approved by International Accounting Standards Board.
- IFRS seek to have one separate reporting standard the world over.
- IFRS represent the most commonly accepted global accounting framework. It is a single set of high quality, understandable and enforceable global accounting standards which assist companies to communicate, and stakeholders to compare corporate financial information across the globe.
- IFRS are principle-based standards rather than rule based. They lay down treatments based on the economic substance of various events and transactions.
- IFRS are applicable to general purpose financial statements and other financial reporting of all profit oriented activities.
- IFRS increase the transparency of disclosures and greater comparability between issuers of financial statements.
- Single reporting standards under IFRS do away with the reconciliations and thus saves costs.
- IFRS improves reliability of financial statements, which in turn, will enhance investors' trust and reliance.IFRS create more confidence among the foreign investors.
- The financial statements under IFRS consist of Statement of Financial Position, Comprehensive Income Statement, either a Statement of Changes in Equity (SOCE) or Statement of Recognized Income or Expense (SORIE) and Cash Flow Statement or Statement of Cash Flows Notes, including a Summary of the Significant Accounting Policies.
- A separate set of IFRS for Small and Medium Enterprises (SMEs) has been issued in July 2009. They are simplified set of standards with disclosure requirements reduced, methods of recognition and measurement simplified.

Global experience

More than 140 countries have currently decided to adopt or already adopted the use of IFRS. The adoption of IFRS as common accounting standards in the reporting of financial information has taken hold first in Europe. The European Union in particular, has adopted virtually all the IFRS. Adoption of IFRS has been approved by the Securities Exchange Commission (SEC) as well. The SEC has issued a roadmap whereby a few big US corporations would begin reporting according to IFRS by 2014. Full conversion would be done by 2016 depending upon the size of the entity. Canada adopted IFRS in full in 2011. Mexico went for adoption of IFRS for all listed entities starting in 2012. Nearly all countries in South America require or permit IFRS as the basis for preparing financial statements: Brazil (2010), Argentina (2012), and Chile (2012). Australia, New Zealand, and Israel have essentially adopted IFRS as their national standards. South Korea adopted IFRS in the beginning of 2011. Japan is working on to achieve convergence of IFRS and began permitting certain qualifying domestic companies to apply IFRS for fiscal years beginning from 2010. Hong Kong has adopted national standards equivalent to IFRS and China is converging its accounting standards with IFRS.

There is a growing realization among the individuals, institutions and governments about the importance of IFRS. There are many evidences in this context. The American Institute of Certified Public Accountants in its document on 'International Financial Reporting Standards (IFRS): An AICPA Backgrounder' published in 2011refers to a survey conducted by the International Federation of Accountants (IFAC) involving 143 (accounting) leaders from 91 countries. 90% of them reported that a single set of international financial reporting standards was 'very important' or 'important' for economic growth of their countries. In addition, leaders of the Group of 20 (G 20) have called for global accounting standards andhave urged the US Financial Accounting Standards Board (FASB) to complete their convergence projects in 2011. Further, Deloitte reports (2013) that over half of the Fortune Global 500 Companies now report using IFRS.In the light of this global experiences, India's commitment and preparedness for IFRS is discussed in the following paragraphs.

India's commitment and preparedness to IFRS

India's commitment to IFRS and the efforts of ICAI in bringing the Indian accounting standards in linewith IFRS is well documented in UNCTD's 'Practical Implementation of International Financial Reporting Standards: Lessons Learned' (2008, pp. 50) in the following words:

As a member body of IFAC, India has recognized in its preface to the statements of accounting standards that "ICAI, being a full-fledged member of the International Federation of Accountants (IFAC), is expected, inter alia, to actively promote the International Accounting Standards Board's (IASB) pronouncements in the country with a view to facilitating global harmonization of accounting standards. Accordingly, while formulating the accounting standards, the Accounting Standards Board will give due consideration to International Accounting Standards (IAS) issued by the International Accounting Standards Committee (predecessor body to the IASB) or international financial reporting standards (IFRS) issued by the IASB, as the case may be, and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India". Accordingly, the accounting standards issued by ICAI are generally in conformity with IFRS. Indeed, with respect to certain recently issued/revised Indian accounting standards, there are no differences between the Indian accounting standards and IFRS. For example, accounting standard No. 7 on construction contracts and accounting standard 28 on impairment of assets are identical to the corresponding IFRS. However, in exceptional cases, when a departure from IFRS is warranted by conditions in India, the major areas of difference between the two are pointed out in the appendix to the accounting standard. ICAI endeavours to bridge the gap between Indian accounting standards and IFRS by issuing new accounting standards and ensuring that existing Indian accounting standards reflect any changes in international thinking on various accounting issues. In this regard, it should be noted that ICAI is making a conscious effort to bring the Indian accounting standards into line with IFRS by revising existing accounting standards. ICAI has so far issued 29 Indian accounting standards corresponding to IFRS.

India wants to converge with IFRS and not to adopt IFRS. Convergence means the Indian Accounting Standards and the IFRS would overtime continue working together to develop high quality, compatible accounting standards. While there are several similarities between GAAPs and IFRS, still there are differences which can have significant impact on financial statements. The process of convergence calls for sorting of certain important issues. These are listed below:

- From a regulatory perspective, convergence to IFRS would require amendments to the Companies Act and the Income Tax Act in particular.

- The legal and regulatory accounting requirements in India differ from the IFRS. Currently industries such as banking and insurance are regulated by specific acts that prescribe accounting norms. For example, the Reserve Bank of India issues guidance for banking companies, the Insurance Regulatory and Development Authority issues guidance for insurance companies, the Central Electricity Regulatory Commission issues guidance for electricity companies. SEBI guidelines prescribe detailed formats for financial statements to be followed by respective enterprises in their financial reporting. There is a need to align the industry-specific accounting guidance issued by various regulators.
- IFRS requires valuations and future forecasts, which will involve use of estimates, assumptions and management's judgments.
- There are some differences between IRFS and revised Accounting Standards. The terminologies are different as against the Indian Accounting Standards. Balance Sheet (IAS) is the Statement of Position (IFRS), Statement of Profit & Loss a/c (IAS) is Statement of Comprehensive Income (IFRS), and the Approval for the Financial Statement for Issue (IAS) is Authorization of the Financial Statement for Issue (IFRS).

In spite of these transition challenges, the initiative for harmonization of the Indian accounting standards with IFRS, have been taken up by the National Advisory Committee on Accounting Standards (NACAS) in 2001. NACAS is a body of experts including representatives of various regulatory bodies and Government agencies, engaged in the exercise of examining the Accounting Standards prepared by ICAI for use by Indian corporate entities. The Central Government also notified 28 Accounting Standards (AS 1 to 7 and AS 9 to 29) in December 2006 in the form of Companies (Accounting Standard) Rules, 2006, after receiving recommendations of NACAS. In notifying the Accounting Standards, the Government has adopted a policy of enabling disclosure of company accounts in a transparent manner at par with widely accepted international practices, through a process of convergence with the IFRS.

The ICAI and the Ministry of Corporate Affairs have already made noteworthy progress in converging towards IFRS.Initially, the ICAI had announced that the IFRS will be mandatory in India for financial statements for the periods beginning on or after April 2011 by revising existing accounting standards to make them compatible with IFRS. The proposed roadmap was as follows:

Phase I: (Opening balance sheet as at 1 April 2011)

- Companies which are part of BSE-Sensex 30 and NSE-Nifty 50
- Companies whose shares or other securities are listed outside India
- Companies whether listed or not, having net-worth of more than Rs. 1000 crores

Phase II: (Opening balance sheet as at 1 April 2013)

- Companies whether listed or not, and having net-worth exceeding Rs. 500 crores but not exceeding Rs. 1000 crores

Phase III: (Opening balance sheet as at 1 April 2014)

- Listed companies which have a net-worth of Rs. 500 crores or less

With a view to ensure smooth transition to IFRS from 1 April 2011, the ICAI took up the matter of convergence with NACAS and other regulators including RBI, IRDA and SEBI.It has been liasioning with the respective regulators to enable smooth transition.ICAI also set up a Group including the nominees from the Ministry of Finance for identifying tax issues arising on convergence. The Group prepared a draft report identifying certain options which could be adopted to achieve tax neutrality. The Secretary, the Ministry of Corporate Affairs also held meetings with the members of the Group and instructed to come up a time bound proposal that would meet the needs of the corporate sector as well as compatible within IFRS.

The Ministry of Corporate Affairs, after wide consultations with all stakeholdersset up a high powered group comprising various stakeholders under the Chairmanship of Shri AnuragGoel, Secretary, to discuss and resolve implementation challenges with regard to convergence of Indian Accounting Standards with International Financial Reporting Standards (IFRS) from the year 2011. The Core Group was supported by two sub-groups. The first sub-group headed by Shri Y.H. Malegam, Chairman, NACAS was entrusted with the task of identifying the changes required in various laws, regulations and accounting standards for convergence with IFRS and to prepare a clear roadmap for achieving the same. The second sub-group of CFOs was setup under the Chairmanship of Shri Mohandas Pai, (Then the Director, Infosys)tointeract with various stakeholders in order to understand their concerns on the issue of convergence with IFRS, identify problem areas and ascertain the preparedness of the stakeholders for such convergence. Converged Standards will have to be followed by Phase I companies with effect from 01-04-2011. Reserve Bank of India also stated that financial statements of banks need to be IFRS-compliant for periods beginning on or after 1 April, 2011.

On January 14, 2011, ICAI posted on its website near-final exposure drafts (near-final ED) of Indian Accounting Standards (IND AS) converged with IFRS. On February 25, 2011, the Ministry of Corporate Affairs notified near-final ED of IND AS after making certain amendments. However, the Ministry's press release said that the date of implementation of IND-AS will be notified at a later dateand IND AS will be implemented in a phased manner.Industry bodies such as Ficci, CII and Assocham had sought postponement arguing that the companies needed more time to adopt the global standards. Hence the Ministry announced that 'let the Companies Act get notified and then we will take up the convergence of IAS-IFRS'. As a result, the implementation of IFRS was decided to be done in a phased manner as follows:

- In the first phase, the companies that have a net worth of over Rs 1,000 crores to adopt IFRS by April 1, 2015.
- In the second phase, the companies with a net worth between Rs 500 crores and Rs 1,000 crores to adopt IFRS by April 1, 2016.

The new accounting standards will deal with mark-to-market projections and valuation of financial assets, among other things. Indian companies listed overseas including the ones doing business abroad currently prepare financial statements as per international standards. The implementation will have a significant impact on all sectors, especially banking and real estate. For instance, a realtor can currently account for his revenues as and when a unit of a real estate project is sold to a buyer. After the adoption of IFRS, however, revenues will be recognized only after the buyer gets the possession.

Challenges before Convergence Process

The challenges in convergence of Indian Accounting Standards with IFRS are manifold: the entity level, industry level and the economy level challenges. There are also subtle issues of cultural barriers to accepting foreign accounting principles. These challenges in convergence are listed below:

- IFRS conversion will involve a fundamental change to an entity's financial reporting systems and processes. It will require a detailed knowledge of the standards and the ability to consider their impact on business transactions and performance measures.

- There is an acute shortage of trained IFRS staff. There is a lack of adequate professionals with practical experience in IFRS. As a result, many companies will have to rely on external advisers and consultants. This enhances the cost of convergence at the individual entity level.
- The reporting requirements are currently governed by various regulators in India and their provisions override other laws. IFRS does not recognise such overriding laws. IFRS does not provide industry specific standards. So there would be additional transition challenges as and when progress is made.
- IFRS requires application of fair value principles in most of the items of financial statements. It also involves a lot of hard work in arriving at the fair value and the services of valuation experts have to be used. In addition, the use of fair value accounting can bring a lot of volatility and subjectivity to the financial statements. Given the current economic scenario, this could result in significant volatility in reported earnings and key performance measures like EPS and P/E ratios. Above all, the markets of many economies such as India normally do not have adequate depth and breadth for reliable determination of fair values.
- It is viewed that IFRS accounting rules are "similar" to Generally Accepted Accounting Principles in India (Indian GAAP), since Indian accounting standards have been formulated on the basis of principles in IFRS. Certain Indian standards offer accounting policy choices which are not available under IFRS. An instance in this context is the use of pooling of interests method in accounting for business combinations.
- In emerging economies like India, a significant part of the economic activities is carried on by small- and medium-sized entities (SMEs). Such entities face problems in implementing the accounting standards because of scarcity of resources and expertise with the SMEs to achieve compliance. Thus, the cost of compliance is not commensurate with the expected benefits.

Conclusion

Convergence of accounting standards in all countries is duly recognized as the future of global accounting standards. There is no escape from IFRS in the light of the growing international consensus that financial reporting should provide high quality information that is comparable, consistent and transparent. Therefore there is an urgent need to address these challenges and work towards full adoption of IFRS in India. It is imperative for Indian corporates to improve their preparedness for IFRS adoption and get the conversion process right. Given the current market conditions, any restatement of results due to errors in the conversion process would be detrimental to the company involved and would severely damage investor confidence in the financial system. Therefore, the most significant need is to build adequate IFRS skills and an expansive knowledge base amongst Indian accounting professionals to manage the conversion projects for Indian corporates. This can be done by leveraging upon the knowledge and experience gained from IFRS conversion in other countries and incorporating IFRS into the curriculum of B-Schools and universities.In addition, there is a need to align the industry-specific accounting guidance issued by various regulators.Consideration of these issues go a long way in changing the landscape for financial reporting. It would reduce different accounting requirements, create confidence in the minds of foreign investors that the financial statements comply with globally accepted accounting standards and help Indian companies to raise capital from foreign markets at lower costs.

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