

## International Financial Reporting Standard (IFRS): Prospects and Challenges

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### Abstract

Consistent, comparable and understandable financial information is the lifeblood of commerce and making investment. The idea of global harmonization of accounting standards stems from lack of comparability of financial statements across the country. Increasing cross border investing and proliferation of financial products have posed a challenge to companies as they faced multiple standards. Harmonization and convergence with IFRS can greatly contribute to the efforts to build global financial reporting infrastructure. This resulted in international initiative of convergence of Accounting Standards to a common standard viz. the International Accounting Standards/ International Financial Reporting Standards (IFRS).

In India, the ICAI formulates the accounting standards on various issues. But since last few years, the aim has been following the IFRS to the extent possible. Henceforth, while issuing accounting standards, IFRS need to be adopted suitably. However, deviations from IFRS have been noted due to some unavoidable reasons like legal and regulatory requirements, economic environment, level of preparedness, conceptual differences etc. Thus, it can be argued that even if there has been a lot of deliberation on convergence of Indian accounting standards with IFRS, it is difficult to adopt IFRS considering the indigenous problems. In order to resolve this problem, the ICAI has given a roadmap through which, IFRS can be adopted in India in a phased manner.

This analytical Paper deals with concept, objective and benefits of convergence with IFRS and explores the way how we converge the Indian GAAP with IFRS. Problems and challenges faced in the process of convergence in Indian perspective have been thoroughly discussed. This paper also focuses on IFRS prospects in Indian scenario. This paper puts forward a view point that convergence will bring forth galore benefits to investors, industry, professionals and the economy as a whole.

**Keywords:** Accounting standards; IFRS; IAS; Convergence

### Introduction

Consistent, comparable and understandable financial information is the lifeblood of commerce and making investment. The idea of global harmonization of accounting standards stems from the lack of comparability of financial statements across the country. In particular, a company having presence in different countries has to prepare financial reports as per Generally Accepted Accounting Principles (GAAP) of the country of operation and then it is required to reconcile all such reports for the purpose of consolidation as per GAAP of the country to which the parent belongs. This increases the cost of preparing the financial reports and also performance measurement across the geographical region becomes difficult because of noncomparable accounting rules.

In India, the Central Government prescribes accounting standards in consultation with the National Advisory Committee on Accounting Standards (NACAS) established under the Companies Act, 1956. NACAS, has been engaged in the exercise of examining Accounting Standards prepared by ICAI. It has adapted the international norms established by the International Financial Reporting Standards [1] issued by the International Accounting Standards Board. The Central Government notified 28 Accounting Standards (AS 1 to 7 and AS 9 to 29) in December 2006 in the form of Companies (Accounting

Standard) [2] Rules, 2006, after receiving recommendations of NACAS. 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 International Financial Reporting Standards (IFRS). The initiative for harmonization of the Indian accounting standards with IFRS, taken up by NACAS in 2001 and implemented through notification of accounting standards by the Central Government in 2006.

Such increasing complexity of business operations and globalization of capital markets makes [3] mandatory a single set of high quality reporting standards. This space can aptly be filled in with the emergence of International Financial Reporting Standards (IFRS), as formulated by the International Accounting Standards Board. IFRS has emerged as a new force in aligning the global firms on a single line.

International Financial Reporting Standards are set by the International Accounting Standards Board (IASB). The mission of IASB is to develop, in the public interest, a single set of high quality, understandable and International Financial Reporting Standards (IFRS) for general purpose financial statements. IASB is an independent standard-setting board, appointed and overseen by a geographically and professionally diverse group of Trustees of the IASC Foundation who are accountable to the public interest. It is supported by an external advisory council (SAC) and an interpretations committee (IFRIC) to offer guidance wherever

divergence in practice occurs. The IASB cooperates with national accounting standard setters to achieve convergence in accounting standards around the world.

In India the Institute of Chartered Accountants of India (ICAI) has decided to fully converge with IFRS issued by the International Accounting Standards Board for accounting periods commencing on or after April 1, 2011. The Ministry of Corporate Affairs (MCA) issued various press releases on the IFRS roadmap and convergence plan for India specifying the convergence date to be 1 April, 2011, through 2014 for select Indian companies.

Since the timeline in the roadmap is no longer valid for Phase I companies, the new implementation date for Ind AS is awaited from the MCA. It is unclear if the MCA will release a fresh roadmap or just amend the implementation date. Convergence will bring forth galore benefits to investors, industry, professionals and the economy as a whole. This is a significant move towards the emergence of IFRS as a global accounting language.

## What is IAS Regulation and IFRS

IAS is International Accounting Standards (IAS) which was issued between 1973 and 2001 by the International Accounting Standard Committee (IASC). On 1 April, 2001, IASC was replaced by International Accounting Standards Board (IASB). Since then International Accounting Standards Board (IASB), based at London - UK is now responsible to issue International Financial Reporting Standard. IASB is an independent body and consists of members from nine different countries around the globe having variety of functional backgrounds. During its first meeting the Board adopted existing IAS and SICs. The IASB has continued to develop standards calling the new standards IFRS.

## International Financial Reporting Standards (IFRS)

Standards, Interpretations and the Framework for the Preparation and Presentation of Financial Statements set and adopted by the International Accounting Standards Board. IFRS has replaced the older term international accounting standard. Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). IFRS are considered 'principles based' set of standards in that they establish broad rules as well as dictating specific treatments.

## Objectives of IFRS

Harmonization is the necessity of modern globalized era because various factors like cross border investments, interdependence on trade, increase of business complexities, global financial crisis, global slowdown and mobility of capital and people across the globe, are significantly influencing the world economy. Therefore, the main objective of IFRS development is harmonization in financial statements reporting. Some additional objectives are:

- To create the global financial reporting infrastructure.
- To generate sound business sense among the beneficiaries.
- To generate the dimensions of fair presentation of financial statement.
- To maintain higher transparency of financial statement and mobility of capital.

## Benefits of Convergence with IFRS

It is sensible to make a careful preliminary assessment and a cost/benefit analysis of whether or not under the particular circumstances, an adoption of IFRS would be desirable and also examine different scenarios concerning timing of adopting IFRS. The number of companies which elect to adopt IFRS is growing and this is because IFRS reporting [4] offers a wide scope of benefits. Examples of these benefits include the following:

- IFRS significantly improves the comparability of entities and provide more consistent financial information.
- IFRS are accepted as a financial reporting framework for companies seeking admission to almost all of the world's stock exchanges (including US).
- The enhanced comparability of the companies' financial information and the improved quality of communication to their stockholders, decrease investor uncertainty, reduce risk, increases market efficiency and eventually minimizes the cost of capital.
- IFRS eliminates barriers to cross border trading in securities, by ensuring that financial statements are more transparent.
- Management reporting for internal purposes under IFRS, can improve the quality and consistency of information that management needs in order to make effective, efficient and timely decisions for the business.
- IFRS adoption may be used as a chance to make some strategic improvements to the finance systems and processes as well as to reduce costs in the longer term.
- IFRS financial statements that are universally understood and comparable can both improve and initiate new relationships with customers and suppliers across national borders.
- Because of the positive effect IFRS financial information has on credit ratings, a company's position strengthens in negotiations with credit institutions and cost of borrowings are reduced.
- IFRS can also result in more accurate risk evaluations by lenders and to a lower risk premium. It also helps companies to take advantage of alternative forms of finance.
- In the case of groups it removes the need for individual companies to prepare two set of financial statements, if all individual companies in the group apply IFRS. It also allows multinational groups to have a common accounting language, thereby improving management reporting and decision making.

As IFRS hit the market, analysts and investors will become more sophisticated very quickly and will be less forgiving towards companies which provide the market with the poor disclosures [5, 6].

## Convergence with IFRS: Indian Prospects

As per European Commission the requirement of compliance of IFRS by all listed companies in their CFS from 2005 (IAS Regulation) onwards will help eliminate barriers to cross boarder trading in securities by ensuring that company accounts throughout the European Union (EU) are more reliable and transparent. If the Indian companies prepare their accounts in accordance with IFRS, they can be more easily compared with their accounts with EU companies and other IFRS user countries. This will, in turn, increase market efficiency and reduce the cost of raising capital for companies, ultimately improving competitiveness and helping boost economy.

In India, manipulations of accounts become a key factor in presentation of financial statements. The Financial Accounting Standards Board (FASB), USA, is having a convergence project with the IASB and is broadly adopting the principle-based approach instead of rule based approach. IFRS are principle-based standards which have distinct advantage that the transactions cannot be manipulated easily to achieve a particular accounting. Examples are:

- IAS 17, Leases, distinguishes finance lease from operating lease based on principle of 'substance over form', whereas corresponding US GAAP lay down rules for making such distinction.
- IAS 27, Consolidated and Separate Financial Statements, lays down criteria of power to govern financial and operating policies for identification of subsidiaries. The corresponding US GAAP lay down requirement for majority ownership of shares only. In India, the Companies Act definition is based on either majority ownership or board control.

The advantages to investors are clear. IFRS make it easier to compare the accounts of companies in different countries. Today, India is one of the fastest growing economies in the world with a compounded average growth rate of 5.7 per cent over the past two decades. Comparability and transparency of financial statements would increase inflows of FDI and foreign capital which is urgently required by the Government of India to implement its plans to transform India into a developed nation by 2020.

### Substance over form

IFRS lay down treatments based on the economic substance of various events and transactions rather than their legal form. The application of this approach may result into events and transactions being presented in a manner different from their legal form. To illustrate, as per IAS 32, preference shares that provide for mandatory redemption by the issuer are presented as a liability. The dividend payable on cumulative redeemable preference shares is treated as expense and not as distribution of profits.

### Non-financial Disclosures

As per the IASB:

**Framework for the Preparation and Presentation of Financial Statements:** The objective of financial statements is to provide information that is useful to a wide range of users in making economic decisions. The Framework recognizes financial statements do not provide all the information required for decisions. To achieve, the objective the financial reports may include additional information in the form of non-financial disclosures. In India, non-financial information played a significant role in making economic decisions. Non-financial disclosure may include information about:-

- Nature of business, Objectives and Strategies, Key resources, Risks, Results Prospects, etc. Such disclosures are usually contained in Management Report. To deal with the aspect, the IASB is developing a separate IFRS on Management Commentary. Recently, a discussion paper on the subject has been issued.

**Issuing accounting standards interpretations on matters related to accounting standards:** With a view to resolve various intricate interpretational issues arising in the implementation of new accounting standards that have already been issued, the ICAI has issued thirty accounting standards interpretations.

**Issuance of background materials on accounting standards:** To facilitate discussion at seminars, workshops, etc., ICAI has issued background material on newly issued accounting standards. The background material deals, inter alia, with the key requirements of the accounting standards with examples and Frequently Asked Questions (FAQs), which accountants and auditors may encounter in the application of accounting standards.

**Issuance of Guidance Notes on accounting matters:** ICAI has issued various Guidance Notes in order to provide immediate guidance on accounting issues arising due to issuance of new accounting standards and to provide immediate guidance on new accounting issues arising due to changes in legal or economic environment and/or other developments. These guidance notes form an important part of the generally accepted accounting principles in India and need to be referred to on a regular basis by people involved in the preparation and presentation of financial statements, as well as by people involved in auditing these statements.

### IFRS Auditing Standards: Indian Perspective

A single set of accounting standards would enable international auditing firms to standardize training and ensure better quality of their work on a global scale. It would also permit international capital to flow more freely, enabling auditing firms and their clients to develop consistent global practices on accounting problems [7]. It would be beneficial to regulators too, as the complexity associated with needing to understand various reporting regimes would be reduced. Auditing Standards are codification of existing best practices in the area of auditing. International Standards on Auditing (ISA) are issued by the IAASB of IFAC. In India, the ICAI formulates Auditing and Assurance Standards (AAS). Basic considerations behind AAS formulation are:

- Harmonization with ISA, to the extent possible – a Membership obligation for ICAI
- Applicable laws in India.
- Customs, usages & business environment in India.

These standards apply whenever independent audit carried out and irrespective of size, legal form or commercial motives of the client. It may appropriately apply to other functions of auditors.

### Convergence with IFRS: Major Challenges

The problem of differences in accounting standards will continue to exist for some time. From a regulatory perspective, convergence to IFRS would require amendments to the Companies Act and the Income Tax Act, to mention the major ones. Currently industries such as banking and insurance are also regulated by specific acts that prescribe accounting norms. Today, IFRS does not provide industry specific standards so there would be additional transition challenges as and when progress is made. IFRS requires valuations and future forecasts, which will involve use of estimates, assumptions and management's judgments. The ICAI and the Ministry of Corporate Affairs have already made noteworthy progress in moving towards IFRS [8].

### Legal and regulatory considerations

In some cases, the legal and regulatory accounting requirements in India differ from the IFRS. In India, Companies Act of 1956, Banking Regulation Act of 1949, IRDA regulations and SEBI guidelines

prescribe detailed formats for financial statements to be followed by respective enterprises in their financial reporting. In such cases, strict adherence to IFRS in India would result in various legal problems [9, 10].

### Economic Environment

Some IFRS require fair value approach to be followed, for example:

- IAS 39, Financial Instruments: Recognition and Measurement
- IAS 41, Agriculture

The markets of many economies such as India normally do not have adequate depth and breadth for reliable determination of fair values. With a view to provide further guidance on the use of fair value approach, the IASB is developing a document. Till date, no viable solution of objective fair value measures is available.

### SME Concerns

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.
- Cost of compliance not commensurate with the expected benefits.

In India, exemptions/ relaxations have been provided to SMEs. These exemptions/ relaxations are primarily related to disclosure requirements, though some exemptions/ relaxations from measurement principles have also been provided, e.g., AS 28 - Impairment of Assets and AS 15 - Employee Benefits. Keeping in view the difficulties faced by the SMEs, the IASB is developing an IFRS for SMEs.

### Training to Preparers

Some IFRS are complex. There is lack of adequate skills amongst the preparers and users of Financial Statements to apply IFRS. Proper implementation of such IFRS requires extensive education of preparers.

### Interpretation

A large number of application issues arise while applying IFRS. There is a need to have a forum which may address the application issues in specific cases. In India, the Institute of Chartered Accountants of India has constituted the Expert Advisory Committee to provide guidance on enterprise specific issues.

### Conclusion

Irrespective of various challenges, adoption of IFRS in India has significantly changed the contents of corporate financial statements as a result of:

- More refined measurements of performance and state of affairs, and
- Enhanced disclosures leading to greater transparency.

With the rapid liberalization process experienced in India over the past decade, there is now a huge presence of multinational enterprises in the country. Furthermore, Indian companies are also investing in foreign markets. This has generated an interest in Indian GAAP by all concerned. In this context, the roles of Indian accounting standards, which are becoming closer to IFRS, have assumed a great significance from the point of view of global financial reporting. More than 12,000 companies and about 109 countries presently require or permit use of IFRS in preparation of financial statements in their country. By 2011, this number is expected to reach 150. The Indian GAAP has conceptual differences with IFRS and our legal and regulatory frameworks need to be amended to adopt IFRS. The bridge to successful IFRS reporting can be crossed only with strenuous efforts of experienced professionals.

India's blue-chip companies have begun to align their accounting standards to the International Financial Reporting Standards (IFRS), two years ahead of the mandatory time for the switchover. The list of companies includes IT firms like Wipro, Infosys Technologies and NIIT, automakers like Mahindra & Mahindra and Tata Motors, textile companies like Bombay Dyeing and pharma firm Dr Reddy's Laboratories. KPMG India launches IFRS Institute which will help companies and individuals to transition from Indian GAAP to IFRS. It has also launched online IFRS institute to provide information updates and view on IFRS.

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