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IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) IN INDIA – PROBLEMS AND PERSPECTIVES

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Abstract

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. In the absence of a Standard or an interpretation that specifically applies to a transaction, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. The main objective of financial statements are to provide information about an enterprise with respect to their Assets, Liabilities, Equity, Income and Expenses, which also includes Gains and Losses. The financial statement also interprets with respect to various sources of cash flows. The present research paper focuses on the History, Significance and Need. This paper also focuses on various challenges in the implementation part of IFRS in India and its advantages.

Key words: IFRS, Statement of changes in equity, statement of cash flows, Measurement of the elements of financial statements.

Introduction

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs, so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing many different national accounting standards. The rules to be followed by accountants to maintain books of accounts which are comparable, understandable, reliable and relevant are as per the users of internal or external.[1]

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India is a member of International Accounting Standards Committee (IASC). The Institute of Chartered Accountants of India (ICAI), the apex body of accounting and auditing, constituted an Accounting Standards Board (ASB) on April 21, 1977, to pronounce standards on various items of the financial statements. The current Indian accounting standards are of good quality in most instances and in fact, are practically the same as International Accounting Standards (IASs). The statutory audit was the only enforcement mechanism till 1999. It was in 1999 when the Government of India constituted the National Advisory Committee on Accounting Standards (NACAS), an advisory body on accounting standards by inserting Section 210A in the Companies (Amendment) Act 1999. So far, the NACAS has advised the adoption of 27 accounting standards developed by ASB.[2]

In support of its commitment to adopt IAS, the ASB is examining the various standards revised by International Accounting Standards Board (IASB) to initiate revision in its corresponding. This Board has been releasing standards from time to time. Certain of the standards have also been revised/deleted/curtailed in the light of new and additional standards as well as the experience of the industry. Moreover, the Board has also prepared a comparative statement listing the IAS with corresponding Indian Accounting Standards, and also the standards which are irrelevant in the context of present economic and business scenario (Till now, 29 Accounting Standards have been issued by the ICAI as against the 41 International Accounting Standards. There are also five International Financial Reporting Standards (IFRS). In India, since the ASB is not yet functional, the accounting standards as pronounced by the ICAI are adaptable by every entity whose financial statements are subject to audit.

Meaning of IFRS:

IFRS stands for ‘International Financial Reporting Standards” A set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements. IFRS are issued by the International Accounting Standards Board. The goal with IFRS is to make international comparisons as easy as possible. This is difficult because, to a large extent, each country has its own set of rules. For example; U.S. Generally Accepted Accounting Principles (GAAP) is different from Canadian GAAP.

[1] Harmonization of Accounting Standards through Internationalization, Nikhil Chandra Shil, ACMA and Dr. Bhagaban Das, International Business Research, Vol.2 No. 2009. Available in www.ccsenet.org/journal.html.
[2]Ibid.

Synchronizing accounting standards across the globe is an ongoing process in the international accounting community.

Conversion is much more than a technical accounting issue. IFRS in India may significantly affect a company's day-to-day operations and may even impact the reported profitability of the business itself. Conversion brings a one-time opportunity to comprehensively reassess financial reporting and take 'a clean sheet of paper' approach to financial policies and processes.[3]

It is imperative for companies which have already performed a diagnostic study for IFRS to revisit their diagnostic study, as IFRS itself is a moving target and gets regularly updated. Companies also need to consider that some IFRS may not be applicable when the diagnostic study is in process, but their applicability in future may result in material changes to the financials. Understanding IFRS and its implications is a business imperative for Indian companies. IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. However, it has been debated whether or not the harmonization has been successful. IFRS are sometimes still called by the original 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 International Accounting Standards Board (IASB) took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards "International Financial Reporting Standards".

In July 2014, the Finance Minister in his Budget speech proposed the adoption of the new Indian Accounting Standards by Indian companies voluntarily from Financial Year 2015-16 and mandatory from Financial Year 2016-17.

In March 2014, the Institute of Chartered Accountants of India (ICAI) submitted to the Ministry of Corporate Affairs (MCA) a proposed new IFRS roadmap and convergence plan for India. In the proposed roadmap, the ICAI recommended implementation of Accounting Standards by select companies only in preparation of their consolidated financial statements.

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[3] Memani, R. (2006). Accounting a Milestone for Global Markets. *The Financial Express*, July 27, 2006, p.2

The new implementation date for AS is awaited from the MCA. It is unclear if the MCA will release a fresh roadmap or just amend the roadmap as submitted by ICAI. Understanding IFRS AS and its implications is a business imperative for Indian companies.

History, Significance and Need of IFRS:

Historically Accounting Standards have been evolved country by country, Standards set by Government, or accounting profession, or an independent board. In the USA there is an independent board – Financial Accounting Standards Board (FASB) since 1973, In Hong Kong Accounting profession – Hong Kong Society of Accountants and In China Government, Ministry of Finance. The significance of IFRS is as fallows,

a. Accountability
b. Cross border Capital flows
c. Bases for business decisions
d. Corporate Reporting failures
e. Corporate Governance
f. Regulatory Framework
g. Changes in Technology and Products.
h. Corporate Restructuring

Importance of IFRS International Financial Reporting Standards (IFRS) provides a set of principles to be followed while accounting for transaction and events in financial statements. Unlike US GAAP it provides management greater discretion and flexibility in preparing financial statements. IFRS was adopted by International Accounting Standards Board (IASB) with the objective to have uniform Accounting Standards across all countries.

The International Accounting Standards Committee (IASC), constituted in 1973 has passed through many phases of its journey to come to this present stage. In mid 1990, the trading relations between Canadian and US companies were improving, and more and more Canadian companies began raising funds from US. So, to facilitate smooth business operation, the Canadian Accounting Standards Board began aligning its Accounting Standards with U.S. GAAP (Generally Accepted Accounting Practice). So, in the present scenario, when companies located in any country are trading globally, there is need for global Accounting Standards. It is felt pertinent to discuss all these, briefly for the knowledge of our esteemed readers. In the year 1995, IASC entered into an agreement with International Organization on Securities Commission (IOSCO) on a mission to complete “comprehensive core set of Standards” that could be used for cross-border and national listings. In fact, this was due to growing recognition of the need for global Accounting Standards. To give proper direction on how to interpret these standards led to the setting up of the Standards Interpretations Committee (SIC) in 1997.[4]

In December 1999, the board of the International Accounting Standards Committee has approved proposal to make changes in the structure of the Committee with a view to achieve global convergence. On May 2000, one most important breakthrough was reached when the International Organization on Securities Commission (IOSCO) accepted 30 core International Accounting Standards.

1. **The IFRS conceptual framework is an attempt to determine nature and purpose of accounting:** The conceptual framework provides assumption and principles that underlie financial reporting. The purpose of IFRS is to provide information to determine how a particular transaction should be accounted. Historical evidence indicates that in absence of conceptual framework, some accounting standards was in conflict with accounting principle of prudence and accrual, many standards were internally inconsistent and few standards were not consistent with other accounting standards. In many cases, the standard setting was based on individual concept of each participant of standard setting board. This led to development of rule based accounting, which is regarded as prescriptive and inflexible. So, to ensure that ‘principle based standards’ are developed, a detailed conceptual framework must be laid down (ACCA, 2011).

Further, the conceptual framework would provide consistent accounting pronouncement over time. US GAAP are a set of guideline provided by FASB (Financial Accounting Standard Board) to record and report transaction for companies and non-profit organization. Further, the GAAP are accounting convention involved over a period of time and designed to provide information to user of financial statements. However, each country follow their own GAAP, like India has IGAAP, UK countries follow UK GAAP. Though the basic accounting principles are same, there are number of differences with respect to

[4] Juan Jose Fermin Del Valle (2005): “International Convergence and Implementation of International Financial Reporting Standard”, Vill Annual Assembly of the Association of Supervisors of Banks of the Americas, Oaxaca, September 9, pp. 3-10. Obazee,

comparability and relevance of accounting standard across GAAP and reduction in information cost to economy.[5]

Today, there are many opportunities for companies to trade across border and raise capital globally. If the company is following local GAAP, the foreign investors perceive the presence of accounting risk in such statement. Accounting risk refers to risk involved in analyzing and interpreting financial statements that follows different GAAP.[6]

Thus, the financial statements prepared in different GAAP, affects the financial ratio, which is a key factor in lending decision by bankers and for compliance with debt covenant. In such cases, the companies restate its financial statement as per local GAAP of foreign country, so as to fasten the process of raising funds. If IFRS based standards are adopted, capital market regulators must be aware of only one set of accounting standards and the companies will experience efficiency in raising capital and reduced information processing cost.

2. **Presentation of Financial Statements:** If IFRS is adopted, then it would provide consistent presentation of financial statements along with uniform measures for recognition, measurement and disclosures of financial transactions. It will lower complication in taxing global income, as the taxes are levied on the total income of the companies, and the company along with its foreign subsidiary follow similar accounting principle and practice (Paul, 2006).
3. **Comparison:** Following different set of accounting standards, comparing financial statements of companies operating in same industry and in different countries are difficult, as the same transaction may be treated in different ways. With IFRS, MNCs and analyst community would experience ease in comparing financial statements of companies located and functioning in different geography.[7]
4. **Listing on Foreign Stock Exchange:** The Companies following local accounting standard are facing problems in getting its stock listed on cross- border stock exchange. With adoption of IFRS, the Companies will no longer be require to prepare its financial

[5] Mills, Robert H. & Abbott L. Brown. 1966. Soviet Economic Development and Accounting. *Journal of Accountancy* 121(6), 40-46.
[6] Chowdhury, A. K. (2000). Compliance with accounting standards in India, why and how? *Management accountant*, *ICWAI*, March 2000.
[7]United Nation's Practical implementation of international financial reporting standards: Lessons learned, 2008 p. 3

statement under different GAAP and make the task of listing shares on foreign stock exchange easier.

5. **Transition Cost:** The companies have to incur one time transition cost towards adjusting its accounting systems, updating internal control procedure and documenting it. Further, IFRS require companies to provide financial statement for at least one prior year or may be up to three years for SEC listed companies. In addition, the companies have to hire external consultant to train their employees and familiarize analysts and investors with IFRS. The listed companies of European Union States including UK, France and Germany, have adopted IFRS since 2005. Developed country like US has given an option to its companies to voluntarily adopt IFRS Standards, whereas Canada requires all listed entities to follow IFRS from January 01, 2011. Asian countries like China has converged its national standard to IFRS standards.[8]

The process of converging towards IFRS is still going on in India. Japan has permitted multinational companies in its region to prepare its financial statements as per IFRS. IFRS is a method of reporting financial transaction and presenting financial statements. Compliance with IFRS will reduce accounting risk associated with preparing financial statements as per local GAAP. However, the fair value concept advocated in IFRS may increase the subjectivity in accounting the value of asset that is not traded freely. So, if the value of such asset is not correctly arrived, the financial statements may distort its purpose. Sufficient efforts by local accounting body are required to enable companies to adopt IFRS and the companies have to incur substantial cost in first year of preparing statements as per IFRS. However, the Companies will derive long term benefit from using IFRS standard for reporting its financial transactions. The benefits of the IFRS also can be seen in the following points.

1. Same language.
2. Cross border investments leading to economic growth.
3. Comparability of financial statements of any two companies anywhere in the world.
4. Globalization of economy and world trade.
5. For Some groups of Companies.
6. Consolidation of group financial statements made easier.

[8] http://www.iasplus.com (Retrieved on 12.01.2015).

7. Accounting and audit functions made easier and cheaper.
8. Compliance with regulatory requirements of bodies such as stock exchanges.
9. Mergers and acquisitions made easier.
10. Access to multinational funds.
11. The job of Governments and standard setters in the developing countries made easier.
12. The job of tax authorities made easier.
13. Time and money saved by international professional accounting firms in planning and execution of accounting and audits.
14. Administrative costs of accessing the capital markets around the world reduced.

The main question is why IFRS in India? We in India have Generally Accepted Accounting Principles (GAAP), that's why companies are going for IFRS in India. IFRS offers many benefits as compared to GAAP. The benefits are,

1. To Improve Transparency in accounting system.
2. Globally Accepted.
3. New Opportunity.
4. Allows exercise of professional judgment.
5. IFRS are increasingly being recognized as Global Reporting Standards for financial statements.
6. Indian GAAP is becoming rare because it has some limitations if we compare with IFRS.
7. As global capital markets become increasingly integrated, many countries are adopting IFRS.
8. More than hundred countries already permit the use of IFRS in their countries.

Regulatory framework and enforcement of Accounting Standards:

In the following paragraphs, the regulatory framework of financial reporting and Enforcement of accounting standards will be discussed.

a) **Legal Recognition of Accounting Standards issued by ICAI under the Companies Act (1956):** The Companies Act (1956) provides the basic requirements for financial reporting of all companies in India. 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 laying down of 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. While, as stated earlier, ICAI bases its accounting standards on the corresponding IAS/IFRS, the committee also specifically considers any deviations from– and reasons, if any, for them – the corresponding IAS/IFRS when reviewing ICAI accounting standards. Where the committee is not satisfied by any deviation, it requests ICAI to amend the standards to comply with IFRS. ICAI generally deviates from the corresponding IAS/IFRS because of the following factors:

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

The committee has recommended to the Government all 29 accounting standards issued by ICAI, with the exception of accounting standard No. 8 on accounting for research and development (which has already been withdrawn pursuant to accounting standard No. 26 on intangible assets), which will become mandatory for notification under the Companies Act (1956). These include the revised accounting standard No. 15on employee benefits, recently issued by ICAI in line with IAS 19 on employee benefits. Notification by the Government for these standards is expected shortly. Until then, the Companies Act (1956) specifically provides that companies must adhere to ICAI accounting standards.

b) **Legal Recognition of Accounting Standards by other Regulators:**

Reserve Bank of India: The Reserve Bank of India was established to regulate the issue of banknotes and the keeping of reserves to secure monetary stability in India, as well as to generally operate the currency and credit system of the country to advantage. The Banking Regulation Act (1949) empowers the bank 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 sheet, 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.

Securities and Exchange Board of India: The Securities and Exchange Board of India Act protects investors and regulates the securities market. Listed companies in India are required to comply with the requirements prescribed by the board in its 1992 Act and the Securities Contracts (Regulation) Act of 1956, which provides for the regulation of securities transactions. 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 ICAI.

The 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). This authority has been constituted to regulate, promote and ensure orderly growth of the insurance business and reinsurance business. Insurance companies and their auditors are required to comply with the requirements of the authority's 2002 regulations, entitled "Preparation of Financial Statements and Auditor's Report of the Insurance Companies", when preparing and presenting their financial statements and the format and content of the audit report. The authority's regulations require compliance with the accounting standards issued by ICAI.

The Institute of Chartered Accountants of India: ICAI requires its members to ensure compliance with all the accounting standards that it issues while discharging their attesting function. Further, ICAI members are required to follow a detailed code of ethics**,** as prescribed under the Chartered Accountants Act (1949). The ICAI council is also entrusted with disciplinary powers that are exercised through its disciplinary committee. Recently, extensive changes have been introduced into the Act through the Chartered Accountants (Amendment) Act (2006), which has made the ICAI disciplinary mechanism more stringent. ICAI, with a view to further improving and strengthening 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 of 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 improve the quality of financial reporting in the country.

ICAI introduced a peer review of audit firms by establishing a 11-member peer review board in March 2002. The peer review board provides guidance on enhancing the quality of services provided by ICAI members. In the first phase, peer review focuses on the review of firms that audit major enterprises at least once in a three-year period. The peer review does not lead to any disciplinary or regulatory mechanism. Peer review certification is either given or not given according to the findings of the review. Peer reviewers are practitioners with at least 15 years' audit experience.

The Chartered Accountants (Amendment) Act (2006) created a quality review board to replace of the peer review board; the new board will make recommendations to the ICAI Council on the formulation of standards regarding the quality of services provided by the members. Further, the proposed quality review board would also review the quality of services provided by ICAI members, including audit services, and guide ICAI members in improving the quality of services and compliances with the various statutory and other regulatory requirements.

Challenges in the implementation part of IFRS in India:

As accounting standards in India are formulated on the basis of IFRS issued by the IASB, ICAI interacts with the IASB at various levels, namely:

1. Sending comments on the various draft IFRS issued by the IASB;
2. Active participation in the meetings of the global standard-setters with the IASB;
3. Active participation in the meetings of the regional standard-setters with the IASB;
4. Contribution in the discussions on various ongoing projects of the IASB,

In spite of the various benefits of adopting IFRS, implementation of IFRS is an herculean task in India. Following are a few challenges faced during adoption and implementation of IFRS,[9]

1. **Awareness about International practices**: Adoption of IFRS means that the entire set of financial statements will be required to undergo a drastic change. There are a number of differences between the two GAAP's (discussed below). This may cause the users of financial statements to look at them from a new perspective. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.

Another structural problem that needs to be overcome is the lack of knowledge of International Standards on the part of the clients that retain the services of the large accounting firms. One partner who was interviewed revealed that only two of the accountants and one of the top Russian enterprises had any knowledge of the international standards whatsoever. This low level of knowledge makes it more difficult for any accounting firm to provide the proper services. Over time, this problem will shrink in importance, as the accounting firms train their clients and as a new crop of accounting graduates take their places in the accounting departments of these enterprises. But this process takes time.

2. **Training:** Professional accountants are looked upon to ensure successful implementation of IFRS. The biggest hurdle for the professionals in implementing IFRS is the lack of training facilities and academic courses on IFRS in India. As the implementation date draws closer (2011), it is observed that there is acute shortage of trained IFRS staff. The solution to this problem is that all stakeholders in the organisation should be trained and IFRS should be introduced as a full time subject in the universities.
3. **Amendments to the existing Law:** It is observed that implementation of IFRS may result in a number of inconsistencies with the existing laws which include the Companies Act 1956, SEBI regulations, banking law and regulations and the insurance law and regulations. Currently, the reporting requirements are governed by various regulators in India and their provisions override other Laws. IFRS does not recognise such overriding laws. Although steps to amend these Laws have been initiated, the authorities need to ensure that the Laws are amended well in time.

[9] Rivera, J. M. (1989). The Internationalization of Accounting Standards: Past Problems and Current, Perspectives, International Journal of Accounting, 24(4), 320-342.

4. **Taxation:** IFRS convergence would affect most of the items in the financial statements and consequently the tax liabilities would also undergo a change. Thus the taxation Laws should address the treatment of tax liabilities arising on convergence from Indian GAAP to IFRS. It is extremely important that the taxation Laws recognise IFRS compliant financial statements otherwise it would duplicate administrative work for the organizations.
5. **Fair value:** IFRS uses fair value as a measurement base for valuing most of the items of financial statements. The use of fair value accounting can bring a lot of volatility and subjectivity to the financial statements. It also involves a lot of hard work in arriving at the fair value and valuation experts have to be used. Moreover, adjustments to fair value result in gains or losses which are reflected in the income statements. Whether this can be included in computing distributable profit is also debated.[10]
6. **Management Compensation Plan:** The terms and conditions relating to management compensation plans would also have to be changed. This is because the financial results under IFRS are likely to be very different from those under the Indian GAAP. The contracts would have to be re-negotiated which is also a big challenge.
7. **Reporting Systems:** The disclosure and reporting requirements under IFRS are completely different from the Indian reporting requirements. Companies would have to ensure that the existing business reporting model needs to be amended to suit the reporting requirements of IFRS. The information systems should be designed to capture new requirements related to fixed assets, segment disclosures, related party transactions, etc. Existence of proper internal control and minimizing the risk of business disruption should be taken care of while modifying or changing the information systems.

Conclusion:

Harmonization of accounting standards has become a highly demanded issue of discussion and debate among accounting professionals around the globe. Accounting Standards are the authoritative statements of best accounting practices issued by recognized expert accountancy bodies relating to various aspects of measurements, treatments and disclosures of accounting transactions and events, as related to the codification of GAAP.

[10] Bansal Atul and Bansal Shweta (2010): "Challenges for IFRS Implementations in India –An Accounting Revolution", International Journal of Research in Commerce and Management, Vol. No: 1 Issue No.4 pp. 113-126.

More than 100 countries throughout the world, including 27 European Union member States, require or permit the use of International Financial Reporting Standards (IFRSs), developed by the IASB. The number of countries adopting IFRS is expected to increase to 150 by the end of 2011. Countries such as China and Canada have announced their intention to adopt. The Securities and Exchange Commission in India has issued a roadmap whereby a few big US corporations would begin reporting according to IFRS by 2014. Such conversion would be done by 2016 depending upon the size of the entity".

Hence IFRS plays an important role in guiding the countries as to how they could record the transactions in a systematic way so as to refer in future. Sufficient efforts by local accounting body are required to enable companies to adopt IFRS and the companies have to incur substantial cost in the first year of preparing statements as per IFRS. However, the Companies will derive long term benefit from using IFRS standards for reporting its financial transaction**.** Information systems and internal tax reporting tools would need to change to match the way information is reported. The accounting major should take the time to learn about this initiative. As early as 2011, the CPA Exam will include topics on IFRS. It is no wonder that all the accounting trade journals and publications are issuing articles about this anticipated change.

The greatest challenge for the participants was "preparing for the adoption of the international standards." What must be done nationally? What support, if any, can be expected from the international standard setters? How will national initiatives to achieve international convergence affect the reporting entities in a country, and what actions should be taken nationally to address these effects, and who should take these actions? How can the education and training of professional accountants keep pace with the changing environment in which the international standards are being set? Who will keep investors, analysts, journalists, and members of the public informed of these changes and their consequences? As international convergence progresses, questions like these will continue to be raised. Most importantly, we all need to remember that convergence to a single set of globally accepted high quality standards is ultimately in the best interest of the public, contributing to efficient capital flows within countries and across borders. In the views of the majority of participants, international convergence is vital to economic growth. Thus, while the challenges are great, the rewards are potentially even greater.