CONVERGENCE OF INDIAN ACCOUNTING STANDARDS WITH 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. The main fascination with adoption or convergence of IFRS is sound business sense. Increasing cross border investing and proliferation of financial products have posed a challenge to companies as they faced multiple standards. Harmonisation 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 Institute of Chartered Accountants of India (ICAI) has decided to adapt IFRS for accounting periods commencing on or after April 1, 2011. This decision is an important milestone in achieving full convergence with IFRS, as India will join 109 countries which presently require or permit use of IFRS. By 2011, this number is expected to reach 150. This analytical article 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 article also focuses on IFRS prospects in Indian scenario. This article puts forward a view point that convergence will bring forth galore benefits to investors, industry, professionals and the economy as a whole. 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. This is a significant move towards the emergence of IFRS as a global accounting language.

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

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measurement across the geographical region becomes difficult because of non-comparable accounting rules. As global diversification of portfolio has become an important issue of fund management, therefore, an attempt has made to create a global financial reporting infrastructure which would help to increase understandability of financial statements. This would also help in cross border rising of funds. The expanding globalization of business and investment is driving increased interest as well as pressure to enhance the quality of financial reporting throughout the world – to compare apples with apples, so to speak- so that effective evaluation between companies can be made. The most significant resultant development is the adoption of International Accounting Standards (IAS) by a large number of countries.

Convergence with International Accounting Standards/ International Financial Reporting Standards (collectively referred to as IFRS), issued by the International Accounting Standard Board (IASB) has gained momentum in recent years all over the world after the decision taken by the European Union (EU) to make IFRS mandatory for all its listed companies starting from2005. Consequently, more than 8000 EU companies adopted it in one go. The reason for this is obvious as the capital markets become increasingly global in nature more and more investors see a need for a common set of International Accounting Standards. The main fascination with adoption or convergence of IFRS is sound business sense. Increasing cross border investing and proliferation of financial products have posed a challenge to companies as they faced multiple standards. Harmonisation and convergence with IFRS can greatly contribute to the efforts to build global financial reporting infrastructure.

The tilt in the Indian thinking and in the Indian economic policies towards globalisation from the socialist economy in early 1990s was a landmark national decision. Globalisation in itself intends to institutionalize a rule-based world economy, trade and investment without barriers. In fact even before different countries of the world began to understand the concept and structure of globalisation, India had begun to put into practice the ideas and theories of globalisation. Actually even before the WTO came into being and began to lay down multilateral rules for trading, investment etc., we in India began implementing them. The very architecture and drive of globalisation is global finance, which is driven by investment bankers, rating agencies and financial professionals. One of the key factors which will determine the success of globalisation is the understandability of the financial statements by one and all. The ultimate goal of any Accounting Standard is to produce transparent and comparable information to the user of the financial statements. Even though the Indian Accounting Standards are some of the most developed standards and have consistently and successfully benchmarked with best standards and practices And the Indian Accounting Standards, as they stand today, are more defined and even more executed and deeply influences the micro and macro understanding of the users of the financial statements. The IASB, which operates out of free unequivocal support of many worldwide accounting bodies and also international organisations, launched a co-operative initiative to strengthen the global architecture by having a long-term solution with regard to the preparation of financial statements. This resulted in international initiative of convergence of

Accounting Standards to a common standard viz. the International Accounting Standards/ International Financial Reporting Standards (IFRS). The accounting bodies all over the world have realised that the adoption of the IFRS would enable the world to speak the accounting language understood by all.

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. Convergence will bring forth galore benefits to investors, industry, professionals and the economy as a whole. IFRS will be adopted for public interest entities such as listed companies, banks, mutual funds, insurance companies and other large-sized entities holding and subsidiary companies. This decision is an important milestone in achieving full convergence with IFRS as India will join 109 countries which presently require or permit use of IFRS. By 2011, this number is expected to reach 150. India will be adopting IFRS from 2011 which means our national GAAP will be the same as that practised in over 100 countries today. 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 were 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 Standards (IFRS) and International Accounting Standards (IAS)**.** 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) are 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.

International Financial Reporting Standards comprise:

- 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. There is also a Framework for the Preparation and Presentation of Financial Statements which describes of the principles underlying IFRS.

LIST OF EFFECTIVE IFRS AND IAS ISSUED BY IASB

1	IFRS 1	First-time adoption of international financial reporting standards
2	IFRS 2	Share-based payment
3	IFRS 3	Business combinations
4	IFRS 4	Insurance contracts
5	IFRS 5	Non-current assets held for sale and discontinued operations
6	IFRS 6	Exploration for and evaluation of mineral and assets
7	IFRS 7	Financial instruments: disclosures
8	IFRS 8	Operating segments
9	IAS 1	Presentation of financial statements
10	IAS 2	Inventories
	IAS 5	Information to be disclosed in financial statement superseded by IAS 1 in 1997
	IAS 6	Accounting responses of changing prices superseded by IAS 15
11	IAS 7	Cash flow statements
12	IAS 8	Accounting policies, changes in accounting estimates and errors
	IAS 9	Accounting for research and development activities superseded by IAS 38
13	IAS 10	Events after the balance sheet date
14	IAS 11	Construction contracts
15	IAS 12	Income taxes
	IAS 13	Presentation of current assets and current liabilities superseded by IAS 1
16	IAS 14	Segment reporting
	IAS 15	Information reflecting the effects of changing prices withdrawn December 2003
17	IAS 16	Property, plant and equipment
18	IAS 17	Leases
19	IAS 18	Revenues
20	IAS 19	Employee benefits
21	IAS 20	Accounting for government grants and disclosure of government assistance
22	IAS 21	The effects of changes in foreign exchange rates
	IAS 22	Business combinations superseded by IFRS 3
23	IAS 23	Borrowing costs
24	IAS 24	Related party disclosures
	IAS 25	Accounting for investments superseded by IAS 39 and IAS 40
25	IAS 26	Accounting and reporting by retirement benefit plans

26	IAS 27	Consolidated and separate financial statements
27	IAS 28	Investments in associates
28	IAS 29	Financial reporting in hyperinflationary economies
	IAS 30	Disclosures in the financial statements of banks and similar financial institutions superseded by IFRS 7
29	IAS 31	Interests in joint ventures
	IAS 32	Financial instruments: presentation disclosure provisions superseded by IFRS 7
30	IAS 33	Earnings per share
31	IAS 34	Interim financial reporting
	IAS 35	Discontinuing operations superseded by IFRS 5 effective 2005
32	IAS 36	Impairment of assets
33	IAS 37	Provisions, contingent liabilities and contingent assets
34	IAS 38	Intangible assets
35	IAS 39	Financial instruments: recognition and measurement
36	IAS 40	Investment property
37	IAS 41	Agriculture

It may be noted that International accounting standards nos. 3, 4, 5, 6, 9, 13, 15, 22, 25, 30 and 35 have already been withdrawn by the international accounting standards (board IASB).

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:

1. To create the global financial reporting infrastructure.
2. To generate sound business sense among the beneficiaries.
3. To generate the dimensions of fair presentation of financial statement.
4. 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 offers a wide scope of benefits. Examples of these benefits include the following:

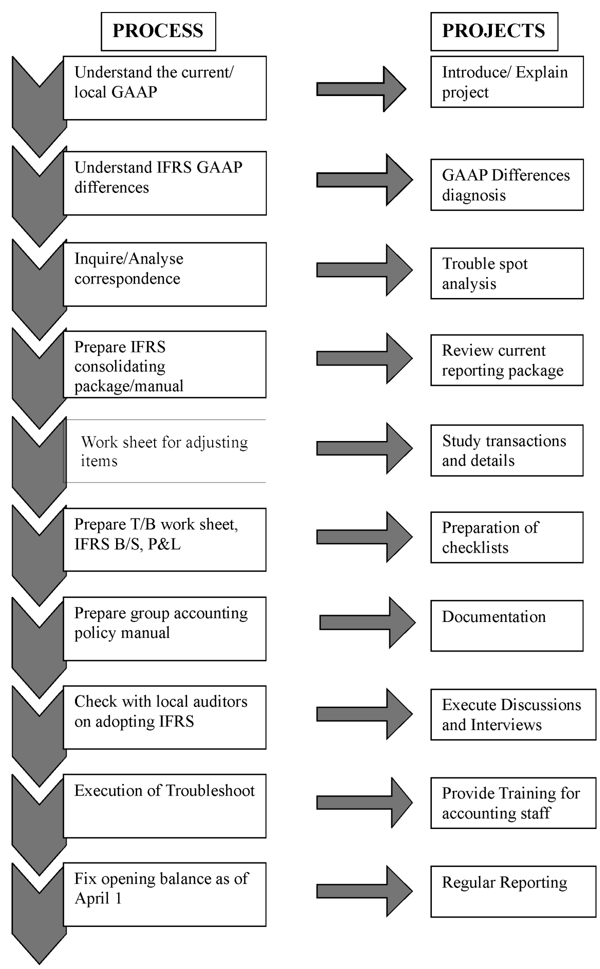
- IFRS significantly improves the comparability of entities and provide more consistent financial information.
- IFRS are accepted as a financial reporting framework for companies

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 minimises 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.
- IFRS reporting makes easier to implement cross-border acquisitions, initiate partnerships & cooperation agreements with foreign entities, simplify the sale of the reporting entity and lower the costs of integration in post acquisition periods.

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.

PROCESS OF CONVERGENCE WITH IFRS



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.

According to ***Hindu Business Line*** "Indian Companies can now get listed on London Stock Exchange (LSE) by reporting their financial results based on Indian Accounting Standards. Until now, these companies had to report their financial data in accordance with the International Financial Reporting Standards (IFRS)." This is an indication of the growing convergence of Indian accounting standards to IFRS.

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 can not 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.

CONVERGENCE WITH IFRS: INDIAN PERSPECTIVE

Indian Accounting Standards (AS) is formulated on the basis of the IFRS. While formulating AS, the endeavor of the ICAI remains to converge with the IFRS. The ICAI has till date issued 29 AS corresponding to IFRS. Some recent AS, issued by the ICAI, are totally at par with the corresponding IFRS, e.g., the Standards on 'Impairment of Assets' and 'Construction Contracts'. While formulating Indian Accounting Standards, changes from the corresponding IAS / IFRS are made only in those cases where these are unavoidable considering:-

- Legal and/ or regulatory framework prevailing in the country.
- To reduce or eliminate the alternatives so as to ensure comparability.
- State of economic environment in the country
- Level of preparedness of various interest groups involved in implementing the accounting standards.

Level of preparedness

Considering practical difficulties, the ASB has decided not to require mandatory adoption of the component approach prescribed in IAS 16, Property, Plant and Equipment. Under the 'components approach', fixed assets are segregated into various significant components for the purpose of accounting, for example, for depreciation.

IFRS Auditing Standards: Indian Perspective

A single set of accounting standards would enable international auditing firms to standardise 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 consistence global practices on accounting problems. 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 judgements. The ICAI and the Ministry of Corporate Affairs have already made noteworthy progress in moving towards IFRS.

1. 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.

2. 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.

3. 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.

4. 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.

5. 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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