



International Financial Reporting Standards (IFRS) in India: Problems and Challenges

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ABSTRACT

Globalization has laid down a way for all the countries to adopt a single set of accounting standards. Recent years have seen major changes in financial reporting worldwide under which the most obvious is the continuing adoption of IFRS worldwide. More than 100 countries have converged or recognized the police of convergence with the IFRS. IFRS are the globally accepted accounting standards and interpretations adopted by the IASB. An upcoming economy on world economic map, India, too, decided to converge to International Financial Reporting Standards (IFRS). In India, ICAI has decided to adopt the IFRS by April 2011. This paper discusses the IFRS adoption procedure in India and the utility for India in adopting IFRS, the problems and challenges faced by the stakeholders and its impact on India. Lastly, paper concludes with the ways through which these problems can be addressed.

Key words: Globalization, Financial reporting, Problems, Challenges.

INTRODUCTION

International Financial Accounting Standards (IFRS), formerly known as International Accounting Standards (IAS) are the Standards, Interpretations and Framework for the Preparation and Presentation of Financial statements adopted by the International Accounting Standards Board (IASB). IAS was issued in 1973 and 2001 by the board of the Internal Accounting Standards Committee (IASC). On April 1 2001 the new IASB took over the responsibility of setting International Accounting Standards from IASC. It has since then continued to develop standards called as the new standards IFRS. It is a set of international accounting and reporting standards that will help to harmonize company financial information, improve the transparency of accounting, and ensure that investors receive more accurate and consistent reports.

Globalization has changed the close economy into open economy. Now a day's national economy is integrating in international market with other countries by spreading their trade and business outside their own country.

Foreign Direct Investments, Foreign Institutional Investors, Merger and Acquisition, Franchising and Business Outsourcing are some example of international transaction in global business. For the integrity of different county's business together in the world market it was necessary for the business to adopt a common set of accounting standard, since accounting is the language of a business. Therefore in 1973, international professionals from different countries established the International Accounting Standard Committee. Main objective to this committee is to issue International Accounting Standards, at this present time Ministry of Corporate Affairs notified 35 Accounting Standards. In 2001 International Accounting Standard Committee are superseded as International Accounting Standard Board. Now the board issues the International Financial Reporting Standard formerly known as International Accounting Standards. Accounting Standards were prepared for some benefits in global market which are compelling.

The use of common set of accounting standards throughout the world provides an easy way of comparability and transparency of financial information. It also reduces the cost of preparing financial statements. A constant use of accounting standards provide higher quality information which enables the investors to make a better decision, indirectly fund will allocate in more efficient manner in the market and the company can reduce its overall cost of capital.

CONCEPT OF IFRS

“ A single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions” IFRS in Indian context. At present, Accounting Standards Board (ASB) formulates and issues accounting standards in India which are more or less in line with IFRS except for a few instances where departure is necessary to comply with the legal, regulatory and economic environment. Council of the Institute of Chartered Accountants of India (ICAI) opined in May 2006 that adopting IFRS was considered and supported by the ASB. IFRS task force was set up to provide a road map for convergence and it decided to converge with IFRS from the accounting period commencing on or after 1 April 2011. In India, Ministry of Corporate Affairs carried out the process of convergence of Indian Accounting Standards with IFRS after a wide range of consultative process with all the stakeholders in pursuance of G-20 commitment and as result thirty five Indian Accounting Standards converged with International Financial Reporting Standards (henceforth called IND AS).

Adopting IFRS in India is going to be very challenging by Indian Corporate but at the same time Indian Corporate are likely to obtain significant benefits from adopting IFRS. The European Union addresses many benefits as a result of adopting IFRS. Overall most investors, financial statement preparers and auditors concern that IFRS improve the quality of financial statements and implementation of IFRS was a positive sign for development for European Union financial reporting (2007 ICAEW Report on EU Implementation of IFRS and the Fair Value Directive). At the present time IFRS are harmonizing as a financial reporting language across the globe. Over a 100 countries in the Europe Union, Africa, Most-Asia and Asia-Pacific region either require or permit the use of IFRS. In India recently ICAI released a concept paper on convergence with IFRS in India; it includes the detail of strategy for adoption of IFRS in India with effect from April 1 2011. Ministry of Corporate Affairs had also confirmed the agenda for convergence with IFRS in India by 2011. In the US replacing the IFRS in place of US GAAP, is still an ongoing debate.

IFRS - IN GLOBAL

In the present scenario of globalization and liberalization, the world has become a small village. The globalization of business firms and entities, attendant structures and the regulations, which support it and with development of the concept of e-commerce made a single globally accepted financial reporting system. By today the number of business entities and multinational companies are establishing their business with various countries. The corporate entities in emerging economies are enhancing access to the global markets in order to fulfill their capital fund needs by getting their securities listed on the stock exchanges with other countries. Thus the capital markets are becoming consistent with this global trend. The use of various different accounting practices in different countries, require inconsistent treatment and presentation of the same underlying economic transactions, and create problems for the users of financial statement reporting. Such problems and confusions led to inefficiency in capital markets across the globe. So, increasing rigidity of business transactions and globalization of capital markets set up a single set of high quality accounting standards. High standards of financial reporting underpin the trust among investors. A single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS.

IFRS - IN INDIA

The drastic shift in the economic environment in India during last decade has led to increased attention towards accounting standards as a means to ensuring potential and transparent financial reporting by the corporate entities. ICAI, as a premier accounting authority in our country, playing a leadership role by establishing ASB, more than two and half decades back, to fall in line with the national and global expectations. In the present scenario the accounting standards issued by the ICAI have come a long way. The ICAI as the accounting standard - formulating body in the country has always made efforts to setup high quality Accounting Standards and the institute is quite successful in doing so. Indian Accounting Standards established by the institute have withstood the test of time. With the continuous globalization, has given rise to the discussion on convergence of national accounting standards of ICAI with International Financial Reporting Standards. Today, the ASB of ICAI formulates the Accounting Standards based on International Financial Reporting Standards. However, these accounting standards have remained sensitive to local conditions, including both the legal and economic environments. Likewise, Accounting Standards issued by the institute (ICAI) depart from corresponding International Financial Reporting Standards with a view to ensure consistency with legal and economic environment of India.

IFRS ADOPTION PROCEDURE IN INDIA

To rationalize accounting practices in the country, the Indian government in 1949, established Institute of Chartered Accountants of India by passing ICAI Act, 1949. Accounting Standard Board was constituted by ICAI in 1977 in order to create harmony among the diversified accounting policies and practices in India. Three steps process was laid down by the accounting professionals in India which are summarized as follows:

Step 1 – IFRS Impact assessment this is the first step. In this step the firm will assess the impact of IFRS adoption on Accounting and Reporting issues, on procedures and systems, and on core business of the entities. Then the firm will find the key conversion dates according to IFRS training plan has laid down. As and when the training plan is in place, the firm will have to identify the important Financial Reporting Standards which will apply to the firm and also the variations among the present financial reporting standards being followed by the firm and IFRS both.

Step 2 – Preparations for IFRS implementation this is the second step of the process, which will carry out such activities required for IFRS implementation process. Then the firm will reform the internal reporting systems and processes. IFRS first deals with the adoption and implementation of first time adoption process.

Step 3 – Implementation this is the final step of the process which deals with the actual implementation of IFRS. The initial phase of this step is to prepare an opening Balance Sheet at the date of transition to IFRS. To understand the actual impact of the transition from the Indian Accounting Standards to IFRS is to be developed. This will follow the full

application of IFRS as and when it is required. At the initial stage of implementation of IFRS requires lot of training and various technical difficulties may be experienced. The smooth implementation of the transition from Indian Accounting Standards to IFRS, regular training to personals and identify the problems while carrying out the implementation.

BENEFICIARIES OF CONVERGENCE WITH IFRS

The researchers have pointed out several beneficiaries to the convergence of Indian Generally Accepted Accounting Principles (GAAP) with IFRS. Some of them are discussed here below.

1. **The Investors:** Convergence of Indian Accounting Standards with IFRS makes accounting information more reliable, relevant, timely and comparable across different legal and economic frameworks and requirements since it would then be prepared by using a common set of accounting standards which will facilitate the investors who willing to invest in the countries apart from India. It will also develop better understanding of financial statements worldwide which increase the confidence among the people as investors.
2. **The Industry:** The other important set of beneficiary the researchers came across is the industry which in the event of convergence with IFRS will be benefited because of some basic reasons. Firstly it will enhance confidence in the minds of the foreign investors,
3. secondly, it decreases the burden of financial reporting, thirdly, it would make the process of preparing the individual and group financial statements easier and simplest, and the last and important one is that this will reduce cost of preparing the financial statements using different sets of accounting standards.
4. **Accounting Professionals:** However, there would be initially many problems but convergence with IFRS would surely benefit the accounting professionals and it will be helpful them to sell their talent and expertise across the globe.
5. **The corporate world:** Convergence with IFRS would build the reputation and long lasting relationship of the Indian corporate world with the international financial entities. Moreover, the corporate entities back in India would be benefited because of several reasons. The higher level of consistency will be maintained between external and internal reporting, two, because of better access to global financial markets, three, it will improve the risk rating and makes the corporate world more and more competitive globally as their comparability with the global competitors will increase.
5. **The Economy:** All the discussions made above explains how convergence with IFRS would help industry grow and is beneficial to the corporate entities in the country as this would make the internal and external highly consisted, and it will report improvement in the risk rating among the foreign investors. Moreover, the international comparability is also benefiting the industrial and capital markets in the country which lead to better economy across the country.

PROBLEMS AND CHALLENGES OF IFRS

IFRS are formulated by International Accounting Standard Board. However, the responsibility of convergence with IFRS vests with local government and accounting and regulatory bodies, such as the ICAI in India. Thus ICAI need to invest in infrastructure to ensure compliance with IFRS. India has several constraints and practical challenges to adoption and compliance with IFRS. So there is a need to change some laws and regulations governing financial accounting and reporting in India. There are some legal requirements which determine the manner in which financial information are presented in financial statements. For example...The Companies Act provides the format for preparation of financial statement but this may be different from the requirement under IFRS. One more exam is related to Business Combination-under Indian GAAP, acquisitions are accounted at book values of identifiable assets and liabilities of the acquire, with the excess of consideration over the net book value recognized as goodwill. Under IFRS, accounting is done for all assets including hidden intangibles at fair value. As the assets are recognized at fair value, amortization of these assets will reduce future year profits under IFRS. Other problem is there is lack of adequate professionals with practical experience of IFRS conversion; therefore Indian Companies have to rely upon external advisors and auditors which are costly.

Another issue is Indian GAAP should have been formulated on the basis of the principles of IFRS which may shows differences between Indian GAAP and IFRS. At the end some principles need to be amended, implements or remove in the Indian GAAP. For example, use of pooling of interests method in accounting for business combination is not available in the principles of IFRS. Thus it should be eliminated from Indian GAAP.

Therefore there are several challenges that will be faced on the way of IFRS convergence. These are:

1. **Difference in GAAP and IFRS:** Adoption of IFRS means that the entire set of financial statements will be required to undergo a drastic change. The differences are wide and very deep routed. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.
2. **Issue of GAAP Reconciliation:** The Securities Exchange Commission(SEC) laid out two options in its proposal-one calling for the traditional IFRS first-time adoption reconciliation, the other requiring that step plus an on-going unaudited reconciliation of the financial statements from IFRS to U.S. GAAP which is clearly more costly approach for companies and for investors.
3. **Training and Education:** Lack of training facilities and academic courses on IFRS will also pose challenge in India. There is a need to impart education and training on IFRS and its application.
4. **Legal and Regulatory considerations:** Currently, the reporting requirements are governed by various regulators in India and their provisions override other laws. IFRS

does not recognize such overriding laws. The regulatory and legal requirements in India will pose a challenge unless the same is been addressed by respective regulatory.

5. **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.
6. **Fair value Measurement:** 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 instability and prejudice 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.
7. **Re-negotiation of Contract:** The contracts would have to be re-negotiated which is also a big challenge. This is because the financial results under IFRS are likely to be very different from those under the Indian GAAP.
8. **Reporting systems:** Companies would have to ensure that the existing business reporting model is 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.

MEASURES TAKEN TO ADDRESS THE CHALLENGES

1. For changes required in rules and regulations of various regulatory bodies, draft recommendations have been placed before Accounting Standard Board.
2. The ICAI issued 30 interpretations of accounting standards, with a view to resolve various intricate interpretational issues arising in the implementation of new accounting standards.
3. Guidance notes have been issued by ICAI for providing immediate guidance on accounting issues.
4. To facilitate discussions at seminar, workshops, etc., ICAI has issued background material on newly issued accounting standards.
5. For the purpose of assisting its members, the ICAI council has formed an expert advisory committee to answer queries from its members.

Moreover to face the challenges we need to take more effective steps like we should build adequate IFRS skills professionals by investing in training processes for Indian accounting professionals to manage the conversion projects for Indian corporate. This can be done by research on effect of IFRS conversion in different countries and brief knowledge of IFRS should be added into the studies for professional courses with worldwide latest examples.

CONCLUSION

From the above debate it is very much clear that conversion from Indian GAAP to IFRS will face many difficulties but at the same time looking at the advantages that this adoption will confer, the convergence with IFRS is strongly recommended because the measures taken by ICAI and the other regulatory bodies to facilitate the smooth convergence to IFRS are creditable and give the positive idea that the country is ready for convergence. Keeping in mind the fact that IFRS is more a principle based approach with limited implementation and application guidance all accountants whether practicing or non practicing have to participate and contribute effectively to the convergence process so the need is to have a systematic approach to make the organization and the investors ready for the change and the for renovation. Moreover, corporate need to gear themselves for constant updating and not only for the first time adoption. This would lead to subsequent revisions from time to time arising from its global implementation and would help in formulation of future international accounting standards. A continuous research is in fact needed to harmonize and converge with the international standards and this in fact can be achieved only through mutual international understanding both of corporate objectives and rankings attached to it. However, senior management at many companies views IFRS as a Finance priority because of the required changes in accounting practices but Indian Corporate World which has been preparing its Financial Statements on Historical Cost Basis will have tough time while shifting to Fair Value Accounting.

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