



UTILITY AND CHALLENGES IN THE ADOPTION OF IFRS: AN OVERVIEW IN THE INDIAN CONTEXT

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Abstract: *International Financial Reporting Standards (IFRS Standards) is a single set of accounting standards, developed and maintained by the International Accounting Standards Board (the Board) with the intention of those standards being capable of being applied on a globally consistent basis with the ability to compare the financial performance of publicly listed companies on a like-for-like basis with their international peers. The paper tries to understand the procedure by which the IFRS has been adopted by companies in India. And also tried to examine the utility of Indian companies by adopting IFRS. The paper also reveals the challenges raised by the adoption of IFRS . The paper concludes by calling the lawmakers to do the necessary amendments in the existing Companies Act 1956 and also emphasises the need for training the professionals for facilitating the easy adoption of IFRS in India.*

Key Words: *IFRS, Adoption and Implementation*

1. Introduction

International Financial Reporting Standards (IFRS Standards) is a single set of accounting standards, developed and maintained by the International Accounting Standards Board (the Board) with the intention of those standards being capable of being applied on a globally consistent basis—by developed, emerging and developing economies—thus providing investors and other users of financial statements with the ability to compare the financial performance of publicly listed companies on a like-for-like basis with their international peers.

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 de facto harmonization has occurred. Standards that were issued by IASC (the predecessor of IASB) are still within use today and go by the name International Accounting Standards (IAS), while standards issued by IASB are called IFRS. IAS were 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".

IFRS Standards are now mandated for use by more than 100 countries, including the European Union and by more than two-thirds of the G20. The G20 and other international organisations have consistently supported the work of the Board and its mission of global accounting standards.

IFRS Standards are developed by the Board, the standard-setting body of the IFRS Foundation—a public-interest organisation with award-winning levels of transparency and stakeholder participation. Its 150 London-based staff are from almost 30 different countries. The Board's 12 members are appointed and overseen by 22 Trustees from around the world, who are in turn accountable to a Monitoring Board of public authorities.

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 the many different national accounting standards. They are the rules to be followed by accountants to maintain books of accounts which are comparable, understandable, reliable and relevant as per the users internal or external.

2. Review of Literature

As mentioned earlier, the available literature on IFRS and its implementation covers the data from European Union. Few studies have been carried out analysing the data from other countries. Zhou et al (2009) in one such study of Chinese firms' data concluded that the firms adopting IFRS are less likely to smooth earnings in the post IFRS adoption period. Their findings also pointed out the need for a stricter enforcement mechanism of financial reporting standards in emerging markets.

Working on the data of European firms, Armstrong et al (2010) found out a positive reaction to IFRS adoption events for firms with high quality pre adoption information, consistent with investors expecting net convergence benefits from IFRS adoption.

In his study of 1084 European Union firms during the period of (1995-2006), Siqi Li (2010) concluded that on average, the IFRS mandate significantly reduces the cost of equity for mandatory adopters. He also suggested in his research that this reduction is present only in countries with strong legal enforcement and that increased disclosures and enhanced information comparability are two mechanisms behind the cost of equity reduction.

Cai & Wong (2010) in their study of global capital markets summarized that the capital markets of the countries that have adopted IFRS have higher degree of integration among them after their IFRS adoption as compared to the period before the adoption.

Paananen & Lin (2009) gave a contrary view to prior research that IFRS adoption ensures better quality of accounting information. Their analysis of German companies reporting showed that accounting information quality has worsened with the adoption of IFRS over time. They also suggested that this development is less likely to be driven by new adopters of IFRS but is driven by the changes of standards.

Iatridis (2010) concluded, on the basis of data of firms listed on London stock exchange, that the IFRS implementation has favorably affected the financial performance (measured by profitability and growth potential) of firms. The study also demonstrated that following the fair value orientation of IFRS, the transition to IFRS appears to introduce volatility in Income statement figures.

Lantto & Sahlstrom (2009) in their study of key financial ratios of companies of Finland found that the adoption of IFRS changes the magnitude of the key accounting ratios. The study also showed that the adoption of Fair Value Accounting rules and stricter requirements on certain Accounting issues are the reasons for the changes observed in Accounting Figures and financial ratios.

Chand & White (2007) in their paper on convergence of Domestic Accounting Standards and IFRS, demonstrated that the influence of Multinational Enterprises and large international accounting firms can lead to transfer of economic resources in their favour, wherein the public interests are usually ignored.

The study carried out by Callao et al (2007) on financial data of Spanish firms revealed that local comparability is adversely affected if both IFRS and local Accounting Standards are applied in the same country at the same time. The study, therefore calls for an urgent convergence of local Accounting Standards with that of IFRS. Barth et al (2008) in their study of financial data of firms from 21 countries examined whether application of IAS/IFRS is associated with higher accounting quality.

3. Statement of the problem

As evident from the literature review, good number of studies carried out in different countries have highlighted the benefits of having single set of financial reporting standards across the globe. Few of the studies have also brought out the procedural aspects of implementation of IFRS. Some of the studies have given a contradictory view wherein the articles talk about the difficulties and complications faced in implementing IFRS.

4. The objectives of the study

The objectives of the study can be listed down as below:

- 4.1. To discuss the IFRS adoption procedure in India;
- 4.2. To discuss the utility for India in adopting IFRS;
- 4.3. To discuss the problems faced by the stakeholders in the process of adoption of IFRS in India; and
- 4.4. To discuss the ways through which these problems can be addressed.

5. IFRS Adoption Procedure in India

In 1949, Indian government to streamline accounting practices in the country established Institute of Chartered Accountants of India by passing ICAI Act, 1949. Accounting Standard Board was constituted by ICAI in 1977 with a view to harmonize the diverse accounting policies and practices in India. The other objectives of the Board are: (i) conceive of and suggest new areas in which Accounting Standards are needed, (ii) formulation of Accounting Standards, (iii) examine how far IAS and IFRS can be adapted while formulating the accounting standards and to adapt the same and (iv) review the existing Accounting Standards and revise them regularly as and when necessary, among others. In 2006, a task force was set up by ICAI. The objective of the task force was to lay down a road map for convergence of IFRS in India.

Based on the recommendation made by the Task Force and on the basis of outcome of discussions and public opinions on IFRS adoption procedure, a 3 step process was laid down by the Accounting Professionals in India. This three steps IFRS adoption procedure can be summarized as follows:

5.1 IFRS Impact Assessment

In this step, the firm will begin with the assessment of the impact of IFRS adoption on Accounting and Reporting Issues, on systems and processes, and on Business of the firm. The firm will then identify the key conversion dates and accordingly a IFRS training plan will be laid down. Once the training plan is in place, the firm will have to identify the key Financial Reporting Standards that will apply to the firm and also the differences among current financial reporting standards being followed by the firm and IFRS. The firm will also identify the loopholes in the existing systems and processes.

5.2 Preparations for IFRS Implementation

This step will carry out the activities required for IFRS implementation process. It will begin with documentation of IFRS Accounting Manual. The firm will then revamp the internal reporting systems and processes. IFRS 1 which deals with the first time adoption of IFRS will be followed to guide through the first time IFRS adoption procedure. To make the convergence process smooth, some exemptions are available under IFRS 1. These exemptions are identified and applied. To ensure that the IFRS are applied correctly and consistently, control systems are designed and put in place.

5.3 Implementation

This step involves actual implementation of IFRS. The first activity carried out in this phase is to prepare an opening Balance Sheet at the date of transition to IFRS. A proper understanding of the impact of the transition from Indian Accounting Standards to IFRS is to be developed. This will follow the complete application of IFRS as and when required. First time implementation of IFRS requires lot of training and some difficulties may also be experienced. To ensure a smooth transition from Indian Accounting Standards to IFRS, Continuous training to staff and addressing all the difficulties that would be experienced while carrying out the implementation is also required.

6. Utility for India in Adopting IFRS

Economies across the globe have benefitted by adopting IFRS for financial reporting purposes. Previous Studies have suggested various benefits of adopting IFRS, notably, Better financial information for shareholders, Better financial information for regulators, Enhanced comparability, Improved transparency of results, Increased ability to secure cross-border listing, Better Management of global operations and Decreased cost of capital. This study will try to connect some of these and few other benefits with respect to the firms in India and also India as a country.

6.1 Better Access to Global Capital Markets

During the last decade, India has emerged as a strong economy on the global economy map. Indian Firms are expanding. These firms are not only setting plants in other countries but also acquiring other firms across the globe. For this they need funds at cheaper cost which is available in American, European and Japanese Capital Markets. To meet the regulatory requirements of these markets, Indian Companies should report their financials as per IFRS. Thus adoption of IFRS not only helps Indian Firms in accessing global Capital Markets for funds but also availability of funds at cheaper cost.

6.2 Easier Global Comparability

Across the globe, Firms are using IFRS to report their financial results. With the adoption of IFRS by Indian firms, the comparison of two becomes easier. Investors, Bankers and Lenders also find it easy to compare the two financial statements following same reporting procedure. Indian companies in the process of raising funds from overseas capital markets have to provide financial results to interested parties. Since majority of Indian Firms are accessing European capital markets, preparation and presentation of financial statements on the basis of IFRS helps firms in getting easy accessibility to these capital markets.

6.3 Easy Cross Border Listing

As mentioned earlier, Indian firms require funds for their expansion plans which are not limited to the economic and political boundaries of India. Indian Firms are acquiring firms outside India also. They are also getting listed in European and American Capital Markets through raising funds from these markets. One of the major pre-requisites of getting listed on European Markets is preparation of Accounts as per IFRS requirements. A few Indian Companies which have raised funds through the European Capital Markets have started preparing their Financial Statements as per IFRS.

6.4 Better Quality of Financial Reporting

Adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of Accounting Principles and improvement in reliability of financial statements. Among various latest trends-based concepts, IFRS follows a concept of fair value which can help Indian firms to reflect their true worth of Assets held in the financial statements. Since a single body (IASB, London) is preparing IFRS, these are very consistent, reliable and easy to adopt ensuring better quality of financial reporting.

6.5 Elimination of Multiple Reporting

Large Business Houses in India like TATA, BIRLA, and AMBANI have firms registered in India and also firms registered outside India in European and American capital markets. Firms registered in India prepare their Accounts as per Indian Accounting Standards whereas firms registered in other countries prepare their financial statements as per the Reporting standards of the respective country. Adoption of IFRS ensures the elimination of multiple financial reporting standards by these firms as they are following single set of Financial Reporting. The above benefits are perceived benefits of adoption of IFRS.

7. Challenges in the Process of Adoption of IFRS in India

Institute of Chartered Accountants of India set up a task force in 2006 to study and suggest a path for adoption of IFRS in India. On the basis of the recommendation of task force, a 3 phased programme has been initiated to adapt to IFRS in India.

Accounting Professionals in India and across the world have listed various benefits of adopting IFRS. In spite of these benefits, adoption of IFRS in India is difficult task and faces many challenges. Few of these have been listed as below:

7.1 Awareness of International Financial Reporting Practices

Adoption of IFRS means a complete set of different reporting standards have to bring in. The awareness of these reporting standards is still not there among the stakeholders like Firms, Banks, Stock Exchanges, Commodity Exchanges etc.. To bring a complete awareness of these standards among these parties is a difficult task.

7.2 Training

Professional Accountants are looked upon to ensure successful implementation of IFRS. Along with these Accountants, Government officials, Chief Executive Officers, Chief Information officers are also responsible for a smooth adoption process. India lack training facilities to train such a large group. As the implementation date draws closer (2011), It has been observed that India does not have enough number of fully trained professionals to carry out this task of adoption of IFRS in India.

7.3 Amendments to the Existing Laws In India

Accounting Practices are governed mainly by Companies Act 1956 and Indian Generally Accepted Accounting Principles (GAAP). Existing laws such as Securities Exchange Board of India regulations, Indian Banking Laws & Regulations, Foreign Exchange Management Act also provide some guidelines on preparation of Financial Statements in India. IFRS does not recognize the presence of these laws and the Accountants will have to follow the IFRS fully with no overriding provisions from these laws. Indian Lawmakers will have to make necessary amendments to ensure a smooth transition to IFRS.

8. Suggestions

Ensuring a high quality corporate financial reporting environment depends on effective Control & Enforcement Mechanism. Merely adopting International Financial Reporting Standards is not enough. Each interested party, namely Top Management and Directors of the Firms, Independent Auditors and Accountants and Regulators and Law Makers will have to come together and work as a team financial Statements in compliance with IFRS. Some other ways to tackle the obstacles in adoption of IFRS can be summarized as follows:

8.1 The lawmakers in India will have to make necessary changes in the existing Companies Act 1956, Tax Laws, Foreign Exchange Management Act, Insurance Act etc. These changes are required to bring Indian Accounting Practices in line with IFRS. In July 2009, a committee has been formed by Ministry of Corporate Affairs Government of India, with a view to identify the various legal and regulatory changes required for convergence and to prepare a roadmap for achieving the same.

8.2 In order to ensure timely adoption of IFRS in India, trained Accountants and Auditors in IFRS are required in large number. India currently does not have the sufficient number of IFRS trained Accountants and Auditors. The Institute of Chartered Accountants of India (ICAI) has started IFRS Training programmes for its members and other interested parties. Yet there exists a large gap in the Trained Professionals required and trained professional available.

8.3 To ensure that all the Firms are complying with adoption procedure, Indian lawmakers and Accounting Body (ICAI) should have a Financial Reporting Compliance Monitoring Board. Other than the job of monitoring the compliance part, the board can play the advisory role also for the firms on IFRS Adoption Procedure.

9. Conclusion

To conclude, IFRS adoption in India is inevitable. Indian Government and Accounting Body are taking every possible step for a smooth transition process. In this regard, self-regulation is the answer which will ensure a complete and smooth adoption procedure. Awareness and proper Training should contribute to that process. Only enforcement mechanism will not help the procedure but an Advisor is also required. With all these systems in places, the IFRS adoption in India will become very smooth and accurate.

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