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A Conceptual Study on International Financial Reporting Standards and Its Adoptation in India

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Abstract – The Institute of Chartered Accountants of India (ICAI) has announced its decision to adopt IFRS in India with effect from 1 April, 2011. The standards will have a significant impact on capital markets. Many European countries shifted to IFRS as early as 2005. An understanding of Indian Generally Accepted Accounting Principles (GAAP) and IFRS standards is an urgent need of hour. Therefore, by investigating the perception of IFRS, this study aims to assess the level of planning for adopting the standards in India. International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB).The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting. Having an international standard is especially important for large companies that have subsidiaries in different countries. Adopting a single set of world-wide standards will simplify accounting procedures by allowing a company to use one reporting language throughout. A single standard will also provide investors and auditors with a cohesive view of finances. The present paper focuses on understanding the background of IFRS, and its objectives. The process involved in adoption of International Financial Reporting Standards in India is discussed in detail along with the benefits of standards to various parties involved, in general and in specific. The researcher has analyzed the challenges faced in implementations of IFRS in India and utilities of post IFRS regime in India.

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INTRODUCTION

The available literature on IFRS and its implementation covers the data from European Union.

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.

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 adoption.

RESEARCH METHODOLOGY:

An exploratory research technique based on review of notable journals, articles, sites and blogs covering wide collection of academic literature on International Financial Reporting Standards and its adoption in India was used. According to the objectives of the study, the research design is of descriptive in nature. Available secondary data was extensively used for the study.

OBJECTIVES OF THE STUDY

1. To understand the background and objectives of IFRS.

2. To understand the process involved in adoption of IFRS in India.

3. To study the benefits of IFRS implementation to various stakeholders.

4. To study the challenges faced in IFRS convergence in India.

5. To understand the utilities of adopting IFRS in India

INTRODUCTION:

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB).

The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting.

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Currently, over 100 countries permit or require IFRS for public companies, with more countries expected to transition to IFRS by 2015. Proponents of IFRS as an international standard maintain that the cost of implementing IFRS could be offset by the potential for compliance to improve credit ratings.

IFRS is sometimes confused with IAS (International Accounting Standards), which are older standards that IFRS has replaced.

OBJECTIVES OF IFRS

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.

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.

BENEFICIARIES OF CONVERGENCE WITH IFRS

Some of benefits of IFRS is discussed 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 are willing to invest in the countries apart from India. It will also develop better understanding of financial statements worldwide which increases the confidence among the people as investors, from whole of the world.

2. The Industry:

The other important 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, 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.

3. Accounting Professionals:

However, there would be initially many problems but convergence with IFRS would surely benefit the accounting professionals and it will be helpful to them to sell their talent and expertise across the globe.

4. 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

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.

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. 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.

3. Legal Consideration:

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.

4. Taxation effect:

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.

5. 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.

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.

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.

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.

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.

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.

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. Researches are yet to be carried out to understand actual benefits of adoption of IFRS. Such researches are negligible for Indian financial data, as India is yet to step in the era of IFRS. This calls for a future scope of study on impact of adoption of IFRS by Indian Companies on Indian Economy and Firms.

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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