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IFRS Convergence and Applicability in India: Some Issues

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ABSTRACT

Standardisation of Accounts has been a constant effort and concern to the various professional accounting bodies both national and international. Standards are a set of rules that are aimed at making accounts more consistent, comparable and thereby bringing in a harmonisation of accounting policies and principles and practices that, in turn, are expected to enhance corporate governance and responsibility. One of the recent developments in the field of standard setting is the International Financial Reporting Standards (IFRS). At the wake of globalisation, an attempt to bring in parity in the reporting of Financial Statements before the users has been made by the professional accounting bodies by trying to formulate a single set of accounting standards to be followed by the world. Since many countries including India have their own set of national Accounting Standards that are different on many counts especially on the socio-economic, cultural and legal norms, following of a set of common standards that are altogether different in practice will require some compromise between the prevailing standard norm and the new provisions. The present paper mainly attempts to focus on the steps adopted in India and problems being faced in the convergence of IFRS with Indian Accounting Standards and thereby to throw light on the convergence issue by highlighting the convergence attempts taken by the IASB and the FASB on the international front.

Key words: *IFRS, Accounting Standards, IASC, FASB, Convergence, GAAP, ICAI.*

Introduction:

Accounting Standards are certain guidelines that direct the manner of proper application of a particular accounting principle in the preparation and presentation of the accounts of an entity. Many such standards are available throughout the world. Each country is having its own set of accounting standards on one hand and International Accounting Standards [as given by the International Accounting Standards Committee (IASC)] on the other and accounts are being prepared and presented applying the standards that suits to the country economically, socially and in legal terms. This is because business is the part of a society and it reflects the social, cultural, economic and legal norms of the place it belongs to.

Of late, the globalisation factor has brought about a sea change in the world of business and it is observed that many countries (e.g. India) have been trying to or have made changes in the laws governing business to bring in global adaptability. Once a business enters into global platform, it needs to prepare and present its accounts in a manner that is understandable to the world since accounts are regarded as the language through which a business communicates with the people, known as users of accounts. Hence, application of the country-specific accounting standards is not enough to make the accounts globally understandable.

Keeping this into view, standardisation of accounts has now become a routine work and a matter of serious concern to the various professional accounting bodies. This is also because, standards are known to be a set of rules that aim at making accounts more consistent, comparable and thereby bringing in a harmonisation of accounting policies and principles. A set of prudent accounting standards is expected to enhance corporate governance and responsibility that is a much talked-about topic as of now.

One of the recent developments in the field of standard setting is the International Financial Reporting Standards (IFRS). These are principles-based Standards, Interpretations and Framework adopted by the International Accounting Standards Board (IASB) since its inception in April 2001 [earlier known as International Accounting Standards Committee (IASC)]. The IASC from 1973 (the year of its formation) till 2001 have pronounced as many as 41 International Accounting Standards (IAS) and the IASB has added eight new standards. These are collectively known as the present IFRS.

India has got its own set of national Accounting Standards [as given by the Accounting Standard Board (ASB)] that are different on many counts especially on the socio-economic, cultural and legal norms. Accounts and Financial Statements are being prepared in India by applying these standards. The present era of globalisation needs application of some common standards so that the accounts of each country are globally understandable and acceptable. It is worth mentioning here that, following of a set of common standards that are altogether different in practice will require some compromise between the prevailing standard norm and the new provisions. The standards given by the two authorities (IASB and ASB), although aim at better reporting practices, yet there are differences in the methodology and applicability of the standards. Hence convergence of the standards is sought for.

Objectives of the Study:

The present paper mainly attempts to focus on the steps adopted in India in the convergence of IFRS with Indian Accounting Standards and thereby to throw light on the convergence issue by highlighting the convergence attempts taken by the IASB and the Financial Accounting Standard Board, USA (FASB) on the international front.

Convergence: Meaning and Necessities:

Convergence means alignment of the standards of different standard setters with a certain rate of compromise, by adopting the requirements of the standards either fully or partially. The Wall Street crash (1929) in the past and other corporate failures during recent times like bankruptcy of Enron Corporation (2001), fall of the Lehman Brothers and the American Insurance Group (AIG) (2008) and the Satyam Scandal (2009), all have pointed towards a bad corporate governance resulting in the non-reliance of the investors on the corporate business in particular and the loss of faith on the corporate by the society at large. Moreover, at the advent of globalisation, business activities of the corporate sector in particular have increased manifold. In a globalised economy, the business has to keep itself updated with facts which demands standardisation of accounting and reporting in a manner that the accounts of different countries become harmonised and hence understandable to all its users. More precisely, the accounting and reporting should be in a manner that could be easily understood by the present stakeholders and the prospective investors for taking appropriate decisions. This requires that the different accounting standards be bent towards formulating a set of Global Accounting Standards (GAS). The Securities and Exchange Commission, US (SEC) also has recommended formulating a High Power standard that can serve the purpose of disclosure on global terms. Convergence of accounting standards has now become a necessary step to make the accounting reports more reliable.

Convergence of IFRS and US-GAAP

In the year 2002, with a view to converging of the standards, the IASB and the FASB have signed a MoU to adopt various initiatives, popularly known as the Norwalk Agreement. In that agreement both the boards have pledged to put their efforts to make the standards more compatible and practicable. In April and October 2005 they reaffirmed of their priority in making a set of high quality global standards. Again in February 2006 both the standard setting boards signed a MoU on three main points of principles to be reached by the year 2008. These principles are, (i) convergence of the accounting standards by bringing in a set of high quality common standards, (ii) instead of eliminating differences between the two standards, a set of new common standards be issued for the benefit of the investors and (iii) replacement of the old standards to bring in convergence. The SEC, by this time has loosened some of its restrictions that they had imposed on the operation of the non-US listed companies in the US earlier and has welcomed the idea of common set of standards. Since then, in a bid to make a compromise, these professional accounting bodies have engaged themselves in a toilsome work towards convergence.

By this time, many long term joint projects have been undertaken by the above two standard setting bodies. Some of the projects undertaken are:

1. Designing of Conceptual Framework
2. Fair value measurement guidance
3. Valuation and Disclosure of Financial Instruments
4. Presentation of Financial Statement.
5. Accounting for and presentation of Intangible assets.
6. Accounting for Leases
7. Presentation of Liabilities and Equity.
8. Revenue recognition, etc.

Convergence of IFRS and India:

In India, the process of convergence has made the take-off with the initiatives taken by the Institute of Chartered Accountants of India (ICAI) in the pronouncement of new accounting standards. At present there are in total 32 Indian Accounting Standards, and the last one, i.e. the 32^{nd} relates to IFRS 7 the Financial Instruments: Disclosure. In regard to better reporting practice, the National Advisory Committee on Accounting Standards (NACAS) was formed in the year 2001 to render advisory service regarding accounting standards to the Government.

The ICAI affirms India's adoption of the IFRS from April 1, 2011 onwards for large sized companies, i.e. those having Net worth of INR 1000 crores or more, turnover more than INR 100 crores and borrowings more than INR 25 crores. In this attempt, some distinct phases for adoption of IFRS with Indian Standards have been proposed by the ICAI. In the First Phase, Companies which are part of NSE Index – Nifty 50, Companies which are part of BSE Sensex – BSE 30, Companies whose shares and other securities are listed on a stock exchange outside India and Companies whether listed or not, having a net worth of INR 1000 crores or more are required to prepare Opening Balance Sheet as at April 1, 2011. Similarly, Companies not covered in Phase I and having Net worth exceeding INR 1000 crores will require preparing Opening Balance Sheet as at April 1, 2012 under Phase II, while Listed Companies not covered in earlier phases will have to prepare their Opening Balance Sheet under IFRS as at April 1, 2014 under Phase III.

Besides ICAI, the other players in the field of convergence of IFRS and Indian Accounting Standards are National Advisory Committee on Accounting Standards (NACAS), Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA), the Government in remodelling of Income Tax laws and the Securities and Exchange Board of India (SEBI). These authorities are constantly working in bringing up a successful convergence.

Adoption of IFRS will need a well-knit standards having international appearance with Indian flavour. The table below (Saxena, 2009) displays certain differences between IFRS and Indian Accounting Standards:-

Subject	IFRS	Indian GAAP
Components of Financial Statements	Comprises of _ Statement of Financial Position, _ *Statement of Comprehensive Income _ Statement of Cash flow _ Notes to Accounts _ Statement of Changes in Equity (Note * - Also includes items of other comprehensive income such as revaluation gains, foreign exchange fluctuations, etc)	Comprises of _ Balance sheet _ Profit and Loss A/c _ Cash flow statement and _ Notes to Accounts
Format of SOFP	No particular format prescribed. However IAS prescribes disclosure on the basis of current and non-current assets and liabilities.	According to the format prescribed in Schedule VI to the Companies Act 1956, Banking Regulation Act for Banks etc.
Format of Income Statement	IAS 1 prescribes the format of income statement.	According to the format prescribed in Schedule VI to the Companies Act 1956, Banking Regulation Act for Banks etc.
Statement of Cash Flows	Mandatory for all entities	Exempted for Level 3 entities as prescribed by ICAI.

Presentation of extraordinary items	IFRS prohibits the presentation of extraordinary items in the statement of comprehensive income or in the notes.	Indian GAAP requires extraordinary items to be presented in the profit and loss statement of the entity distinct from the ordinary income and expenses for the period. As a result, extraordinary items are considered to determine the profit / loss for the period.
Dividends proposed after the end of the reporting period	Dividends declared after the end of the reporting period but before the financial statements are authorised for issue are not recorded as liability in the financial	Dividends declared after the end of the reporting period but before the financial statements are approved are recorded as liability in the financial statements.
Depreciation rates	Allocated on a systematic basis to each accounting period during the useful life of the asset.	Depreciation is based on the higher estimate of useful life of the asset, or the rates prescribed by Schedule VI of The Companies Act 1956.
Change in the depreciation Method	Treated as a change in the accounting estimate and hence is accounted for prospectively.	Treated as a change in the accounting policy and is accounted for retrospectively (i.e. for all the relevant previous years). Any excess / deficit in the case of this kind of recalculation must be adjusted in the period in which the change is effected.
Entire class to be revalued	If an item of property, plant and equipment is revalued, the entire class of assets to which that asset belongs should be revalued.	An entire class of assets can be revalued, or selection of assets for revaluation can be made on a systematic basis.
Component accounting	Mandates component accounting.	Recommends component accounting.
Functional and foreign Currency	Functional currency is the currency of the primary economic environment in which the entity operates. Functional and presentation currencies	No concept of functional currency.

	may be different. The standard contains detailed guidance on this.	
Goodwill	Goodwill is not amortised under IAS 38 but is subject to annual impairment test under IAS 36.	AS 14 provides that goodwill arising on amalgamation in the nature of purchase is amortised over a period of 5 years.
Measurement of intangible assets	Can be measured at cost or revalued amount.	Are measured at cost only.
Actuarial gain or loss	IAS 19 gives three choices for the treatment of actuarial gains or losses arising on measurement of employee benefits.	Actuarial gains and losses should be recognised immediately in the statement of profit and loss as an income or expense.
Contingent asset disclosure	Contingent assets are disclosed in the financial statements only if the inflow of economic benefit is probable. (Para 37)	Contingent assets are disclosed as part of the director's report (approving authority) and are not disclosed in the financial statement.
Entities operating in hyper inflationary economies	IAS 29 – Financial Reporting in Hyper Inflationary Economies prescribes reporting requirement for entities operating in hyperinflationary economies.	There is no equivalent standard.

The above table shows that there are many points on which the IFRS and Indian GAAP are different, especially regarding presentation of financial statements, treatment of goodwill, inflation accounting and contingent assets disclosure. Hence, in order to ensure transparency of accounts under global platform, convergence becomes an essential task.

<u>Expectations from convergence:</u>

Convergence is expected to ensure the following:

a) Same language of business

b) Cross border flow of investments leading to economic growth
c) Comparability of the financial statements on global parlance becoming possible
d) Globalisation of economy and world trade. Harmonisation along with convergence in accounting practice will ensure better world trade.
e) Advantageous to multinational companies as convergence will help bringing in a common accounting practice.
f) The work of the standard setters and the governments of the developing countries becoming easier.
g) The work of the tax authorities made easier by converging accounting practice for taxation.
h) Saving of time and money in planning and executing of accounting and auditing.
i) Costs involved in the access to the capital market are expected to reduce.

An Insight into the Convergence Process:

(A) Attempts made so far:

Attempts are being made in institutional capacity by the ICAI and the Government for legal back-up in India to bring about IFRS convergence. The activities done till now in India regarding convergence can be highlighted in brief as below:-

The ICAI

1. The ICAI has been playing active role in remodelling the Accounting Standards in India that can be globally accepted. Since the year 2000, the beginning of the convergence era, it has either pronounced new standards or has revised the existing ones. To speak of a few such standards, AS 7 Construction Contracts has been revised to become valid on and from 1st April 2003, similarly, AS 11, The Effects of Changes in Foreign Exchange Rates has been revised and operative from 1st April 2004. Moreover, seventeen standards were newly issued in between 2000 and 2009, of which AS 30, 31 and 32 deals with Financial Instruments, conforming to IFRS 7.
2. In the matter of extending training and cooperation regarding convergence work, the ICAI has been putting its best efforts.

The Government

3. As regards the legal framework, the Government has been keen enough to remodel some laws to suit the convergence process.
   (i) The Department of Corporate Affairs has designed a new company law contained in the Company Bill 2009 to be implemented soon.
   (ii) The taxation laws have also been rationalised into the Direct Tax Code Bill and the Goods and Services Tax that are expected to become operative soon.

(B) Some obvious problems ahead:

Fair Valuation:

One of the most talked about point that appears to be vexed at present is the concept of Fair Value in the valuation of the assets, particularly the intangibles, goodwill and the financial instruments. This problem arises as Indian standards require historical cost as the basis of valuation in most cases. Moreover, fears are expressed from many quarters that the fair value concept would reduce the assets value of an Indian company sharply. For instance, Companies like Tata Steel, Tata Motors and Hindalco, that acquired big companies overseas through borrowed funds, paid additional amounts above the enterprise value for the goodwill of the foreign companies, that typically reflects the extra amount for synergy benefits, research and development and other off-balance sheet items would get reduced if these are valued under the norms of IFRS.

Concept of Substance over Form:

Indian Accounting practice considers the written contract and the form of the transaction rather than the substance. Adoption of IFRS norms would cause difficulty in the revenue recognition process following substance over form.

Disclosures in Financial Statements:

The Companies Act 1956 under Schedule VI prescribes a detailed form for disclosure and lays great emphasis on the quantitative aspect of information such as, sales, amount of transaction with related parties, production capacities, etc. On the other hand, the IFRS gives more stress upon the qualitative aspect of information such as, qualitative information of the stakeholders, terms of related party transactions, risk management policies, sensitivity analysis of the currency, etc. Further, IFRS requires segregation of all assets and liabilities into current and non-current, which is not appropriately reported by Indian companies. This is because, under the Indian GAAP, even some long term deposits and advances are reported under 'current assets, loans and advances'.

Proposed Dividend:

Another important problem is related to the treatment of proposed dividend. Under the Indian GAAP, provision is required to be made for proposed dividend that may be declared by the entity and approved by the shareholders after the Balance Sheet date. On the other hand, under the IFRS dividends proposed or declared after the balance sheet date is not regarded as a liability. According to the IFRS, proposed dividend is a non-adjusting event and should be recorded as a liability in the period in which it is declared and approved. This is another problem area where a compromise needs be made.

Recent Up-dates on Applicability of IFRS in India:

The new Company Bill gives a renewed format for presenting Profit and Loss Account while the form of Balance Sheet is drawn under vertical method taking into considerations of the ruling under IFRS. The Direct Tax Code 2012 also attempts to simplify Indian Income Tax and Wealth Tax provisions. These attempts indicate a positive march towards convergence process, though in a slow pace.

It is being observed that some countries for instance, South Africa, Hong Kong, Australia, Montenegro, etc. (Wikipedia) could adopt IFRS so far. India, on the other hand, failed to adopt IFRS-converged standards till date although it announced of the adoption by 1st April, 2011. Some of the obvious reasons of non-adoption might be:

a) Non-recognition of Accounting Standards by the Indian Income Tax Law
b) Hurdles in shifting to Fair Value Accounting from the present Historical Cost Accounting system
c) Lack of proper guiding rules towards convergence
d) Lack of consensus among the Stakeholders, Directors, Accountants, Auditors, etc. relating to convergence matter
e) Lack of properly trained personnel to help in the process of convergence.

In recently published news (2012, Nov), it is known that some of the IFRS-converged standards (known as Ind Accounting Standards or Ind- AS) have been designed and made available at the website of the MCA (Ministry of Corporate Affairs) Government of India to help the stakeholders in getting familiar to the standards and in deciding upon the date of its adoption.

Conclusion and Suggestions:

In the process of adoption of IFRS, difficulties have cropped up particularly relating to the differences lying in between the prevalent standards and the IFRS norms. The applicability of IFRS in India in particular needs be made keeping such difficulties in sight. The process of convergence has been making a slow but steady progress till now. It can be expected to have a common set of IFRS-converged standards within a short span of time.

As the convergence work is still going on, the practical application of IFRS-converged standards are yet to come up. As such, threat of problems in the post-application periods cannot be denied and moreover, the types of such problems cannot be forecasted for certain at this point of time.

Hence, preparation of IFRS-converged standards is a challenge before the preparers both in India and outside.

Suggestions:

Following points can be suggested at this point of time in regard to convergence:

1. Convergence should mean only compromise between the norms of the standards. It should in no way distort the cultural, socio-economic and legal identity of an entity. Hence, the preparers of IFRS-converged standards should be careful in this regard.
2. More number of trainers should be engaged to help the preparers.
3. The stakeholders must be properly educated in this line so that they can understand the IFRS-converged reports properly and can take their decisions.
4. Necessary modifications need be made in the laws governing business so that minimum hurdles are faced to apply IFRS-converged standards.
5. The idea of convergence of IFRS with other national standards and US GAAP should be publicised through Seminars, Workshops and Symposiums, etc. and later on the same may be put in the syllabi in the subject of Accountancy in the degree level courses of Universities in India in particular so that graduates become compatible to the new guidelines of accounting.

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