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ADOPTION OF IFRS IN INDIA

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ABSTRACT

IFRS is used in many parts of the world, including the European Union, Hong Kong, Australia, Malaysia, Pakistan, GCC countries, Russia, South Africa, Singapore and Turkey. As in December 2011 more than 110 countries around the world, including all of Europe, currently require or permit IFRS reporting. Approximately 85 of those countries require IFRS reporting for all domestic listed companies. In subsequent years, many other countries either adopted IFRS or converged to IFRS. An upcoming economy on world economic map, India, too, decided to converge to IFRS. IFRS convergence, in recent years, has gained momentum all over the world. As the capital markets become increasingly global in nature, more and more investors see the need for a common set of accounting standards. India being one of the key global players, migration to IFRS will enable Indian entities to have access to international capital markets without having to go through the cumbersome conversion and filing process. It will lower the cost of raising funds, reduce accountant's fees and enable faster access to all major capital markets. Furthermore, it will facilitate companies to set targets and milestones based on a global business environment rather than an inward perspective. Furthermore, convergence to IFRS by various group entities will enable management to bring all components of the group into a single financial reporting platform. This will eliminate the need for multiple reports and significant adjustment for preparing consolidated financial statements or filing financial statements in different stock exchanges. Historically, each country developed its own generally Accepted Accounting Principles (GAAP) for financial accounting and reporting and there was no uniformity among the GAAPs of different countries. Comparison of financial statements issued by business firms from different countries has become difficult leading toward suboptimal capital allocation across countries in the world. Gradually, there emerged a global demand for convergence of GAAP of different countries into a single set uniform accounting standards applicable to all countries. As a result, the International Accounting Standards Committee (IASC) was established in 1973. The IASC formed International Accounting Standards Board (IASB) in 2001, which began issuing International Financial Accounting Standards (IFRS). This paper presents details of each of these suggested alternatives and future adoption procedure, utility, challenges, implementation and transition of IFRS into the Indian accounting and reporting system.

KEYWORDS

GAAP, IFRS, international accounting standards board, adoption in India, transition.

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INTRODUCTION

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. 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. IFRS began as an attempt to harmonies accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. They are sometimes still called by the original name of International Accounting Standards (IAS). In India, the Institute of Chartered Accountants of India (ICAI), as the accounting standards formulating body in our country, has always formulated accounting standards that have withstood the test of time. As we globalize, the significance of convergence with International Financial Reporting Standards (IFRS) increases. In today's scenario of global business village India cannot afford to insulate itself from the developments and modifications taking place worldwide. In India, the accounting standards board set up an IFRS task force with the objective to explore the approach for achieving convergence with IFRS and laying down a road map for achieving convergence with IFRS with a view to make India IFRS complaint. In Feb, 2011, IFRS converged Indian Accounting Standards (Ind AS) came into existence. The implementation was postponed until April 2012 due to the practical challenges faced by Indian Regulators as well as corporates. Irrespective of the varying opinions convergence of IFRS with local standards is now not just a forum of discussion but a reality.

NEED FOR UNIVERSAL GAAP

In recent times, capital markets have become global and continue to expand. Moreover, there has been significant globalization of production and trade. Investors can trade shares and securities worldwide. Entities are in a position to access the funds globally in the most advantageous markets. For this, investors from all over the world rely upon financial statements before taking decisions. They need to be convinced that the financial statements are true and fair and what they understand from the statements is what the person preparing them intends to convey. However, different countries adopt different accounting treatments and disclosure patterns with respect to the same economic event. This may create confusion among the users while interpreting the financial statements. Financial statements that are based on a single, universally accepted and used GAAP will enable the world to exchange financial information in a meaningful and trustworthy manner. This will accelerate the globalization of finance.

WHY IFRS?

Conversion to IFRS offers companies a number of important benefits. Companies that operate in a global environment and comply with foreign reporting requirements can streamline their financial reporting. This will reduce related reporting costs by developing common reporting systems and will ensure consistency in statutory reporting. Furthermore, comparison and benchmarking of financial data with international competitors would be possible. Adoption of IFRS will make cross border acquisitions and joint venture possible, and also provide access to foreign capital. This is because majority of stock exchanges require financial information presented according to the IFRS. Early adoption of IFRS may offer an edge to the companies over their competitors as they can claim early adoption. This, in turn, will enhance the brand value of the company. The companies can trade their shares and securities on stock exchanges world-wide. For this, most of the stock exchanges require financial statements prepared under IFRS. Another major benefit of convergence is that the management of a company can view all the companies in a group on a common platform. This will reduce the time and efforts involved to adjust the accounts in order to comply with the requirements of the national GAAP. Business acquisition would be reflected at fair value in IFRS rather than the carrying values. This would ensure greater transparency in the financial statements. The implementation of IFRS in the corporates would require trained accountants, auditors, valuers and actuaries. This will boost the growth of the service sector also as India can emerge as an accounting services hub. Moreover, a single set of accounting standards worldwide would ensure that auditing firms standardize their training and quality of work is maintained globally.

WHAT IS IFRS/IAS?

IAS/IFRS is a single set of high quality, understandable and enforceable global accounting standards. It is a "principles based" set of standards which are drafted lucidly and are easy to understand and apply. Financial International 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.

GLOBALIZATION AND FINANCIAL REPORTING IN INDIA

In recent past, India has seen a sea change in its way of financial reporting. The process of changes started in the late 1980s with the initiation of economic reforms and globalization process in India. Since independence in 1947 to mid-1980s, Indian industries were in complete control of the state. Price and quantity restrictions were in place and any entrepreneur interested in starting a new business venture (or, expansion of its existing capacity) had to take multiple permissions from various government departments. Rent seeking activity and excess capacity used to be the normal feature of the then Indian industries. Foreign Investment was negligible and funding for business was coming mainly in the form of loan from public sector commercial banks and financial institutions (e.g., IDBI). In the aftermath of liberalization program initiated in 1991, India faced severe Balance of Payments crisis and had to pledge its gold reserve to the Bank of England to overcome the crisis. The then Congress Government took some revolutionary steps with regard to opening up of Indian economy to foreign competition and inviting foreign investments in various industrial sectors. Both the industrial and financial sectors were deregulated and rupee was made convertible on Current Account.vi Capital Markets were made more accessible for Indian companies. Corporate houses were allowed to tap the foreign financial markets for their fund requirement. Insurance, banking, telecom, retail, and software, among many others were opened for foreign investments. These developments have encouraged foreign companies to invest in India. These increasing investment trends in India from abroad demand a corporate financial reporting system fully harmonized with the one being used worldwide. The demand is further supported by the Indian companies, which were either buying foreign companies or entering into joint ventures with foreign companies. Goldman Sachs (2003) also supported this phenomenon through a study on BRIC (Brazil, Russia, India & China) in which it suggested that these countries will become among the four most dominant economies by the year 2050. Currently, Indian Companies are reporting their financial statements based on Indian Accounting Standards prepared by Institute of Chartered Accountants of India (ICAI).These Standards are quite similar to IFRS. Till date, ICAI has issued 32 Accounting Standards covering many areas.

INDIA AND IFRS

In India, there will be two set of accounting Standards-

1. The existing Indian accounting Standards (IAS) – will be applicable to all companies which are not required to adopt IFRS converged standards.
2. Indian Accounting Standards, as converged with IFRS (Ind-AS) – will be applicable to companies operating in India in phased manner. The date of implementation of the Ind-AS is yet to be notified.

There are conceptual differences between IAS and IFRS. Keeping in view the extent of gap between IAS, Ind-AS and the corresponding IFRS- conversion process would need careful handling. By introducing a new company law, the Indian Government has initiated the process to amend the legal and regulatory framework. The conversion would involve Impact assessment, Revisiting Accounting Policies and thereafter changing the Accounting & Operational Systems (including ERP) in order to be carefully compliant with Ind-AS or IFRS.

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:

Step 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.

Step 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 than 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.

Step 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.

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 globev iii. For this they need funds at cheaper cost which is available in American,European and Japanese Capital Marketsix.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, Firma 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. Researchers 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.

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 (already discussed somewhere in this paper) 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:

- **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, and Commodity Exchanges etc. To bring a complete awareness of these standards among these parties is a difficult task.
- **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.
- **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.
- **Taxation** IFRS adoption will affect most of the items in the Financial Statements and consequently, the tax liabilities would also undergo a change. Currently, Indian Tax Laws do not recognize the Accounting Standards. A complete overhaul of Tax laws is the major challenge faced by the Indian Law Makers immediately. Enough changes are to be made in Tax laws to ensure that tax authorities recognize IFRS-Compliant financial statements otherwise it will duplicate the administrative work for the Firms
- **Use of Fair Value as Measurement Base** IFRS uses fair value to measure majority items in financial statements. The use of Fair Value Accounting can bring a lot of volatility and subjectivity to the financial statements. Adjustments to fair value result in gains or losses which are reflected in the Income Statements and valuation is reflected in Balance Sheet. Indian Corporate World which has been preparing its Financial Statements on Historical Cost Basis will have tough time while shifting to Fair Value Accounting.
- **Financial Reporting System** IFRS provide complete set of reporting system for companies to make their Financial Statements. In India, various laws and acts provide the financial reporting system but not as comprehensive as provided by the IFRS. Indian Firms will have to ensure that existing business reporting model is amended to suit the requirements of IFRS. The amended reporting system will take care of various new requirements of IFRS. Enough control systems have to be put in place to ensure the minimum business disruption at the time of transition. All the challenges mentioned here can be worked out by bringing a proper Internal Control & Reporting system in place. Firms, Regulators and Stock Exchanges in India should take some guidelines from the countries which have adopted the IFRS and have similar economic, political and social conditions.

IMPLEMENTATION OF IFRS WOULD THUS ENSURE THE FOLLOWING BENEFITS

i) Same language
ii) Cross border investments leading to economic growth
iii) Comparability of financial statements of any two companies anywhere in the world
iv) Globalisation of economy and world trade
v) For multinational companies:

- Consolidation of group financial statements made easier
- Accounting and audit functions made easier and cheaper
- Compliance with regulatory requirements of bodies such as stock exchanges
- Mergers and acquisitions made easier
- Access to multinational funds

vi) The job of governments and standard setters in the developing countries made easier
vii) The job of tax authorities made easier
viii) Time and money saved by international professional accounting firms in planning and execution of accounting and audits
ix) Administrative costs of accessing the capital markets around the world reduced.

IFRS IMPLEMENTATION CHALLENGES IN INDIA

Inspite of the various benefits of adopting IFRS, implementation of IFRS is a herculean task in India. Following are a few challenges faced during adoption and implementation of IFRS:

- **Awareness about international practices**

Adoption of IFRS means that the entire set of financial statements will be required to undergo a drastic change. There are a number of differences between the two GAAP's (discussed below). This may cause the users of financial statements to look at them from a new perspective. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.

- **Training**

Professional accountants are looked upon to ensure successful implementation of IFRS. The biggest hurdle for the professionals in implementing IFRS is the lack of training facilities and academic courses on IFRS in India. As the implementation date draws closer (2011), it is observed that there is acute shortage of trained IFRS staff. The solution to this problem is that all stakeholders in the organisation should be trained and IFRS should be introduced as a full time subject in the universities.

- **Amendments to the existing law**

It is observed that implementation of IFRS may result in a number of inconsistencies with the existing laws which include the Companies Act 1956, SEBI regulations, banking laws and regulations and the insurance laws and regulations. Currently, the reporting requirements are governed by various regulators in India and their provisions override other laws. IFRS does not recognise such overriding laws. Although steps to amend these laws have been initiated, the authorities need to ensure that the laws are amended well in time.

- **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. It is extremely important that the taxation laws recognise IFRS compliant financial statements otherwise it would duplicate administrative work for the organisations.

- **Fair value**

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 volatility and subjectivity 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. Moreover, adjustments to fair value result in gains or losses which are reflected in the income statements. Whether this can be included in computing distributable profit is also debated.

TRANSITION TO IFRS

The Institute of Chartered Accountants of India has proposed two options for convergence:

- All at once
- Stage-wise approach

It has been observed that there are certain implementation dangers and compliance problems with either AS or IFRS in adopting the all at once approach. Therefore, stage-wise approach would be preferable.

FIRST TIME ADOPTION

For first time adoption, two key terms need to be understood:

- **Reporting date**-It is the end of the latest period covered by the financial statements.
- **Transition date**- It is the beginning of the earliest period for which an entity presents its first full IFRS compliant financial statements. ICAI has proposed that in the case of Indian corporates, the first reporting date will be 31-03-2012 and transition date will be 01-04-2010. Therefore, the first set of financials will be for the period 01-04-2011 to 31-03-2012 with IFRS comparable, which are to be provided for the period 01-04-2010 to 31-03-2011. It is mandatory for entities to include atleast one comparative period in IFRS compliant financial statements. After considering the current economic environment, ICAI has decided that IFRS should be adopted for public interest entities such as listed companies, banking companies, insurance companies and other large sized entities from the accounting periods commencing on or after 1st April, 2011.

CONCLUSION

The accounting principles are broad guidelines for general application, they permit a wide variety of methods and practices. The lack of uniformity of methods and practices makes it difficult to compare the financial reports of different companies. Moreover, the multiplicity of accounting practices makes it possible for management to conceal economic relatives by selecting those alternative presentations of financial results, which allow earnings to be manipulated. The financial statements prepared under such conditions, therefore, may have limited usefulness for several users of information. This problem has been recognized all over the world and various professional bodies are engaged in the task of standardizing accounting practices. The financial reporting thus has to be competitive and based on global accounting standards. IFRS are the global standards and will change accounting practice for financial assets. IFRS has today become a universal financial reporting language through which all the global companies are communicating with its global investors rather than having a divergent set of standards applied differently in different countries. India has already announced the convergence of Ind. AS with IFRS. The Ind. AS will be implemented very soon. The Indian accounting professionals have to make them well equipped at the earliest possible time by acquiring adequate knowledge through training. The comparison of financial statement will be easier and more cost-effective through common financial reporting language of IFRS. Indian Government and Accounting Body are taking every possible step for a smooth transition process. With all these systems in places, the IFRS adoption in India will become very smooth and accurate. IFRS adoption in India is inevitable.

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