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International Financial Reporting Standards: Significance, Acceptance and New Developments

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Abstract

Investors and creditors throughout the world base their decisions on the information published in various financial and economic reports issued by business entities It is, therefore, imperative that these reports convey information that reflects the economic reality of an entity in a meaningful, transparent and comparable fashion.

The globalization of markets and trades presupposes a set of high quality and globally consistent accounting standards, which would win the confidence of both domestic and foreign investors, as the current accounting and reporting practices fall short of meeting the information needs of the capital markets of the 21st century

Though the Generally Accepted Accounting Principles (GAAP) have acted as a suitable and reliable set of standards, they comprise items from various organizations that vary in format, unity, and structure and at times GAAP have been considered inconsistent and difficult to interpret; again recently there have been a host of corporate financial scandals, accompanied by fraudulent financial reporting, both in the U.S. and abroad, which have shaken the very foundation of corporate financial reporting and investor confidence.

The use of different accounting standards by different countries over the years has also had an adverse effect on the flow of investment capital across borders. This has negatively affected international economic growth and security valuations. As financial reporting has become increasingly more complex, stock holders and non-experts have expressed concern about how foggy some company's financial statements are.

A critically important element in the solution to this problem is the convergence of US GAAP and IFRS(International Financial Reporting Standards) a process now under way. The goal is an improved reporting model built on principle-based standards that can be applied in a cost-effective manner. If there is to be convergence to a single set of accounting standards or something very close to it the resulting standards hopefully will be those that permit judgment rather than stifle it, and those that reflect simplicity over complexity.

This paper discusses the need for and progress underway towards a global set of principles-based accounting standards; the changing global standard setting and regulatory environment; and the implications of these developments to accounting professionals.

Keywords: *Accounting Standards, Convergence, GAAP, IFRS*

Introduction

In the era of globalization, the world has become a small village. The globalization of capital markets is driving the increasing convergence of accounting standards worldwide. The trends of globalization and the need for harmonized accounting standards induced the creation of the International Accounting Standards Committee (IASC). In 1973, leading professional accountants from Australia, Canada, France, Germany, Japan, Mexico, Netherlands, U.K., Ireland, and the U.S. reached an agreement to establish the IASC (Sacho & Oberholster, 2008). The IASC was a private-fund company and its members were from these member-countries. Two years later, Belgium, India, Israel, New Zealand, Pakistan and Zimbabwe joined the Committee as associate members (Véron, 2007a). Many other countries and national accounting bodies continued joining the Committee until 1987 (Camfferman & Zeff, 2007). In 1981, the World Bank, the United Nations, the Organization for Economic Co-operation and Development (OECD), and other market participants formed the IASC's Consultative Group (Véron, 2007a). The International Organization of Securities Commissions (IOSCO) joined the group in 1987. In 1990, the European Commission (EC) and the U.S. Financial Accounting Standard Board (FASB) joined the IASC meetings as observers (Véron, 2007a).

The national standard setters have struggled with the issue of harmonizing local and international accounting standards since the formation of the International Accounting Standards Committee (IASC), investors have proceeded without restraint into global markets. By the end of 1995, investors in the United States had invested over $1.2 trillion in non-US equities while two-thirds of the investments in the United Kingdom were in foreign firms. Regulators finally realized that globalization of capital markets will not be abated by lack of uniformity in accounting standards and indeed, "global convergence of our markets has [already] occurred" They now seem to be ready to grab the reins, so that they will have a role in directing the progress of globalization and will continue to be able to protect the public.

Accounting has been regarded as "the language of business," and the question that has been recently the centre of attention is, "Can all accountants worldwide speak the same language?" In other words, "Is a set of globally accepted accounting standards feasible through an effective convergence?"

The convergence process: a chronology

Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have jointly set out on the path of convergence, the beginning of the IASB and FASB convergence project can be traced back to the 2002 Norfolk agreement, where the two regulatory bodies committed to develop a set of high quality "compatible" standards. As noted above, the EU adopted the IFRS in 2004 and made IFRS compulsory for the consolidated accounts of listed companies as of 2005. In turn, this move brought about an active role by national regulatory boards, which were entrusted to issue standards for private companies and for simple accounts. Consequently, the convergence process did not produce a common set of "European" accounting standards across EU state members but

rather the cohabitation between a set of "international" standards and a variety of "national" standards. Although national accounting standards have converged in the recent past to IAS/IFRS, they are still not fully equivalent across countries and European accountants have to adapt to this diversity.

In 2006, the IASB and FASB signed up a "Memorandum of Understanding" (MoU) which enhanced their commitment from a "compatible" to a "common" set of high quality standards. The MoU, which constituted a definite step forward in the convergence process, listed 11 topics that were deemed critical to convergence:

- Business combinations.
- Consolidation.
- Fair value measurement guidance.
- Liabilities and equities distinction.
- Performance reporting.
- Post-retirement benefits.
- Derecognition.
- Financial instruments.
- Revenue recognition.
- Intangible assets and
- Leases.

In 2007, the Securities and Exchange Commission (SEC) removed the reconciliation requirement for non-U.S. companies reporting under IAS/IFRS in order to register in the U.S. In this manner, the SEC effectively recognized IAS/IFRS as a set of high quality accounting standards which satisfied the information needs of U.S. investors. Ultimately, the SEC granted operations of IAS/IFRS in the U.S. only for non-U.S. companies. However the incipient financial crisis exerted a definite impact on the convergence process. In particular, it prompted debates on such fundamental issues as

(i) How to report information about financial instruments

(ii) The appropriateness of fair values and

(iii) The perimeter of consolidation in cases of "special purpose" business combinations.

These three items were already on the list of the fundamental topics considered in MoU of 2006 and the Boards were under pressures to issue accounting standards on these issues.

In September 2008, at the peak of the current financial crisis, the IASB and the FASB updated the MoU of 2006. In the new document, the two regulatory bodies reaffirmed the list of 11 fundamental topics that would lead to accounting convergence and stated 2011 as deadline. In November 2009, the IASB and FASB issued a Joint Statement that restated the convergence process and confirmed 2011 as a deadline. The Joint Statement comprised a detailed status of the convergence

process and identified two particularly controversial topics

(i) Accounting for financial instruments and

(ii) Derecognition of assets and liabilities

It's worth restating that the goal is an improved reporting model built on principle-based standards that can be applied in a cost-effective manner, delivered through a convergence process that will go as far as it can. Rules that allow this judgment to be exercised will produce better, more reliable and more useful information.

The scope and nature of accounting and reporting standards will be gradually altered. Two accounting, regulatory and legal 'cultures' – the US and all territories now following IFRS – will need to come into a new and closer relationship if the convergence process is to succeed.

Currently, more than 100 countries require or allow their companies to prepare their financial statements using International Financial Reporting Standards (IFRS) (Johnson and Leone, 2008). Nonetheless, IFRS is not universally perceived as a panacea because convergence is a very complex process influenced by political, cultural, and regulatory differences that often generate significant uncertainty and resistance.

Convergence can be understood as a process of the gradual elimination of differences between IFRS and United States generally accepted accounting principles (US GAAP), as contemplated in formal agreements, such as the Norwalk Agreement of 2002 between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).This process entails changes in both US GAAP and IFRS to eliminate differences, collaboration in establishing accounting standards and ultimate adoption of IFRS in place of US GAAP.

The convergence of accounting standards is critically important to our future economic strategy. In order to make our economy more dynamic and competitive, the country needs to have fair and transparent markets, which could maintain and foster market vitalities. The importance of investors' viewpoint needs to be reaffirmed and the confidence in our capital markets needs to be enhanced.

Major points bear close consideration.

1 The global convergence of accounting standards is a very positive development.
   - It will contribute to the free flow of global investment and achieve substantial benefits for all capital markets stakeholders.
   - It will improve the ability of investors to compare investments on a global basis and thus lower their risk of errors of judgment.
   - It has the potential to create a new standard of accountability and greater transparency, which are values of importance to all market participants including regulators.
   - It will create an unprecedented opportunity for standard setters and other stakeholders to improve the reporting model.

2 The process of creating this blueprint should clarify the scope and purpose of reporting and determine the role of standard setters.

- Accounting standards should address the needs of stakeholders and provide a comprehensive overview of financial information.

3 Cultural, legal and political obstacles along the convergence path cannot be underestimated.

- The appropriate authorities should make every effort to minimize these difficulties.

4 Additional strategies, protocols and tactical agreements are needed to further the convergence process.

- Attention must be given to the process of developing converged standards that fairly reflect the views of the global audiences to which they are accountable. The Boards should commit to coordinate agendas and work programmes with the ultimate goal of achieving fully compatible, high-quality financial reporting standards

Anecdotal evidence (e.g., [WebCPA, 2008a], [WebCPA, 2008b] and [Berkowitz, 2008]) reveals that the majority of corporate executives and accounting practitioners have no experience using IFRS. Expecting that US convergence to IFRS will have a direct impact on the auditors and their auditing work, they are yet to prepare for IFRS adoption. Thus, it is crucial for regulators and standard setters, as well as accounting professionals, academics, investors, financial analysts, and companies to have a robust understanding of the differences in US GAAP and IFRS and accordingly, to participate in further developments, refinements, and promulgation of IFRS. We conjecture that an effective convergence to IFRS requires familiarity with, knowledge of resource availability and proper enforcement by all concerned parties including companies and their boards of directors, executives and auditors, as well as regulators, standard setters and educators.

Convergence as a regulatory objective

There exist several notions (or interpretations) of convergence in accounting standards. From a strict viewpoint, "convergence" refers to the enforcement of a single set of accepted standards by several regulatory bodies, while a soft notion of "convergence" refers to diminishing differences among accounting standards issued by several regulators. In-between notions of "convergence" relate to the extent to which two or more jurisdictions may agree on a core set of common standards but allow varying approaches and interpretations regarding non-core issues.

In a related vein, there exist three fundamental approaches towards the policy implications of the "convergence" process. For example, we can aim at merging all standard setting bodies into a unified "global" body or alternatively, keeping each of the existing standard setting bodies as the sole authority in their respective jurisdiction. The intermediate position would refer to a national standard setting body coexisting with international coordination bodies.

From a theoretical point of view the unified solution of a single international setting body and no national setting bodies has been advanced as optimal.

Importance of convergence between IFRS and US GAAP

The harmonization of financial reporting around the world will help to raise confidence of investors generally in the information they are using to make their decisions and assess their risks. The opposite is perhaps the clearer case. If accounting for the same events and information produces radically different reported numbers, depending on the system of standards that are being used, then it is self-evident that accounting will be increasingly discredited in the eyes of those using the numbers.

- For individual companies it should be the case that the greater confidence in reliable and transparent information translates into a lower cost of capital – reduced interest costs and higher share prices.
- For those companies with joint listings in both America and another country, there should be substantial savings, particularly in terms of preparation costs. Obviating the burdensome US GAAP reconciliation statement required at present would be a worthwhile prize.
- Harmonization of requirements also assists the international mobility of professionally qualified accountants themselves. Mobility of skilled labour can also be a good thing.

So where is the process currently? Encouragingly, good progress has been made so far. Some of the major sources of differences have been eliminated or are declining. For example, the issuing of IFRS 3 meant that the treatment of business combinations and how to deal with changes in groups has been harmonized. Going forward in this manner will be largely the same under the two systems. This is an important development given the level of global merger and acquisition activity.

There is however, a downside to all of this for IFRS – a price in terms of costs and difficulties of the changes in the standards that convergence inevitably creates. These include:

- Extra costs in the preparation of financial statements by all IFRS companies implementing new requirements and restating previously reported numbers.
- Changes have to be communicated and understood by all of those involved in preparing the accounts, auditing them and using them.
- Translations of the amended standards are required for the many languages in which IFRS are applicable.
- The changes have to be approved by the various national endorsement authorities and incorporated into their legal systems.
- Continuous piecemeal changes undermine the reputation of IFRS. Some might justifiably ask why high quality standards need such frequent amendment.

But this does not mean that convergence should stop. What it does mean is that changes to IFRS should always be justified by the improvement in the quality of the reporting that results.

For example, the recent proposals to replace the international standard on segment reporting IAS14 with equivalent provisions derived from the corresponding US

standard SFAS131. This is a convergence project pure and simple. The costs are clear. Companies (many applying IAS14 for the first time last year) will now have to redo their segmental disclosures. It is hard to see where the improvement and benefit comes. There appears to be a loss of information compared to the existing requirements. There seems more risk that there will be a biased or incomplete disclosure of data. Not all analysts will think this represents progress.

Convergence of IFRS in India.

Presently, the Accounting Standards Board (ASB) of the Institute of Chartered accountants of India (ICAI) formulates Accounting Standards (ASs) based on the IFRSs keeping in view the local conditions including legal and economic environment, which have recently been notified by the Central Government under the Companies Act, 1956.

The term IFRS comprises, IFRS issued by IASB; IAS issued by IASC and Interpretations issued by the Standing Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB. The IFRS issued by the International Accounting Standards Board (IASB) are increasingly being recognized as Global Reporting Standards.

In line with the global trend, the Institute of Chartered Accountants of India (ICAI) has proposed a plan for convergence with IFRS with effect from April 1, 2011. Convergence to IFRS would mean India would join a league of more than 100 countries, which have converged with IFRS.

Meaning of Convergence with IFRS

Convergence means to achieve harmony with IFRSs; in precise terms convergence can be considered "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRSs". i.e., when the national accounting standards will comply with all the requirements of IFRS.But convergence doesn't mean that IFRS should be adopted word by word, e.g., replacing the term 'true and fair' for 'present fairly', in IAS 1, *'Presentation of Financial Statements'*. Such changes do not lead to non-convergence with IFRS.

The IASB accepts in its 'Statement of Best Practice: Working Relationships between the IASB and other Accounting Standards-Setters' that "adding disclosure requirements or removing optional treatments do not create noncompliance with IFRSs. But additional disclosures or removing of optional treatment should be made clear so that users of the IFRS are aware of the changes.

Why Convergence with IFRS?

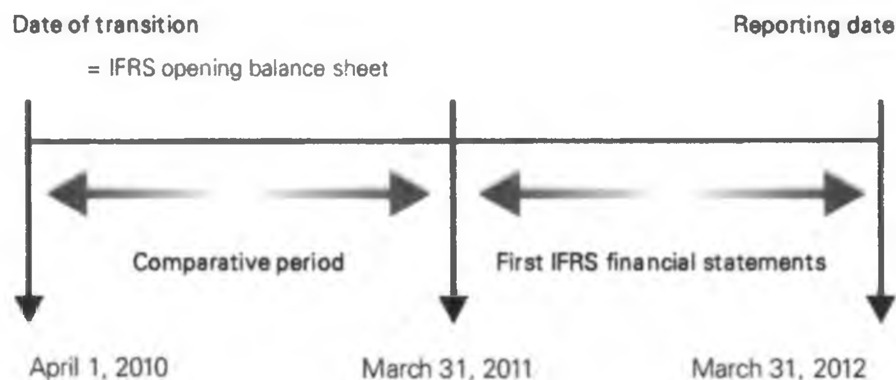
- A single set of accounting standards would enable internationally to standardize

training and assure better quality on a global screen.

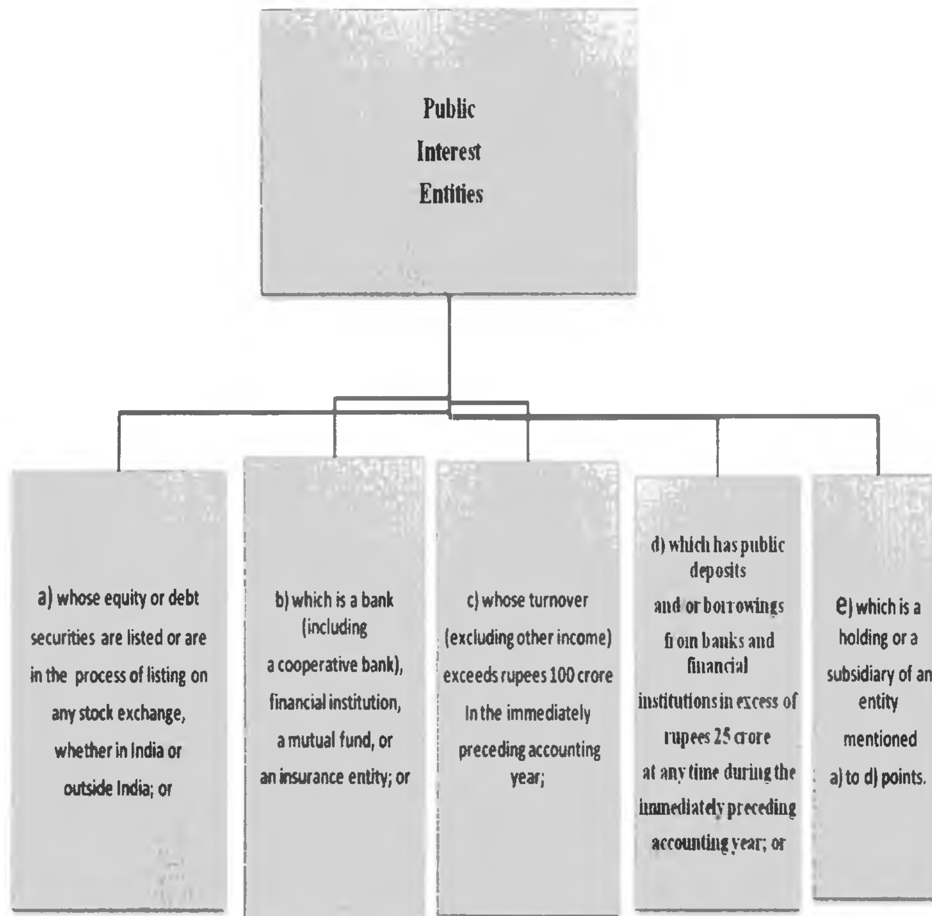
- It would also permit international capital to flow more freely, enabling companies to develop consistent global practices on accounting problems.
- It would be beneficial to regulators too, as the complexity associated with understanding various reporting regimes would be reduced.

IFRS Reporting In India: Proposed Timelines

- Reporting under IFRS, as proposed by ICAI, would be applicable for accounting periods beginning on or after April 1, 2011.
- The first set of IFRS financial statements for the year ending March 31, 2012 would require preparation of:
  - — Opening balance sheet as on April 1, 2010
  - — Comparative financial statements – year ending March 31, 2011
- Reporting enterprises would need to ensure preparedness for IFRS reporting as early as April 2010.



Keeping in view the complex nature of IFRSs and the extent of differences between the existing ASs and the corresponding IFRSs, the ICAI is of the view that IFRSs should be adopted for the public interest entities from the accounting periods beginning on or after 1st April, 2011.

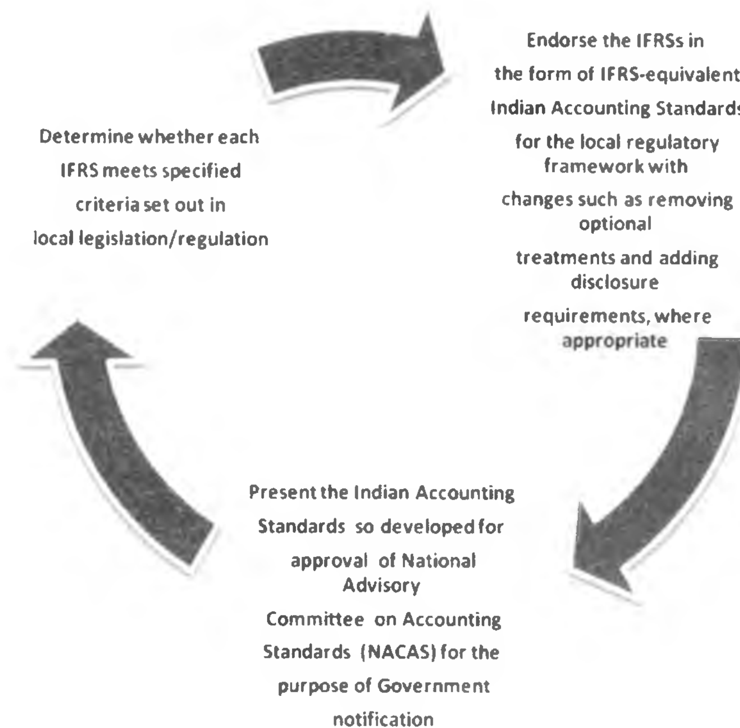


Format of IFRS for India

The format of IFRSs to be adopted for public interest entities should be the same as that of IFRSs, including their numbers. The numbers of the existing Accounting Standards may be given in brackets for the purpose of easier identification. Wherever required, a section may be added at the end of the adopted IFRS indicating the Indian legal and regulatory position.

The IFRSs when adopted will also take into account the International Financial Reporting Interpretations issued by the IFRIC of the IASB. Only in rare circumstances of public interest a carve out from an IFRS may be made

Role of ASB in Post Convergence Scenario.



Benefits of Convergence.

Single Reporting- Convergence with IFRS eliminates multiple reporting such as Indian GAAP, IFRS, US GAAP.

Increase Comparability- FRS will give more comparability among sectors, countries and companies. This will result in more transparent financial reporting of a company's activities which will benefit investors, customers and other key stakeholders in India and overseas.

Access to Global Capital Market- Convergence with IFRS will enable Indian entities to have easier access to global capital markets and eliminate barriers to cross-border listings. It will encourage international investing and thereby lead to more foreign capital flows to the country.

Benefits for Investors- Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national accounting standards.

IFRS Balance Sheet will be closer to Economic Value- Historical cost will be substituted by fair values for several balance sheet items, which will enable a corporate to know its true worth.

Benefits to the Accounting Professional- Convergence to IFRS will increase the

opportunities for Indian professionals abroad as they will be able to sell their services as experts in different parts of the world.

Benefits for the Industry- Currently companies need to prepare additional financial statements based on multiple reporting formats to raise capital in global market. Convergence with IFRS will eliminate the requirement for dual set of financial statements and thereby reduce the cost of raising funds by the companies.

Improvement in Financial Reporting- Better quality of financial reporting due to consistent application of accounting principles will lead to improvement in reliability of financial statements. This will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements.

Challenges of Convergence

Change to Regulatory Environment- For the success of convergence in India, certain regulatory amendment is required. For example, The Companies Act (Schedule VI) prescribes the format for presentation of financial statements for Indian companies, whereas the presentation requirements are significantly different under IFRS. So, the Companies Act needs to be amended in line with IFRS.

Lack of Preparedness - Adoption of IFRS by approximately 5000 listed companies by 2011 would result in a significant demand for IFRS resources. Corporate India and accounting professionals need to be trained for effective migration to IFRS. Additionally auditors would need to train their staff to audit under IFRS environment.

Educating Stakeholders -Educating Stakeholders comprising investors, lenders, employees, auditors, audit committee etc would be a big challenge as this would require a considerable time and effort.

Significant Cost -Significant one-time costs of converting to IFRS (including costs of internal personnel time, adapting IT systems, implementing revised reporting policies and processes, training personnel and educating investors, analysts and members of the board.)

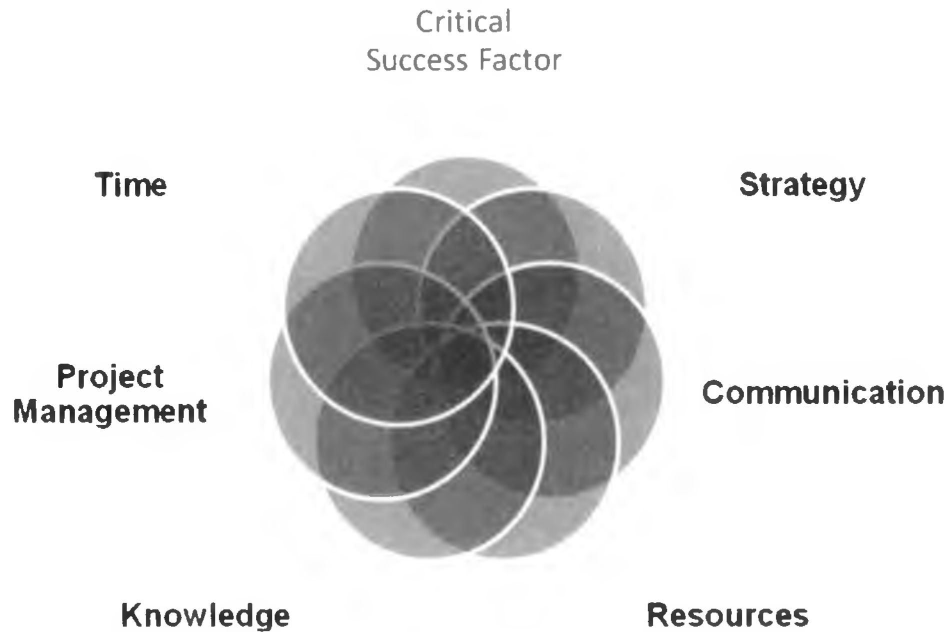
Process Complexity in the Financial Reporting- Under IFRS, companies would need to increasingly use fair value measures in the preparation of financial statements. Companies, auditors, users and regulators would need to get familiar with fair value measurement techniques.

Impact on Financial Performance - Due to the significant differences between Indian GAAP and IFRS, adoption of IFRS is likely to have a significant impact on the financial position and financial performance of most Indian companies.

Communication of Impact of IFRS to Investor- Companies also need to communicate the impact of IFRS convergence to their investors to ensure they understand the shift from Indian GAAP to IFRSs .

Conceptual Differences- For example, the Indian standard on intangibles is based on the concept that all intangible assets have a definite life, which cannot generally exceed 10 years; while IFRS acknowledge that certain intangible assets may have indefinite lives and useful lives in excess of 10 years are not unusual.

Critical success factors for IFRS conversion projects



Project Management for IFRS Convergence Project

Complex tasks are easier when divided into manageable pieces and it is true for IFRS convergence project also. Project can be broken down into **three** key phases.

Assess

1. Identify the key dates and the date of transition to IFRS.
2. Develop an IFRS training plan for accounting and finance personnel.
3. Identify differences in the relevant accounting policies.
4. Identify gaps in systems and processes to gather information needed under IFRS and the currently available information.

Design

5. Redevelop reporting manual i.e., develop IFRS accounting manual modifying chart of accounts and containing detailed instructions.
6. Measure the impact of the differences identified on the latest financial reports prepared under Indian GAAP.
7. Apply latest version of IFRS consistently.
8. Apply IFRS 1 which deals with first-time adoption of IFRS.
9. Identify permitted exemptions from specified IFRS as per IFRS 1.

10. Prepare an opening IFRS balance sheet at the date of transition to IFRS.
11. Explain the impact of transition from previous GAAP to IFRS as required by IFRS 1.
12. Apply IFRS to business as usual.

Benefits derived from convergence are many and so are the challenges. The success of the convergence to IFRS in India will depend on cooperation from government, regulators and tax departments. Ultimately, it is imperative for Indian entities to improve their preparedness for IFRS adoption and get the conversion process right. Given the current market conditions, any restatement of results due to errors in the conversion process would be detrimental to the company involved and would severely damage investors' confidence in the financial system.

The transition to IFRS is likely to be challenging for corporate India. However, if the transition is planned and managed successfully, it will generally be positive for financial reporting in India. This will improve the quality and transparency of the financial reporting process and further align corporate India to the global economy and the global capital markets.

There is an urgent need to address these challenges and work towards full adoption of IFRS in India. The most significant need is to build adequate IFRS skills and an expansive knowledge base amongst Indian accounting professionals to manage the conversion projects for Indian entities. This can be done by leveraging the knowledge and experience gained from IFRS conversion in other countries and incorporating IFRS into the curriculum for professional accounting courses.

Concluding remarksS

The current trend towards globalization suggests that U.S. firms will steadily proceed with the current process towards internationalization, involving investments abroad and the set up of subsidiaries in other countries. Given that more than 100 countries are already on IAS/IFRS, U.S. accountants will likely have to consolidate financial accounts of subsidiaries that are prepared under accounting

standards different from the U.S. GAAP. Consequently, this will require from U.S. accountants an understanding of IAS/IFRS.

Consequently, a setting featuring the coexistence of different accounting standards provides good opportunities to enhance our service to business practice and the society at large. Accounting education in these settings should move from teaching ever temporary rules to emphasize the economic and strategic underpinnings of accounting transactions, which will ultimately let participants in accounting programmes cope with IAS/IFRS adoption and any other future regulatory environment.

It is believed that effective convergence to a set of globally accepted accounting standards would be beneficial to preparers, users, auditors, analysts and standard setters. Convergence in accounting standards can require extensive and possibly costly changes to the standard-setting infrastructure and enforcement process in the US and other countries. This will also require proper training for management, auditors and investors.

Global comparability in financial reporting can be achieved through the use of a single set of high-quality global accounting standards. There are many unresolved issues of an ultimate move towards convergence. IFRS, regarded as principles-based standards, have received global acceptance and have been used by many countries, and are also being considered by US companies, investors, regulators and auditors. Recent initiatives by the SEC in eliminating reconciliation for foreign companies and possibly even allowing US companies to report using IFRS are positive steps toward convergence and this will definitely pave the way for the development of one global financial reporting language.

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