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Global Convergence of Accounting Standards – Challenges Ahead to Indian Corporates

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Abstract

In this scenario of globalization, India cannot isolate itself from the developments taking place worldwide. In India, the ICAI has been complying with the Global convergence of Accounting standard to formulate sound financial reporting standards. The ICAI, being a member of the International Federation of Accountants (IFAC), considers the Global convergence of Accounting standard and tries to integrate it, to the extent possible, in the light of the laws, customs, practices and business environment prevailing in India. The Preface to the Statements of Accounting Standards, issued by the ICAI, categorically recognizes the same. In this paper, the author has made an analytical attempt to discuss the global convergence of Accounting standard focusing on its development stage, features and challenges ahead to Indian Corporates.

Keywords: *Global Convergence of Accounting Standard, IFRS, Corporate Governance.*

Introduction

The global convergence of accounting standards is a global trend that began 30 years ago. The International Accounting Standards Committee (IASC) has contributed to the harmonization of accounting standards by issuing the International Accounting Standards (IAS).In 2001 the International Accounting Standards Committee (IASC) was reconstituted as the International Accounting Standards Board (IASB). The International Accounting Standards Board made a commitment to achieve full convergence to a single set of high quality, understandable and enforceable global accounting standards, to promote the use of those standards, and to bring about convergence of national accounting standards and international standards.

The development process of global convergence of accounting standards

The rapid globalization of capital markets, however, has resulted in further acceleration in the global convergence of accounting standards, as national accounting standards are being converged with one another.

In recent years, the use of International Financial Reporting Standards (IFRSs) has been expanding. While the consistency in their application remains yet to be confirmed, IFRSs is used, mandatorily or optionally, in many countries.

The concept of the international convergence of accounting standards, has three stages. They are: International Comparison, International Harmonization and International Convergence.

Global Comparison. Along with the appearance of the international trade and the multinational capital flows, the accounting international comparison has emerged. It mainly refers to a comparaison among different countries' accounting standards. This can reveal similarities and differences among different national accounting systems, and provide conditions for the international harmonization of accounting standards.

Global Harmonization. It is generally agreed that the international dimension of economic development, promotes international harmonization of accounting.

The Economic Globalization plays an important role in promoting the international harmonization of accounting whose level has gradually improved, so that international convergence of accounting standards is possible.

Global Convergence. The global convergence of accounting standards is driven by the economic globalization, constant international comparison and harmonization of the countries' national accounting standards to establish a global common accounting standards target developments of such a dynamic process.

Features of Global Convergence of Accounting System

The Global convergence of Accounting System has been functioning with the following features:

- The special purpose of Global convergence of Accounting system is to consolidate relationship with control.
- The Global convergence of Accounting standard does not treat the activities of dissimilar nature or temporary control as a justification for non consolidation.
- All the combinations of business are treated as acquisitions
- There is a prohibition of uniting of interest method.
- Revaluations of intangible assets are permitted only in rare cases. It must be amortised over a useful life of the asset.
- For valuing the assets historical cost or revalued cost should be used.
- Depreciation should be allocated on a systematic basis to each accounting period over the useful life of the asset.
- It recognizes the deferred tax assets if recovery is probable.
- Fringe benefit tax included as part of related expenses gives rise to incurrence of the tax.
- Accounting for convertible debt should be done on split basis by allocating proceeds between equity and debt.
- Preliminary expenses should be charged to income statement.
- Origination cost of loans is amortized in Global convergence of Accounting standard.

- Mandatory redeemable preference shares are classified as liabilities.
- Capitalization of borrowing assets is permitted, but not required for qualifying assets.
- Foreign exchange gains or losses are required to be expensed.
- Assets should be reviewed for impairment and impairment losses recognized in the accounts.
- Lease hold land is disclosed as prepaid assets.
- Lease accounting has been in place for a much longer period of time.

These are all the features of Global convergence of Accounting standard which a country has to follow if it comes under the purview of the International Financial reporting system.

Corporate Governance and Convergence of Indian Accounting Standards

The awareness and competitiveness among the corporates would be strengthened when they understand each other and compare their performance, for which the simple, understandable and comparable disclosure is an important instrument. The main objective of disclosure would be fulfilled and the utility of the disclosure towards good Corporate Governance would be improved when the disclosure is done on the basis of uniform and consistent accounting standards. Thus, the development and practice of uniform accounting standards is an essential element of Corporate Governance, for which various bodies have been thinking to strengthen the standards to make the Corporate Governance more effective in the context of the changing corporate environment and have contributed their wisdom. The corporate management is also now feeling the pressure for reforming accounting practices and level of transparency emanating from alert lenders, regulatory agencies, financial analysts and the board of directors who realize that it is the quality of information which will determine how efficiently they have discharged their responsibilities towards the good Corporate Governance.

The Institute of Chartered Accountants of India (ICAI), which is an Apex Body for the development of accountancy in India, has been working for the adoption and improvement of accounting standards. In order to frame the uniform accounting standards the ICAI became an associate member of International Accounting Standards Committee (IASC) in April, 1974. Recognizing the need to hormonise the diverse accounting practices prevalent in India and to integrate them with the global practices, the Accounting Standards Board (ASB) was constituted by ICAI in April 1977.

In view of liberalization of Indian economy in recent times, faster integration between Indian and International Accounting Standards (IAS) is warranted to have the benefits of foreign investments. In this direction, ASB of the ICAI has adopted 15 accounting standards (AS) out of 33 IAS. Two standards i.e. AS-4 on contingencies and events occurring after the balance sheet date and AS-5 on prior period and extraordinary items and changes in accounting policies were made mandatory in April 1989. This was followed by making six other standards namely AS-1 and AS-7 to AS-11 mandatory in respect of accounts for periods beginning on or after 1-4-

1991. Due to recent developments in the economy AS-11 was revised and the revised standard was issued in December 1994 and became effective since April 1, 1995. The other standards i.e. AS-12 to AS-15 issued recently are mandatory for the periods beginning on or after April 1, 1995. Thus, of the 15 standards, at present all are mandatory except AS-2 Valuation of Inventories and AS-3 Changes in Financial Position

Corporate Governance is recognized for competitiveness, better corporate performance and better relationship with all stakeholders which would reform their principles of Governance in Indian corporates.

The Corporate Governance is a voluntary, ethical code of business concerned with the morals, ethics, values, parameters, conduct and behaviour of the company and its management. The corporate responsibility begins with the directors who are the mind and soul of the organization. The Board is expected to act as conscience-keeper of the corporate vision and mission, and devise the right type of systems for organizational effectiveness and satisfaction of stakeholders.

Challenges of Global Convergence of Accounting Standards

Achieving global convergence in accounting standards is not an easy task. There are a number of challenges to overcome.

Environment

Accounting standards have been developed in different countries under different legal, economic, social and cultural environments. For this reason there exists diversity in accounting standards among the countries throughout the globe. If convergence is to be achieved, it is first necessary to arrive at an agreement as to the central objective of financial reporting. Countries that have a different financial reporting philosophy would find it extremely difficult to converge their domestic standards with International Financial Reporting Standards.

Rules Vs Principles

Convergence of accounting standards with international approach will inevitably raise the questions of rules versus principles. IASB standards are principles-based. Thus the countries that have rules-based standards are expected to experience considerable difficulty in converging their standards with IFRS.

Impact

IFRS will not merely be a technical accounting conversion. Convergence will impact most business aspects, including structuring of contracts with customers and vendors, performance appraisal parameters and reward plans, and managing external investor relations and communication. Therefore, it will be imperative for governing members to have a detailed knowledge of the impact of IFRS on a company's business and business processes, including the IT System training to the team communication to its investors and lenders

Quality

The quality of financial reporting depends on the quality of accounting standards as well as the effectiveness of the process by which those standards are implemented.

It will be most critical for boards to monitor the quality and robustness of the conversion process and the road map to IFRS. Essentially, IFRS will be a significant change that will need to be managed properly.

Regulations

Adequate regulatory and other supports are necessary to ensure proper implementation of standards. Implementation of accounting standards is not an easy task. In spite of convergence, there is no assurance that they will be implemented with same amount of vigor in every jurisdiction.

Scarce Resources

One big challenge for countries adopting IFRS is the shortage of resources and more particularly, IFRS-trained resources. The demand for accountants is rising and could run into millions in the coming years.

Risk of Errors and Omissions

Under IFRS, prior years' errors and omissions will have to be effected through restatement of previously declared results, which will be a critical change from prevailing practices in India. With IFRS, the complexities involved in preparing financial statements will increase manifold, thereby increasing the risk of errors and omissions.

Risk of Restatements

Audit committees and board members will need to manage and address the risk of negative restatement effectively. Since restatements are viewed with suspicion by tax authorities in India, who may not be able to understand the changes emanating from convergence with the IFRS reporting framework.

Risk of Stakeholders

The biggest challenge for members charged with governance will be to manage stakeholder expectations in terms of meeting targets and key performance indicators, declaring dividends and explaining variations and volatility in earnings on a quarterly basis. This is a challenging task even now, but with the arrival of IFRS, the challenge is set to assume a different dimension. Audit committees and board members should start preparing for this challenge now.

Convergence may lead to Accounting Chaos

Besides the challenges ahead of Indian corporates the convergence of accounting standards may lead to accounting chaos.

Lack of clarity

The new accounting standards led the companies to prepare the balance sheet with lack of clarity. They prepared a confused balance sheet.

Controversies in Reporting Data

Indian companies are preparing the balance on the basis of IAS for the period beginning 1 April 2011 with opening balance as on 1 April 2010. One important aspect to be kept in mind is that the preparation of the opening IFRS balance sheet will be based on the IFRS guidance as prevalent at the annual reporting date (i.e., 31 March 2012) and not at the transition date.

Basic Rules

IFRS lays down four basic rules for the preparation of an IFRS-compliant opening balance sheet.

- The first principle is to recognize all assets and liabilities. For example, IFRS requires restructuring provisions to be recognized based on constructive obligation, whereas Indian GAAP, or generally accepted accounting principles, allow it to be based on contractual or legal obligations.
- Derecognize all assets and liabilities not permitted by IFRS. For example, deferred revenue expenditure relating to share issue expenses will have to be adjusted against opening reserves and cannot be carried forward in the opening IFRS balance sheet.
- All assets and liabilities have to be classified in accordance with IFRS. Investments will no longer be classified under current and long-term categories; rather, they would need to be classified under "fair value through profit or loss", "available-for-sale" or "held-to-maturity" buckets, according to current accounting provisions related to "Financial Instruments: Recognition and Measurement".
- Lastly, all assets and liabilities have to be measured in accordance with IFRS. For example, an entity would need to measure investments classified as "at fair value through profit or loss" at opening fair values with resultant impact flowing into equity and reserves. Similarly, long-term receivables and payables would need to be recorded at their present discounted values.

Financial Assets and Liabilities

IFRS prohibits retrospective derecognition of financial assets and financial liabilities, use of hedge accounting, change of estimates and assets classified as held for sale or discontinued operations.

Rigid Estimate

Regarding estimates, IFRS-1 does not allow the use of hindsight to change previous estimates.

Disclosures

IFRS requires certain disclosures to be made in the financial statements

Conclusion

With the policy of liberalization and increase in international capital market activities due to globalization, the gaps between Indian and International Accounting Standards should be narrowed down, the variety of approaches in each accounting standard are to be limited and all accounting standards have to be made mandatory, otherwise it will be exceedingly difficult for Indian investors to trust the Corporate Governance.

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