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Convergence of Indian Accounting Standards with IFRS – Prospects, Difference and Challenges

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Abstract

Now a day's International Financial Reporting Standards is buzz word and burning issue for implementation. Each country had its own rules and regulation besides generally accepted accounting practices for depicting financial statement. In time of globalization each company wants to grasp the opportunity at global level it is very hard to understand numbers and take decision for stakeholders and management. Because of that, to have uniformity of preparing and presentation of financial statement of any business entity, major countries of the globe ready to accept one and unique language of Accounting- International Financial Reporting Standards (IFRS). To acquaint with it Indian accounting standard would need to converge with IFRS. Thus, it is necessary to know that to whom it will be benefited and which are the barriers in the name of challenges have to face. This paper throws light on the benefits, difference between Indian GAAP and IFRS and challenges related with convergence to the Indian Accounting Standard with IFRS.

Keywords: *IFRS, Convergence to IFRS, Stakeholders, Financial reporting*

1. Introduction

Accounting is called language of the business by which business can communicate with the stakeholder of the business. Each and every company should prepare the financial statement to communicate with them by their countries Generally Acceptable Accounting Principles (GAAP). To make uniformity in the all over the world new system of presenting financial statement or the new language of accounting for the world is International Financial Reporting Standard (IFRS).

The International Financial Reporting Standards the "IFRS" aims to make international financial reporting comparisons as easy as possible because each country has its own set of accounting rules. For example, U.S. GAAP is different from Canadian GAAP and both are far apart from India GAAP. Synchronizing accounting standards across the globe is an ongoing process in the international accounting community.

The increasing pace of globalization over recent years has forced the pace for the adoption of truly comparable and consistent international accounting standards. A decade ago, national versions of Generally Accepted Accounting Principles (GAAP) were commonplace. Nowadays, IFRS has gained broad acceptance and is used in over 100 countries. The United States is moving towards the convergence of US GAAP and IFRS, with the present timetable indicating that the set of standards will be applied to large public companies in 2014, though some should have the option to make the move even earlier. Since early 2008, IFRS has been allowed in the United States without reconciliation for foreign private issuers. The Securities and Exchange Commission's (SEC's) roadmap suggests that the decision over the future adoption of IFRS should be made in 2011, though the SEC has suggested that this timescale may be subject to delays.

Presently, the widespread use of US GAAP rather than IFRS can create difficulties for financial analysts, given the challenges in making financial comparisons. However, the timelines for change are far from clear. A joint initiative by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) is aiming to converge existing standards into a single set of standards. In contrast, IFRS has been a requirement in Europe for listed companies since 2005.

In light of the increasingly international trend of IFRS, some emerging economies have been quick to adopt IFRS as their national version of GAAP.

Therefore, in the present era of technology the implementation is necessary for the legal as well as from the interest of the stake holders' point of view. For acquainted with the world India will implement IFRS with in short period.

2. Research Methodology

The study is mainly qualitative in nature and do not use quantitative tool and techniques to analyze the data. It has been carried out primarily on the basis of literature survey and secondary Information. Various journals, newspaper, magazines articles, official website of ICAI and IFRS have been referred to in writing this paper.

2.1 Objective of Study

1. To study the benefits received by Indian Companies in the process of Convergence to IFRS.
2. To study the Difference between IFRS and Indian GAAP.
3. To study the Challenges faced by Indian Companies in the process of Convergence to IFRS.

2.2 Literature Review

Chand & White (2007) in their paper on convergence of Domestic Accounting Standards and IFRS, demonstrated that the influence of Multinational Enterprises and large international accounting firms can lead to transfer of economic resources in their favour, wherein the public interests are usually ignored.

Elena et al (2009) in their article dealing with the issues of convergence between US Generally Accepted Accounting Principles (GAAP) and IFRS were of the opinion that the adoption of IFRS in the USA undoubtedly would mark a significant change for many US companies. It would require a shift to a more principles-based approach, place for greater reliance on management (and auditor) judgment, and spur major changes in company processes and systems.

Vellam (2004) discusses whether the convergence between national GAAP and IAS/IFRS can be achieved in practice, by describing the differences between Polish financial reporting and the IASB conceptual framework. The preference of Polish accounting system for a tax orientation and the lack of an effective enforcement of international accounting standards are perceived as the main reasons of a full compliance of IAS/IFRS requirements.

In Belgium, Jermakowicz (2004) underlines the benefits of complying with IAS/IFRS by all listed and non-listed companies by identifying and describing the main differences between IAS/IFRS and Belgian GAAP. The contribution of this paper as compared to the previous is to analyse the implementation problems with reference to the link between financial accounting and tax accounting by measuring the main impacts on the conversion to IFRS.

3. Meaning of IFRS

The general meaning of IFRS is the one type of rules for preparation and presentation of account.

"International Financial Reporting Standards: a set of rules and guidelines established by the International Accounting Standards Board **for standardizing the preparation of financial statements so that investors, organizations, and governments have a basis for comparison".**

"International Financial Reporting Standards (IFRS) is a set of accounting standards, developed by the International Accounting Standards Board (IASB) that is becoming the global standard for the preparation of public company financial statements. IFRS is a principles-based accounting system, meaning it is objective-oriented allowing for more presentation freedom".

4. Meaning of Convergence with IFRS

Before to understand the needs for convergence with IFRS. It becomes necessary to understand the meaning of the term "Convergence".

'Convergence' means to achieve harmony. According to Oxford Advance Learner's Dictionary, "If ideas, policies aim etc. Converge, they become very similar or the same.

Form the above, it is clearly said that convergence with IFRSs means "to design and maintain national accounting standards in a way that financial statements prepared accordance with national accounting standards draw unreserved statement of complains with IFRSs.

Convergence- is harmonization of national GAAP with IFRS through design and maintenance of accounting standards in a way that financial statements prepared with national accounting standards are in compliance with IFRS.

5. Need for Convergence

The convergence of Accounting Standards is gaining importance among accounting circles. They are pressures in favor of convergence of Accounting Standards. The main objective of convergence of accounting standards is to have a uniform set up of accounting standards, which should be need by all countries of the world the question arises that why there should be convergence of Accounting Standards. The convergence of Accounting Standards has been advocated due to following reasons:

- Globalization and growth of International companies.
- Increasing Foreign Investment.
- Growth of International Markets.
- Business Process Outsourcing.(BPO)

- Growth of international Audit Firms.
- Uniformity in reporting to interested groups i.e. Tax authorities, Investors, Researchers etc.

The Convergence of Accounting Standards in the need of the hour, for the purpose of maintaining its uniformity in accounting and reporting practices. After convergence of Accounting Standards giving same results and it would have a path for the development of a global capital market.

6. Who will be Benefited?

The convergence with IFRSs gives benefits to all the concerned parties. The industry, the accounting professionals, the economy and the investors are some of the beneficiaries of convergence.

The convergence with IFRS entails benefit to the following:

1. **The Investors:** The investor will be benefited in as the way accounting information made available to them will be more reliable, relevant, timely and most importantly the information will be comparable across different legal framework. It will develop better understanding and confidence among the investors.
2. **The Professional:** The professional, both in practice and in employment will get benefits as they will be able to provide their services in various part of the world, as few years after everybody will follow the same reporting standards.
3. **The Corporate world:** The Indian corporate reputation and relationship with international finance community will elevate because of achievement of higher level of consistency between reporting structure and requirements; better access to international markets; improving confidence among the international investors. The international comparability will also get improve strengthening the industrial and capital markets in the country.
4. **Benefit to economy:** If an economy has adopted the policy of globalization and liberalization, the convergence with IFRSs is increasingly required. The convergence with IFRSs helps maintain efficient capital markets and increase the capital formation and in this way economic growth is achieved. The convergence with IFRSs increases the trust of investors and thereby more foreign capital can be brought to the country.

7. Difference between Indian GAAP and IFRS

The convergence of Indian GAAP with IFRS is not easy because the following points indicate the difference between them. The following are some points which clearly indicate the vast difference between Indian GAAP and IFRS:

Points of difference	*Indian GAAP*	*IFRS*
Form and components of financial statements	The Companies Act does not prescribe preparation of statement of changes in equity. Further, preparation of a cash flow statement is not mandatory for all companies.	In IFRS Balance sheet, Income statement, Statement of changes in equity, Statement of cash flows requires to prepare for all company.
Events after the Balance Sheet date	Non-adjusting events are not required to be disclosed in financial statements but	Non-adjusting events are required to be disclosed in the financial statements.

Points of difference	*Indian GAAP*	*IFRS*
	are required to be disclosed in the Director's report as per Section 217 of the Companies Act, 1956.	
Consolidated financial statements	There is no mandatory requirement under the Companies Act, 1956 for an entity to present consolidated financial statements.	An entity having a subsidiary must present consolidated financial statements.
Valuation of Goodwill	Goodwill/Capital reserve is calculated by computing the difference between the cost to the parent of its investment in the subsidiary and the parent's portion of equity in the subsidiary.	The fair value approach is followed while calculating the goodwill at the time of preparing consolidated financial statements.
Accounting for taxes on income	Deferred taxes are based on timing differences. Timing difference is a term with a narrower meaning than temporary differences.	Deferred taxes are based on temporary differences in i.e. difference between carrying amount and tax base of assets and liabilities.
Property, plant and equipment	Depreciation is based on higher of useful life or Schedule VI rates.	Depreciation is based on useful life of assets.
Classification of Deferred Tax	Deferred tax assets, net are disclosed after "Net Current assets", whereas deferred tax liabilities, net are disclosed after "Unsecured Loans".	Deferred tax assets and liabilities are classified net as non-current with supplement disclosures for: a) components of temporary differences and, b) amounts expected to be recovered within 12 months and more than 12 months of the balance sheet date.
Employee benefits	AS 15 Revised does not provide any option with regard to recognition of actuarial gains and losses. It requires such gains and losses to be recognized immediately in the statement of profit and loss.	In IFRS, IAS 19 provides an option with regard to recognition of actuarial gains and losses i.e. in equity or profit and loss account.
Interim Financial reporting	The listing agreement in India requires all listed companies to furnish interim financial results on a quarterly basis.	IFRS does not require public entities to furnish interim financial statements, though it encourages interim reporting.
Accounting policies, errors and estimates	There is no concept of re-statement of comparatives except in financial statements prepared for certain specific purposes like public offers.	Accounting policy changes and corrections of prior period errors are accounted for retrospectively by restating equity and comparatives, unless impracticable.
Share-based payments	Share-based payments are accounted as per the Guidelines issued by SEBI and the Guidance note on accounting for employee share-based payments both of which permit the use of Intrinsic Value method as an alternate to the Fair value method.	Share-based payments are accounted as per Fair Value method.
Business combination	Indian GAAP deals only with amalgamations and there is liberal use of pooling of interests method which in not permitted under IFRS.	Business combination has a wider scope and is accounted using the purchase accounting method.

Points of difference	*Indian GAAP*	*IFRS*
Inventories	Indian GAAP provides that the cost of inventories should be assigned by using FIFO, or weighted average cost formula.	IFRS requires same cost formula to be used for all inventories having a similar nature and use. Where inventories have a different nature and use, different cost formulas may be justified.
The Effects of Changes in Foreign Exchange Rates	In Indian GAAP, there is no concept of functional currency. Financial statements need to be in Indian Rupees only.	An entity measures its assets, liabilities, revenues and expenses in its functional currency, i.e. the currency of the primary economic environment in which the entity operates. Functional currency of an entity may be different from the local currency.
Related party transactions	A non-executive director of a company should not be considered as a key management person by virtue of merely his being a director unless he has the authority and responsibility for planning, directing and controlling the activities of the enterprise.	IFRS provides for including non-executive director under key management personnel.

8. Challenges in Convergence with IFRS

Despite several benefits as may be looked out by the different people, there will be several challenges that will be faced on the way of IFRS convergence.

Implementation of IFRSs is not a cup of tea for each country. There are several impediments and practical challenges to adoption of and full compliance with IFRSs for each country. These are:

1) **Significant costs of convergence:** Each country's accountants have to learn IFRS. The auditors have to learn IFRSs. The regulators have to learn IFRSs. The university faculty in each country has to learn IFRSs and teach it to students and the textbooks in each country have to be rewritten. There will be costs to dismantling the standard setting infrastructure in each country. All this has to be done in a short period of time announced deadlines are to be met.

2) **Legal and regulatory requirements:** In some cases, the legal and regulatory requirements are at variance from IFRSs. ICAI has to consider there while formulating IFRSs.

   To illustrate:

   As per IAS 32, Financial Instrument: Presentation, preference shares that provide for mandatory redemption by the issuer are considered as liability, based on the substance, whereas as per the Companies Act, 1956, there are parts of equity.

   IAS 27, Consolidated and Separate Financial Statements, defines the teams'control' in a manner which is different form that followed in the definitions of the 'holding' and 'subsidiary' companies under section 4 of the Companies Act, 1956.

3) **Special Auditing Challenges:** All business entities in Spain that meet certain requirements are required to file with financial statements with the Mercantile Registry. These documents

are required to be audited by a certified auditor.

4) **Level of preparedness:** Ultimately, it is imperative for Indian corporates 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 investor confidence in the financial system.

5) **Educating investors:** Educating investors to understand the changed financial reporting's under IFRS. So, they can come to know about whether it is profitable to invest or not. Because investors are the real stake holder of the company and they are also boon for organization.

   Though the commitment is given for convergence or transition to IFRS by the authorities and the council of the ICAI. Yet how many people are aware of IFRS in India is a question mark.

6) **Conceptual differences:** The difference between IFRS and Indian Accounting Standard may produce certain hurdles in implementation of IFRS. For overcome the problem one common conceptual criterion for understanding the basic concept should be developed. Complexities of the introduction of concepts such as present value and fair value measurement, recognition and the extent of disclosure required under IFRS. For example, a few listed below though not all:

   IFRS does not provide for the compromise, merger and amalgamation through court schemes, effect of all such schemes are recognized through income statement.

7) **Differences between Indian GAAP and IFRSs:** 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.

   The differences are wide and very deep routed, to say a few -Plant Property and Equipment (PPE) accounting, Financial Instruments accounting, Investment accounting, Business combination, Share based payment, current and non-current classification of asset and liabilities, presentation of financial statements, all are not dealt under Indian GAAP.

8) **Training:** Expectation will be from the professionals to deliver, besides training to the user, it is unclear what steps are being taken to train the professionals. Time is approaching very fast and without proper education and training, it will be extremely difficult to provide desired service to the society.

9) **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.

10) **Communication:** IFRS may significantly change reported earnings and various performance indicators. Managing market expectations and educating analysts will therefore be critical. A company's management must understand the differences in the way the entity's performance will be viewed, both internally and in the market place and agree on key messages to be delivered to investors and other stakeholders.

   Reported profits may be different from perceived commercial performance due to the increased use of fair values and the restriction on existing practices such as hedge accounting. Consequently, the indicators for assessing both, business and executive performance, will need to be revised.

11)**Fair value Measurement:** IFRS uses fair value as a measurement base for valuing most of the items of financial statements. The use of fair value accounting can bring a lot of 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.

12)**Problem of Co-operation:** The success of the convergence effort in India will depend on co-operation received by ICAI from the government, regulators, tax authorities, courts & tribunals.

13)**Shortage of resources:** Adoption of IFRS by approximately 5000 listed companies by 2011 would result in a significant demand for IFRS resources.

9. Conclusion

IFRS is a single language of accounting which is very much helpful for the preparation and presentation of accounts. Different people have different opinion for the IFRS. So, to make harmony in the accounting language for the world with the adoption of IFRS its take too much time because there are number of hurdles is being faced by major country in the world. The main reason for this is to match the IFRS with GAAP of the each country. To achieve the goal to make one language for accounting team work, proper strategy and effective leadership is need of hours.

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