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IFRS – Implementation and Challenges in India

S.NAGALAKSHMI

Assistant Professor, Department of Commerce, IFIM College, Banglore – 560 100

ABSTRACT

International Financial Reporting Standards (IFRS) adopted by International Accounting Standards Board (IASB) is a standardized format of financial reporting that is gaining momentum world wide and is a single consistent accounting framework and is likely to become predominant GAAP in times to come. International Financial Reporting Standards (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. 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.

In this world of globalization in which Indian economy has also flourished, adopting IFRS would not only make Indian companies at par with other global companies but shall also increase India's marketability globally in terms of foreign investments. 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 accountants' 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.

The present paper makes an attempt to understand the various beneficiaries by adopting IFRS, the challenges faced by India in adopting the same. The paper also makes an attempt to analyze the requirements for successful implementation of IFRS in India.

KEYWORDS : IFRS, Capital Markets, Convergence, IASB, Globalization, GAAP.

CONCEPTUAL FRAMEWORK

International Financial Accounting Standards (IFRS), formerly known as International Accounting Standards (IAS) are the Standards, Interpretations and Framework for the Preparation and Presentation of Financial statements adopted by the International Accounting Standards Board (IASB). IAS was issued in 1973 and 2001 by the board of the Internal Accounting Standards Committee (IASC). On April 1 2001 the new IASB took over the responsibility of setting International Accounting Standards from IASC. It has since then continued to develop standards called as the new standards IFRS.

How the world is converging into IFRS

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 2013 more than 110 countries around the world, including all of Europe, currently require or permit IFRS reporting. Approximately 92 of those countries require IFRS reporting for all domestic listed companies.

IFRS in India

Conversion is much more than a technical accounting issue. IFRS in India may significantly affect a company's day-to-day operations and may even impact the reported profitability of the business itself. Conversion brings a one-time opportunity to comprehensively reassess financial reporting and take 'a clean sheet of paper' approach to financial policies and processes.

It is imperative for companies which have already performed a diagnostic study for IFRS to revisit their diagnostic study, as IFRS itself is a moving target and gets regularly updated. Companies also need to consider that some IFRS may not be applicable when the diagnostic study in process, but their applicability in future may result in material changes to the financials. Understanding IFRS and its implications is a business imperative for Indian companies.

In July 2014, the Finance Minister in his Budget speech proposed the adoption of the new Indian Accounting Standards (Ind AS – the converged IFRS standards) by Indian companies voluntarily from FY 2015-16 and mandatory from FY 2016-17.

In March 2014, the Institute of Chartered Accountants of India (ICAI) submitted to Ministry of Corporate Affairs (MCA) a proposed new IFRS roadmap and convergence plan for India. In the proposed roadmap, the ICAI recommended implementation of Ind AS by select companies only in preparation of their consolidated financial statements.

Plans for converging

The Ministry of Corporate Affairs - a part of the Government of India had in January 2010 announced a multi-phase plan for transition beginning April 1, 2011 to the new Converged Indian Accounting Standards (India's attempt to converge to IFRS, which has carve outs that distinguish it from IFRS and is now known as "Ind AS").

The MCA finalized thirty-five Ind AS in February 2011. While these standards are similar to IFRS in many respects, some exemptions / changes have been made to some of them which may result in significant differences between IFRS and Ind AS for some companies.

Keeping in view these conceptual differences between AS and IFRS, the extent of gap between AS, Ind-AS and the corresponding IFRSs – 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 fully compliant with Ind - AS or IFRS.

IFRS ADOPTION PROCEDURE IN INDIA

To rationalize accounting practices in the country, the Indian government in 1949, established Institute of Chartered Accountants of India by passing ICAI Act, 1949. Accounting Standard Board was constituted by ICAI in 1977 in order to create harmony among the diversified accounting policies and practices in India. Three steps process was laid down by the accounting professionals in India which are summarized as follows:

Step 1 – IFRS Impact Assessment

This is the first step. In this step the firm will assess the impact of IFRS adoption on Accounting and Reporting issues, on procedures and systems, and on core business of the entities. Then the firm will find the key conversion dates according to IFRS training plan has laid down. As and when the training plan is in place, the firm will have to identify the important. Financial Reporting Standards which will apply to the firm and also the variations among the present financial reporting standards being followed by the firm and IFRS both.

Step 2 – Preparations for IFRS Implementation

This is the second step of the process, which will carry out such activities required for IFRS implementation process. Then the firm will reform the internal reporting systems and processes. IFRS first deals with the adoption and implementation of first time adoption process.

Step 3 – Implementation
This is the final step of the process which deals with the actual implementation of IFRS. The initial phase of this step is to prepare an opening Balance Sheet at the date of transition to IFRS. To understand the actual impact of the transition from the Indian Accounting Standards to IFRS is to be developed. This will follow the full application of IFRS as and when it is required. At the initial stage of implementation of IFRS requires lot of training and various technical difficulties may be experienced. The smooth implementation of the transition from Indian Accounting Standards to IFRS, regular training to personals and identify the problems while carrying out the implementation.

BENEFICIARIES OF CONVERGENCE WITH IFRS
The researchers point out several beneficiaries to the convergence of Indian GAAP with IFRS. Some important ones are discussed as below.

1. The Investors. Convergence with IFRS makes accounting information more reliable, relevant, timely and comparable across different legal frameworks and requirements as it would then be prepared using a common set of accounting standards thus facilitating those who want to invest outside India. Convergence with IFRS also develops better understanding of financial statements globally and also develops increased confidence among the investors

2. The Industry. The other important set of beneficiary as the researchers perceive is the industry which in the event of convergence with IFRS will be benefited because of, one, increased confidence in the minds of the foreign investors, two, decreased burden of financial reporting, three, it would simplify the process of preparing the individual and group financial statements, four, it leads to lower cost of preparing the financial statements using different sets of accounting standards.

3. Accounting Professionals. Although there would be initial teething problems, convergence with IFRS would definitely benefit the accounting professionals as the later would then be able to sell their expertise in various parts of the world.

4. The corporate world. Convergence with IFRS would raise the reputation and relationship of the Indian corporate world with the international financial community. Moreover, the corporate houses back in India would be benefited because of one; achievement of higher level of consistency between the internal and external reporting, two, because of better access to international market, three, and convergence with IFRS improves the risk rating and makes the corporate world more competitive globally as their comparability with the international competitor's increases.

5. The Economy. All the discussions made above explains how convergence with IFRS would help industry grow and is advantageous to the corporate houses in the country as this would bring higher level of consistency between the internal and external reporting along with improving the risk rating among the international investors. Moreover the international comparability also improves benefiting the industrial and capital markets in the country.

SOME KEY CHALLENGES TO IMPLEMENTATION
1. Amendments in the Law: IFRS will have a bearing on the legal provisions as are presently set out in the Indian Income Tax Act, Companies Act, etc. After the enactment of the Companies Act, 2013, the ministry of corporate affairs, wants to implement the international financial reporting standards (IFRS) beginning with companies that have a net worth of over Rs 1,000 crore from April 1, 2015.

In the second phase, both listed and unlisted companies with a net worth of over Rs 500 crore but less than Rs 1,000 crore will have to converge with the international accounting standards from the financial year beginning April 1, 2016. Currently, the reporting requirements are governed by various regulators in India and thei provisions override other laws. IFRS does not recognize such overriding laws. The regulatory and legal requirements in India will pose a challenge unless the same is been addressed by respective regulatory.

2. Impact on financial results
Financial reports will experience a lot of changes. For example treatment of depreciation differs. Hence, the value of assets as well the profitability of the organization may swing, which, in turn, may impact the net worth.

3. User awareness, training and Education:
Many people are yet not aware of IFRS, their complexities and impact. A change in the reporting format will require awareness of these new norms and systems, training and education, both for the professional as well the user. There is a need to impart education and training on IFRS and its application.

IFRS had been put on the back burner by the government given issues raised by corporate and unresolved taxation issues. Industry bodies had sought postponement arguing the industry needed more time to prepare.

4. Difference in GAAP and IFRS:
Adoption of IFRS means that the entire set of financial statements will be required to undergo a drastic change. The differences are wide and very deep routed. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.

5. Issue of GAAP Reconciliation:
The Securities Exchange Commission(SEC) laid out two options in its proposal-one calling for the traditional IFRS first-time adoption reconciliation, the other requiring that step plus an on-going unaudited reconciliation of the financial statements from IFRS to U.S. GAAP which is clearly more costly approach for companies and for investors.

6. 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.

7. 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 instability and prejudice 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.

8. Re-negotiation of Contract:
The contracts would have to be re-negotiated which is also a big challenge. This is because the financial results under IFRS are likely to be very different from those under the Indian GAAP.

9. Reporting systems:
Companies would have to ensure that the existing business reporting model is amended to suit the reporting requirements of IFRS. The information systems should be designed to capture new requirements related to fixed assets, segment disclosures, related party transactions, etc.

RECOMMENDATIONS AND CONCLUSION
1. In keeping with international best practices, IFRS under the auspices of IASB should take cognizance of the GAAP of different countries in its subsequent review so that users can benefit globally.
2. IFRS should be included in curriculum at universities, polytechnics and at UG Level so as to build human capacity that will support the preparation of financial statements in organization.
3. A continuous research is in fact needed to harmonize and converge with the international standards through mutual international understanding of corporate objectives.

4. Since tax laws of different nations gives rise to varied tax liabilities, IFRS under the auspices of IASB should also resolve the question of tax liabilities as a result of convergence.
5. In IFRS and other nations reporting requirements, the differences between fair value and carrying value need to resolve in measurement of most financial statements.

Looking at the present scenario of the world economy and the position of India convergence with IFRS can be strongly recommended. But at the same time it can also be said that this transition to IFRS will not be a speedy and effortless process. Implementing IFRS would rather require change in formats of accounts, change in different accounting policies and more extensive disclosure requirements. Therefore all parties concerned with financial reporting also need to share the responsibility of international harmonization and convergence. IFRS has its own advantages and offers a chance for India to align and integrate with common International Accounting standard which will save the cost which has to be incurred by MNCs and internationally listed corporate for maintaining dual accounting and reporting system. It will also provide opportunity for small and mid size industry and institutions to transact with counterparts across the Globe and harvest efficiencies and broader exposure. But to adopt IFRS, especially by small and Midsized Industry would be a challenge in terms of scarcity of expertise and prohibitive cost to change/ upgrade the IT systems. A collective, collaborative and centralized effort for smooth, efficient and effective transition and implementation of IFRS across Government bodies, financial institutions, banking sector, and Corporate, Industry and Educational system is required.

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