



Harmonization in Indian Accounting System

KEYWORDS

Globalization, Harmonization, Accounting development in India, Accounting

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ABSTRACT *Purpose – The purpose of this paper is to examine the recent accounting regulations designed to facilitate international harmonization in India and to show how India developed an accounting system that harmonizes with international standards while preserving macroeconomic control. Design/methodology/approach – This paper is developed using the theoretical framework on globalization. Findings – The recent development of accounting aims to implement India's commitment to harmonize its accounting system with the world. This process has faced some difficulties due to national particularities such as India's economic system and accounting tradition. This paper shows that the regulators have been careful in their approach to develop and find ways to combine or adapt when pushing for accounting development: a co-existence of India accounting standards and a uniform accounting system. Research limitations/implications – The different approach to developing accounting regulation in India reflects the key role of the State in preserving governmental control while harmonizing with international standards. Practical implications – This paper studies the influence of globalization on accounting development in India. It suggests that developing accounting practices in a country in harmony with international standards faces obstacles previously evidenced in the literature, such as economic system and accounting tradition. The study also provides insight into problems encountered by regulators who are incorporating international accounting standards into national accounting regulations. These problems suggest that international accounting standard setters and accounting regulators may face issues similar to those in India. Originality/value – This paper contributes to the literature on international accounting harmonization by illustrating the need for considering national particularities as factors that will affect the rate of harmonization with international accounting standards.*

Introduction

In line with such economic reforms, the Indian accounting system was transformed from a Soviet-style accounting system to one that intends to harmonize with international standards. However, there are still many obstacles that influence the harmonization process and accounting development. The aim of our research is to explore the key role of the State in accounting regulation in India. The State had dual purposes, to preserve governmental control and to harmonize with the international standards. Specifically, we analyze the government's involvement in preserving a uniform accounting system (UAS) while developing accounting standards in harmony with the international standards. This process of convergence was heavily influenced by the Indian state's desire to integrate its economy into the global economy and attract foreign investments. We are going to underline that harmonization with international standards faces obstacles such as economic system and accounting tradition differences, previously discussed in the literature.

Indian Accounting system

Throughout the last few decades of the 20th century there has been significant economic development in many Asian regions, including India. We look at India's accounting system as it is an important developing country with the second-largest population behind China and the fourth largest in terms of purchasing power. (Library of Congress, Federal Research Division, 2004) Although India's accounting system is largely based on the 1956 Companies Act upon independence, there was a paradigm shift in government policies and attitudes towards regulation since the 1991 economic crisis. Since its 1991 economic reforms towards a market-based economy, it has become one of the fastest growing economies in the world. (Economic reform in India, 2006) We would look at India's Accounting system and regulations using the social system model. A social system is defined as systems formulated and implemented by social entities with the objective of fulfilling social functions (McKinnon, 1986). It is expected that factors such as colonization, imperialism, war, economic concerns and international influences are likely factors which play a significant role in stimulating change. (Gray, 1988) Using the social system model, we

look at how the political, economic and cultural aspects of a society bring about the development and changes in its Accounting systems and regulations in India. The diagram demonstrates the India's sub-system and part of accounting system and accounting regulation. Accounting system - Accounting objective: informative, shareholder view mainly - Transparency, but flexible: historical accounting, revaluation, gain/loss of borrowing capitalized to asset, straight-line depreciation, inventory valued at the lower of cost and net realizable value, goodwill - Government accounting: implementation accrual basis. Accounting Standards are the authoritative statements of best accounting practices issued by recognized expert accountancy bodies relating to various aspects of measurements, treatments and disclosures of accounting transactions and events, as related to the codification of Generally Accepted Accounting Principles (GAAP). These are stated to be the norms of accounting policies and practices by way of codes or guidelines to direct as to how the items, which make up the financial statements, should be dealt with in accounts and presented in the annual accounts. In fact, such statements are designed and prescribed to improve and benchmark the quality of financial reporting. They bring about uniformity in financial reporting and ensure consistency and comparability in the data published by enterprises.

Harmonization in Indian accounting system

Harmonization of accounting standards has become a highly demanded issue of discussion and debate among accounting professionals around the globe. The process of harmonization gives the global community a single entity. The diversity of stockholding doesn't matter today if the accounting system can generate general purpose financial statements in real sense. Thus, along with the process of globalization, the awareness of investors in capital markets has increased manifold and the size of investors is multiplying. Foreign institution investors (FIIs) are investing in significant volume globally, as also are several Indian companies through GDRs (Global Depository Receipts) and ADRs (American Depository Receipts). Hence, the need for harmonization of accounting standards has been strongly advocated globally in order to faster the economic decision-

making process. Accounting has already bagged the status of the 'language of the business' that requires reporting of the affairs in a commonly understandable way. It is for this reason that the convergence of accounting standards is so important. The process of convergence is accepted as the key factor to implement a single set of accounting standards across the globe.

Rationales of Harmonization of Accounting Standards

To allow the gains from the global economy to be fully realized, it is argued that accounting policy should be standardized among nations. This "harmonization" of accounting standards will help the world economy in the following ways: by facilitating international transactions and minimizing exchange costs by providing increasingly "perfect" information; by standardizing information to worldwide economic policy-makers; by improving financial markets information; and by improving government accountability. However, some specific points are presented below addressing the rationality of harmonization. A harmonization of accounting policy would help provide a "level playing field" globally. Regulators and auditors will be receiving the same information, facilitating the evaluation process. In the absence of free trade, international accounting standards will allow nations' tariffs, quotas and other trade restraint mechanisms to be more accurate and less risky for those engaged in trade. Investors and managers will be able to make more valuable decisions. World resources will be better managed and allocated.

With the absence of harmonization in accounting standards the additional cost of financial reporting along with the difficulties that multinational groups faces in the manner in which they undertake transactions becomes critical. It is quite possible for a transaction to give rise to a profit under one accounting standard, whereas it may require a deferral under another standard.

Harmonized Accounting Standards: Issues and Challenges

In spite of all, achieving global convergence in accounting standards is not an easy task. There are a number of issues to overcome. First of all, there seems to be a reluctance to adopt the International Accounting Standards Committee (IASC) norms in accounting standards have been developed in different countries under different legal, economic, social and cultural environments. For this reason there exists such diversity in accounting standards among the countries through 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. The IASB standards are oriented to serve the needs of investors and capital markets. Countries that have a different financial reporting philosophy would find it extremely difficult to harmonize their domestic standards with International Financial Reporting Standards.

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. 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. Last, 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 harmonization of their standards with IFRS. There are challenges that IASB and nations adopting IFRS need to address in the coming days. One big challenge for countries adopting IFRS is the shortage of manpower and more particularly, IFRS-trained manpower. For case in point, with just six months to go before China's listed companies adopt IFRS, demand for accountants is rising and could run into millions in the coming years, if the

new standards are rolled out for all of the country's companies and not just the listed ones.

Grounds of Diversity between Indian Accounting Standards and IAS

India is slowly entering into the arena of accounting standards. But the progress of formulation of accounting standards has been very slow as compared with the developments at international levels. However, some of the accounting standards in India conform to the International Accounting Standards. Still there are significant variations between these two. Efforts are on to counterpart Indian accounting standards with the IAS. A study of their variations would be crucial for bridging the gaps (Reddy, 2000). For India, the multiplicity of standard setters leads to delay and lack of direction. The increased complexity of the fair valuation models as prescribed by international standards requires extensive valuation/objective professional judgments, integrity and uniformity of approach, which may not be easily achievable across all countries—particularly in the emerging economies like India.

Many of the initial hurdles in the process of harmonization have been overcome and much progress towards convergence of accounting principles and procedures among countries has already been achieved. Convergence initiatives are now working much more effectively than ever before. Differences are still there but they are narrowing. It is expected that the pace of progress in the sphere of convergence will accelerate further in the coming years. In Indian perspective, it will continue to adopt IASs/IFRSs in the near future with few modifications to cater to the requirements of local climate. Setting IFRS under new regulatory framework is also a notable success in harmonization. IAS permits some alternative practices that has been reduced in IFRS to make the prescription common to all so that following same standards cannot generate varying practices. We expect that this process will ultimately set new benchmark for achieving harmonization in both national and international level.

Conclusion

This paper points to the increasing influence of globalization on accounting regulation in India. The recent accounting developments aim to implement India's commitment to harmonize its accounting system with the world. India established the Indian Accounting Standards (GAAP) which is aligned almost entirely with the standards of the IASB (version 2003). Harmonization is the process by which differences in practices among countries are reduced (Doupnik, 1987). The case of harmonizing accounting practices and principles at the international level is stronger today than it has ever been (McComb, 1982). Even, the IASC itself is concerned with removing unnecessary differences in accounting principles and practice throughout the world (McComb, 1982). Overwhelmingly, the harmonization of accounting practices suffers from a lack of synchronization between the issuance of standards at the national level in different countries and the formulation of standards by the IASC (Rivera, 1989). This process has faced with some difficulties due to the national particularities as such the economic system and culture. International harmonization which preserves national particularities of an accounting system is a not easy task. It will take time, but progressively. Indian accounting regulators gain this experience and learn how to solve problems. Our paper shows that the regulators have been careful in their approach to develop and find ways to combine or adapt when pushing for accounting development: a co-existence of IAS and a UAS. This point differs from the Anglo-Saxon world, but is comparable to China. This different approach to accounting developments reflects the key role of the State in accounting regulation aimed at preserving firm governmental control. This paper also contributes to the literature on international accounting harmonization by illustrating the need for considering national particularities as a factor that affects the rate of transition towards a full implementation of International Accounting Standards.

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