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IFRS – A Global Convergence of Accounting Standards

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ABSTRACT

The move towards international accounting standards is being driven by globalization and the breaking down of national barriers. As the world's capital markets have become more integrated, demand has increased for a uniform standard for financial statement presentation and disclosure. The Framework for the Preparation and Presentation of Financial Statements states basic principles for IFRS. The IASB and FASB Frameworks are in the process of being updated and converged. Great strides have been made by the FASB and the IASB to converge the content of IFRS and U.S. GAAP. There is no reason to change that date or extend the time, While pointing out that standard setting was an evolutionary process even at the level of International Accounting Standards Board (IASB), India will converge with those accounting standards as it prevails at the time of transition. Countries throughout the world increasingly favor the idea of setting up a worldwide single accounting framework. The US Securities and Exchange Commission (SEC) recognizes the importance of moves towards common accounting principles across borders. the Board formally added a project to its active agenda to address some specifically identified differences in the short term. Those two projects are discussed in detail below.

Keywords : Convergence of IFRS, GAAP and IFRS, Convergence Project

❖ Introduction :-

International Financial Reporting Standards (IFRS) are principles-based Standards, Interpretations and the Framework adopted by the International Accounting Standards Board (IASB). The move towards international accounting standards is being driven by globalization and the breaking down of national barriers. As the world's capital markets have become more integrated, demand has increased for a uniform standard for financial statement presentation and disclosure. Advocates for a single, international system of standards say that one set of high-quality accounting standards will improve transparency and support international investor relations. Companies acquiring other companies, and those being acquired, will be comparing apples to apples and speaking the same financial language. Converting to IFRS will present a number of challenges for your company.

❖ IFRS :-

IFRS are considered a "principles based" set of standards in that they establish broad rules as well as dictating specific treatments. The Framework for the Preparation and Presentation of Financial Statements states basic principles for IFRS. The IASB and FASB Frameworks are in the process of being updated and converged. The Joint Conceptual Framework project aims to update and refine the existing concepts to reflect the changes in markets, business practices and the economic environment that have occurred in the two or more decades since the concepts were first developed. Its overall objective is to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally converged. Therefore the IASB and the US FASB (the boards) are undertaking the project jointly.

❖ Assumptions of IFRS :-

The following are the four underlying assumptions in IFRS:

1. Accrual basis: the effect of transactions and other events are recognized when they occur, not as cash is gained or paid.
2. Going concern: an entity will continue for the foreseeable future.
3. Stable measuring unit assumption: financial capital maintenance in nominal monetary units or traditional Historical cost accounting.
4. Units of constant purchasing power: financial capital maintenance in units of constant purchasing power during low inflation and deflation.

❖ GAAP And IFRS, Still Differences :-

Great strides have been made by the FASB and the IASB to converge the content of IFRS and U.S. GAAP.

For example:

- IFRS does not permit Last In First Out (LIFO) as an inventory costing method.
- IFRS uses a single-step method for impairment write-downs rather than the two-step method used in U.S. GAAP, making write-downs more likely.
- IFRS has a different probability threshold and measurement objective for contingencies.
- IFRS does not permit curing debt covenant violations after year-end.
- IFRS guidance regarding revenue recognition is less extensive than GAAP and contains relatively little industry-specific instruction.

❖ Requirements of IFRS :-

IFRS financial statements consist of

- ➢ IFRS financial statements consist of
- ➢ a Statement of Financial Position
- ➢ a Statement of Comprehensive Income or two separate statements comprising an Income Statement and separately a Statement of Comprehensive Income, which reconciles Profit or Loss on the Income statement to total comprehensive income
- ➢ a Statement of Changes in Equity (SOCE)
- ➢ a Cash Flow Statement or Statement of Cash Flows
- ➢ notes, including a summary of the significant accounting policies

❖ Convergence to IFRS by India :-

India will stick to its earlier announced deadline for convergence with the International Financial Reporting Standards

(IFRS) by April 2011, a top Government official has said. “Let me make it very clear that India is a signatory to accept IFRS. By accept, I mean convergence to IFRS by April 2011 and not adoption. We stand by that. There is no reason to change that date or extend the time, While pointing out that standard setting was an evolutionary process even at the level of International Accounting Standards Board (IASB), India will converge with those accounting standards as it prevails at the time of transition. “If certain things are changing at IASB, it does not mean we will immediately jump into this. We are converging and do that on our own suitability,” he said. The entire exercise of convergence would have to be in the interest of the country and also that of the growth of the corporate sector.

❖ **IFRS – Drive for Global Convergence, Status in India :-**
In today’s financial world there are two dominant financial reporting systems – US GAAP (Generally Accepted Accounting Practices), used by a significant part of the global capital market; and International Financial Reporting Standards (IFRS), the system now being used as the benchmark in all European Union countries and many other countries on all five continents. Countries throughout the world increasingly favor the idea of setting up a worldwide single accounting framework. India adopted the Accounting Standards of the Republic of India (ASRA) in 2001 which were based on International Accounting Standards (IAS) in force at that time. Since then IASs underwent significant changes: a number of IAS were revised, and International Financial Reporting Standards (IFRS) were introduced and incorporated with IAS under a common framework known as IFRS.

❖ **IFRS business as usual :-**
Each company published its financial statements using the accounting principles accepted in their respective countries. Prior to IFRS adoption, for analysts, investors and other financial statement users, the interpretation and comparison of financial statements were not easy tasks, not even for companies in the same business sector, to the extent that different accounting practices caused material misstatement in any direct comparison. The first wave of the IFRS adoption, known in Europe as the 2005 movement, enabled the direct comparison of companies' financial statements for the first time, facilitating their interpretation and understanding by the market and paving the way for reductions on the cost of capital and a more efficient allocation of funds.

❖ **FASB Works with IASB toward Global Convergence :-**
This article will explore the strategies, policies and procedures in place at the FASB to facilitate convergence of U.S. standards with those of the IASB, including actions taken by the Board in October to accelerate the process of convergence. Specifically, the Board authorized its staff to conduct a research project to identify and catalog all of the substantive differences between U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), which includes International Accounting Standards (IAS). At the same time, the Board formally added a project to its active agenda to address some specifically identified differences in the short term.

❖ **Short-Term Convergence Project :-**
The scope of the short-term convergence project is limited to those differences in which convergence around a high-quality solution appears achievable in the short-term. Because of the nature of the differences, it is expected that a high-quality solution can usually be achieved by selecting between existing U.S. GAAP and IFRS. The short-term project is being conducted in three distinct parts.

➢ **Part One**
The IASB has been conducting a project to improve the standards issued by its predecessor, the International Accounting Standards Committee (IASC) (the “improvements project”). The first part of the short-term convergence project would seek to reduce or eliminate some of those differences, including:

- ✓ **Classification of liabilities on refinancing:** The IAS improvements project would amend IAS to require that liabilities be classified as current unless the refinancing is complete by the balance sheet date. Under U.S. GAAP, liabilities are classified as non-current if the refinancing is complete by the date of issue of the financial statements.

- ✓ **Classification of liabilities due on demand due to violation of debt covenant:** The IAS improvements project would amend IAS to require that such liabilities be classified as current even if the lender had agreed not to demand repayment prior to the issuance of the financial statements. Under U.S. GAAP, those liabilities would be classified as non-current if the lender had agreed before the issuance of the financial statements not to demand repayment for more than one year from the balance sheet date.

- ✓ **Asset exchanges:** The IAS improvements project would amend IAS to require a gain or loss to be recognized on the exchange of similar productive assets based on the fair value of the exchange. U.S. GAAP prohibits recognition of a gain on the exchange of similar productive assets.

- ✓ **Voluntary change in accounting policies:** The IAS improvements project would amend IAS to require retrospective application of voluntary changes. U.S. GAAP generally requires a cumulative adjustment in the year of change.

➢ **Part Two**
Part two of the project would seek to reduce or eliminate some of those differences, including:

- ✓ **Discontinued operations:** The FASB broadened the definition of discontinued operations in FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. IAS has a more restrictive definition of discontinued operations. In addition, differences in the timing of any remeasurement and in presentation will be considered within the project.

- ✓ **Accounting costs associated with exit or disposal activities:** U.S. GAAP requires accounting costs associated with exit or disposal activities to be recognized when the liability is incurred. IAS is generally consistent with U.S. GAAP, but there are differences relating to recognition of costs when future service is required from employees, recognition of income from sublease agreements and subsequent measurement of the liabilities.

➢ **Part Three**
Part three of the project will address some other differences on which convergence appears achievable in the short-term, including:

- ✓ **Inventories-idle capacity and spoilage:** IAS requires those costs to be excluded from the cost of inventory—U.S. GAAP does not.

- ✓ **Accounting policies and changes in accounting estimates:** U.S. GAAP and IAS differ in classification of certain accounting changes as either changes in accounting policy or changes in estimate.

- ✓ **Income taxes:** Although both U.S. GAAP and IAS use a temporary difference approach to accounting for income taxes, there are a number of differences in the application of that method.

- ✓ **Financial reporting in hyperinflationary economies:** IAS requires restatement into current units while U.S. GAAP requires remeasurement into the parent’s functional currency.

- ✓ **Joint ventures and proportionate consolidation:** U.S.

GAAP and IAS differ in the definition of joint ventures. In addition, IAS permits the use of proportionate consolidation more extensively than it is permitted in the United States, where its use is confined to a few industries.

- ✓ **Interim financial reporting:** IAS requires interim financial statements to be prepared as if they covered a discrete period, with certain exceptions. U.S. GAAP treats the interim period as an integral part of the annual period. The distinction has implications for the recognition of revenues and costs.

- ✓ **Research and development:** U.S. GAAP requires research and development costs to be expensed when incurred. IAS requires a distinction to be made between research and development andrequires development costs to be capitalized under certain circumstances.

❖ **Conclusion :-**

There are many differences that exist today simply because neither Board has comprehensively reconsidered the guidance relating to a particular area of accounting in quite some time. For example, there are differences related to lease accounting, pension accounting and other areas where the guidance in both bases of accounting is somewhat dated. Many of those differences would be eliminated if one or both Boards were to initiate a project to comprehensively reconsider that guidance. The criteria the Board considers when adding a project to its agenda include the potential for convergence, thus, identification of that class of differences between U.S. GAAP and IFRS will provide critical information for the Board to consider when it makes future agenda decisions. The process of monitoring these differences and working with the IASB to reduce or eliminate them will be ongoing for many years.

Finally, there are many differences between U.S. GAAP and IFRS that, while not necessarily important issues for either Board individually, present major challenges to those using, preparing, auditing or regulating cross-border financial reporting. Because these differences relate to areas of accounting that would not be areas of high priority to either Board were it not for the convergence objective, they are not expected to be addressed within the scope of any current or contemplated major project of either Board. Consequently, the FASB and the IASB agreed to add a joint project to each of their agendas with the objective of reducing or eliminating differences of this type.