International Financial Reporting Standards: Need in a Globalized Era

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Abstract

A winning effort begins with preparation," states Super Bowl football coach Joe Gibbs, clearly demonstrating his emphasis on preparation as a precursor to successful action. The accounting industry in the world is currently preparing for an industry changing policy shift that often eludes front-page stories in newspapers and magazines: the replacement of national accounting standards with internationally accepted accounting rules used by other nations throughout the world. Several nations have already adopted these standards, while the United States and others are currently in the process of adopting these standards. While these international standards share conceptual similarities with current national standards, there are specific methodical differences that must be understood by accountants to ensure successful implementation of the new policies. The objective of the present paper is to highlight the significance of IFRS in a globalized world and the need of convergence from National Financial Reporting Standards to modern internationally recognized Financial Reporting Standards. The paper also intends that due to convergence of Indian accounting standards into IFRS will facilitate Indian corporate sector to grow at a higher rate and will help India to become internationally accepted economy.

KEYWORDS: Reporting, Accounting, Convergence, Segments, Consolidated.

Financial statements (also known as statement of financial affairs of an enterprise are important source of communicating financial information to the users. These Financial Statements deal with measurement of economic activities showing inflow and outflow of economic resources, so as to arrive at judgment or conclusion. Financial statements are prepared by every business firm and presented before decision makers for a comparative study regarding operating and financial efficiency of the business. Management of the business firm is basically concerned with resource utilization which shows the operating efficiency whereas the investors and potential investors are interested in return on their investments which highlights the financial efficiency of an enterprise. Financial statements are prepared and presented for showing the financial results, financial position and changes in financial condition. Thereafter, the accounting information, which is communicated through financial statements, is redesigned by the management accountant in such a way which may assist top management of the organization in planning, policy formulation and controlling the business operations for enhancing the profitability of the enterprise.

Moreover in a globalized era, the whole world has become a village due to frequent flow of economic and non-economic information from one part of the world to another. The immediate flow of economic information leads to the migration of companies and potential investors also from one corner of the globe to another for maximum return. Thus, in order to

attract investing and lending from the different parts of world, it requires good and efficient financial reporting system. In place of National Financial Reporting Standards an economy like India urgently needs International Financial Reporting Standards. As the National Financial Reporting Standard present the picture of financial affairs in their own currency and according to their customs, usage, socio, political and legal environment. Through International Financial Reporting Standards (IFRS) a developing economy like India may attract more investments (Debt & Equity both) and a comparative picture of financial statements at International Level may be presented before the users for judging the performance of enterprises.

Financial Reporting is a written document which carries accounting information in a systematic way. It is impartial presentation of facts, which may arise out of available (accounting) data. Thus, financial report is the presentation of financial facts related to state of business affairs including performance, problems, prospects etc. The objective of conveying financial information is to report findings, forward ideas and making recommendations for the future course of action. The financial reports are meaningful in judging the economic and personnel performance of the organization. After analyzing the financial statements reports are submitted at the top level regarding effectiveness of different responsibility centers for forecasting of business activities.

Before analysing and presenting report to the decision makers, the management of the enterprise must be sure that these financial statements have been prepared as per the Financial Reporting Standards (Accounting Standards) or not as laid down by different regulatory bodies. Financial statements are the outcome of accounting concepts and conventions combined with personal judgment. If stock valuation, treatment of deferred revenue expenditure, provisions for depreciation etc. are based on personal judgment may impart misleading information to the readers. As inventory may be valued at cost price or market price, methods of issue may be FIFO or LIFO; desperation may be charged on straight line method or on written down value basis. Consequently, the Profit will differ if different practices are followed. It is necessary that financial statements of different enterprises are prepared on uniform basis and a business concern maintains consistency in preparation of financial statements over a period of time. If every business firm follows its own method and procedure for recording transaction in terms of assets liabilities, income and expenditure etc. it may provide misleading information.

Emergence of Generally Accepted Accounting Principles:

Financial Statements are of vital use, when these are prepared, must have consistency and uniformity. In order to have consistency and uniformity in preparation of financial statements Generally Accepted Accounting Principles (GAAPs) are followed which are issued by regulatory authorities of accounting policies.

The term GAAP is originated in USA, also known as US GAAP. In India it is known as Indian GAAP. The term GAAP is used to describe rules developed for preparation and presentation of financial statements and these rules or principles are known as concepts and conventions. The GAAP rules are also considered as the pillars on which the whole structure of accounting system is based. These rules must be followed and understood by the makers and users of accounting information. Over a longer period of time GAAP was considered as base for reporting financial matters. With the passage of time GAAP does not ensure relevant information to the users, as it allows the use of different alternative methods, policies and

practices for treatment of various aspects of accounting such as valuation of inventory, charging of depreciation etc. whereas in this regard, it is necessary that there should be some guidelines. These guidelines are generally called as accounting policies. The intricacies of accounting policies allowed corporate sector to change their accounting rules for their gain, created the problem of comparative study. This variation created a lot of questions on the validity of GAAP for providing authentic and useful information for decision making. Consequently, GAAP came under several criticisms from different corners. To overcome this situation and to have harmonized accounting policies Accounting Standards came into existence.

Emergence of Indian Accounting standards:

Accounting is the art of recording transaction in the best possible manner, so as to assist to the users to arrive at conclusion regarding working of the organization. Accounting being a man made system; it also requires changes as influenced by needs of the users of financial information and professional bodies like, Institute of Chartered Accountants of India, American Institute of Certified Public Accountants, International Accounting Standards Committee, Financial Accounting Standard Board etc.

In order to overcome the problem of alternative accounting policies faced by GAAP the International Accounting Standards Committee (IASC) and National Standard Setting Bodies all over the world tried to harmonize and standardize accounting policies and practices to be adopted in specific circumstances by developing Accounting Standards (AS) based on conceptual framework of accounting for reporting financial information. The objective of AS is to standardize diverse accounting policies with a view to eliminate to the extent possible non comparability of Financial Statements and present fair, reliable and authentic information to the users.

Keeping in mind the above, the institute of Chartered Accountants of India fully recognized the need of harmonizing the diverse accounting policies and practices, established Accounting Standard Board (ASB) on 21st April 1977. The ASB was assigned the responsibility to formulate Accounting Standards in conformity with the provision of applicable laws, customs, usage and business environment. However, the institute will determine the extent of disclosure to be made in the the financial statements. Disclosure of all significant information is one of the important accounting convention, which implies the all the accounts should be prepared in such a way that all material information is clearly disclosed to the users should not conceal any facts and able to make a free judgment. Accounting Standards are intended to apply only to items which are material in nature and applicable to all classes of business enterprises unless otherwise stated.

According to Government of India, at present there are 32 Indian Accounting Standards as followed by I.C.A.I. 22 Accounting Standards came into existence w.e.f. 01.04.2001 and subsequent Accounting Standards from year starting on or after 01.04.2002. Financial Statements prepared and presented in accordance with the Accounting Standards will impart authentic, reliable and valid information to the users for a comparative study also.

As per the Directory of Bombay Stock Exchange, “Financial statements are prepared for the purpose of presenting a periodical review of report on progress by management and deal with the status of investment in the business and the results achieved during the period under review.

This reflect a combination of recorded facts, accounting conventions applied affect them materially. The soundness of the judgment necessarily depends on the competence and integrity of those who make them and on their adherence to Generally Accepted Accounting Principles and Conventions."

Whereas According to T. P. Ghosh "accounting standards are the policy document issued by the recognized expert accountancy body relating to various aspects of measurement, treatment and disclosure of accounting transactions and events."

Emergence of International Financial Reporting Standards (IFRS)

Globalization and implementation of policy of liberalisaton in India also compelled the corporate sector to have global information accounting standards. In a globalised era difference in accounting information makes financial reports less understandable to the users and a comparative study becomes a difficult task for investing decisions whereas, good financial reporting system creates effectiveness in investing and lending activities. Before the commencement of era of globalization, which started around 1975, national accounting standards were quite sufficient, as the investors and companies were within their home countries. Due to globalization, investors have the opportunity to invest their funds all over the world to get a higher return alternatively, the business enterprises also search for capital at the lowest cost, which may be available any where in the globe.

However, due to globalization high quality global standards are required for financial reporting which will be beneficial to capital provider and companies both. From investors point of view, if presentation of financial information is easily understandable nationally and internationally, will facilitate comparative study for decision making. From companies point of view, it will reduce compliance costs, remove uncertainties that affect their cost of capital, it will improve quality of education, training and development and audit through creation of software programmes if applied cautiously.

Before the emergence of IFRS, financial reporting standards were set by the individual countries in the light of International Accounting Standards by the respective professional accounting bodies. However, in the year 1973, the need of global accounting was felt by many countries and accounting standard setters in nine countries jointly created the International Accounting Standard Committee (IASC) provided 41 International Accounting Standards. In the year 2001, the IASC was reorganized and named International Accounting Standard Board (IASB). Till date the IASB has produced 13 International Financial Reporting Standards inherited by International Accounting Standards. Before 2001 the financial reporting standards which were known as International Accounting Standards, after 2001 these are known as IFRS.

The objectives of IFRS is to have a single set of high quality understandable, enforceable and globally acceptable financial reporting standards based upon clearly articulated principles which should be in the best interest of public. By the year 2010, IFRS's had been adopted by 120 countries all over the world. European Union was the first for the adoption of IFRSs, making use of IFRS compulsory in the consolidated financial statements of listed companies in 2005. And all the major economies of the world have established time lines to converge with or adopt IFRS in near future. The International convergence efforts are also supported by the Group of 20 (G-20) who at their meeting at Pittsburg, USA in Sept. 2009, called on International

Accounting Bodies to work fast and complete this convergence task by June 2011. However, the council of I.C.A.I at its meeting held in July 2007 decided to fully convergence with IFRS issued by International Accounting Standards Board from the accounting year on or after April 1st 2011, like other countries as Australia, E. U., Malaysia, Hong Kong, Russia, Turkey etc. After full conversion with IFRS by India, the number is expected to reach 150 by the end of 2011.

Indian Scenario about Convergence into IFRS:

On January 22, 2010, the Ministry of Corporate affairs issued the road map for transition to IFRS. Thereafter, the Institute of Chartered Accountants of India also announced that IFRS will be mandatory in India for financial statements from 1st April 2011. The same date was announced by the R.B.I. for preparing and presenting the financial statements of banks. Despite the time line issued by the ICAI & RBI, India has deferred transition to IFRS by 2012.

Phase wise applicability for different companies in India was also stated by the ICAI viz., **In the first phase,** companies included in NSE Nifty 50 or BSE Sensex 30 and companies whose securities are listed on Stock Exchange outside India and other Companies having networth of Rs. 1000 crores or more will prepare and present financial statements using Indian Accounting Standards converged with IFRS form April 1, 2011. **In the second phase** , whether listed or not, having net worth of more than Rs. 500 crores will convert their opening balance sheet as at April 1, 2013. **Thereafter in the third phase**, listed entities having the net worth of Rs. 500 crores or less will convert their opening balance as at April 1, 2014. Unlisted Companies having net worth of Rs. 500 crore or less and small and medium sized companies will continue to apply existing accounting standards, which may be modified time to time. From applicability point of view transition to IFRS in phased manner is a good move.

Despite the time line issued by the ICAI, Indian regulators did not implement the new International Financial Reporting Standards from April 1st 2011. It shows the lack of preparedness, whereas India has excellent talent in the field of accounting, but could not prepare for transition to IFRS over last four years. The deferment of the transition may make many Indian companies happy, but it will undermine the position of India.

Deferral may be inevitable due to lack of regulatory issues on corporate laws, taxation and differences on certain issues between Indian Accounting Standards and IFRS (like merger and acquisition, financial instruments such as derivatives, environmental issue such as carbon credit, rules related to depreciation and foreign exchange transaction etc.). The Indian regulators should provide clear cut road map for its implementation. The transition to IFRS will assure international investors that India is fully committed for convergence.

Indian Accounting Standards may deviate on certain issues from IFRS; still there are similarities in many ways like:

I) As per IFRS, Financial information should possess certain characteristics for it to be useful. The IASB framework requires financial information to be understandable, relevant, reliable and comparable.
As per Indian GAAP, Accounting frame work sets out characteristics similar to IFRS

II) As per IFRS, there are five reporting elements: assets, liabilities, equity, income (includes revenues and gains) and expenses (includes losses)

As per Indian GAAP, reporting elements and the definition and recognition criteria are similar to IFRS

III) As per IFRS, Historical cost is the man accounting convention, However, IFRS permits the revaluation of intangible assets, property, plant and equipment (PPE) and investment property. IFRS also requires certain categories of financial instruments and certain biological assets to be reported at fair value.
As per Indian GAAP, Historical Cost is the main accounting convention, However Indian GAAP permits the revaluation of property, plant and equipment (PPE) but, there is no requirement on frequency of revaluation, certain derivatives are carried at fair value.

IV) As per IFRS, for Inventories FIFO method is followed.
As per Indian GAAP, same method to IFRS is followed.

V) As per IFRS, two years consolidated Balance Sheet, Income Statement Cash Flow Statement, changes in equity and accounting policies and notes.
As per GAAP, same components of financial statements for single entity parent company (standalone), for public listed company, additionally to prepare consolidated Financial Statements along with the standalone Financial Statements.

VI) As per IFRS, Does not prescribe a particular format of Balance Sheet. A Current and Non-Current presentation of assets and liabilities is used.
As per GAAP, No particular format of Balance Sheet as per AS, formats are prescribed by the Companies Act 1956.

VII) As per IFRS, does not prescribe a standard format for income statement although expenditure is presented in one of two formats (Function or Nature)
As per GAAP, does not prescribe a format, but certain income & expenditure items are shown in accordance with AS and the companies Act.

VIII) As per IFRS, regarding Cash Flow Statement uses standard headings, but limited guidance on contents use direct or indirect method.
As per GAAP, Similar to IFRS, Indirect method is required for listed companies and direct method for insurance companies.

There may be certain deviations and similarities in IFRS with Indian GAAP and AS, but to provide full benefit of convergence, Indian regulators should make such deviations optional. Indian companies may be given a facility, either to follow policies compliant with IFRS or alternate policies provided under Indian Accounting Standards.

Concluding Observations

In the light of present scenario it is clear that the IFRS will play an increasing role in the global business community. As, there are around 10,000 Indian Companies including banks and financial institutions, it was hoped that these will transit to IFRS by April 1st 2011, which is still awaiting. Few Indian Companies already present their accounts as per US GAAP, because they are listed on American Exchange. Indian Accounting Professionals, Capital Market and businessmen fully support the convergence with IFRS. But, when the transition will take place is answerable? With the Convergence, IFRS will become the language of communicating the financial results of Indian Companies also and the Financial Statement will report a true, reliable

and fair view of the business, which may be used by different segments of society globally. It is generally hoped that IFRS adoption worldwide will be beneficial to investors and other users of Financial Statements by reducing the cost of compliance, alternative investments and increasing the quality of information. Companies are also expected to benefit, as investors will be more willing to provide financing. The ICAI has announced the full conversion of Indian Accounting Standards with IFRS in the same form as issued by the International Accounting Standards. Board (AISB).

Over 120 countries have already transmitted to IFRS. It is still too early to tell, whether non-profit making organization, private companies and governmental enterprises will eventually adopt IFRS. Convergence with IFRS has strategic implications and will require harmonization of internal and external reporting. Managing inventors and market expectations will also be of paramount importance for the management and would form a critical component of the convergence process. The implications of adoption of IFRS must also be considered like the cost of adoption, which will derive benefits and how it will be exercised. What will be the radical institutional changes, which may be taken into account for successful and meaningful implementation? Full Conversion into IFRS may lead to public policy implications followed by impact on accounting System, Company Laws and Corporate Governance. However, In order to be global economy, India should also follow the policy of convergence into IFRS at the earliest.

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