Need and Challenges in the Adoption of International Financial Reporting Standards in India

Neetu Purohit, Research Scholar, Department of Commerce, HNB Garhwal University, Srinagar Garhwal, Uttarakhand

Dr. A.K. Tiwari, Associate Professor, Faculty of Commerce, Govt. P.G. College, Vikasnagar, Dehradun

ABSTRACT

Globalization and liberalization has led to the entire world becoming an economic village where it is expected that any company is not only free to do business anywhere but also willing to do the business. India has also in the past in the year 1992 reformed its industrial policy so as to invite foreign companies to do business in India and more so under the present ruling government all steps are being taken aggressively so as to create much better conducive environment for the foreign companies to operate in India. But then it is easier said than done as many times it is seen that every country has their own rules and regulations to govern their countries along with the companies that operate therein. And so to make the world truly an economic village there should be uniformity in the rules and regulations governing the companies even if there may be some differences as far as governing the countries are concerned. This has led to many countries adopting common rules and regulations. India is not far behind and the significant changes are the adoption of common set of principles of accounting commonly known as Generally Accepted Accounting Practices (GAAP) which is known as International Financial Reporting Standards (IFRS) and the other significant change is of the adoption of Goods and Service Tax (GST). Through this research an attempt is made to identify the needs as to what led the adoption of IFRS and the succeeding challenges in adoption of the same.

Keywords

Globalization, Adoption, Challenges, IFRS

INTRODUCTION

The entire world economy is changing very fast in terms of businesses spreading their wings in many countries. The developed businesses are looking for developing economies for expanding their businesses and the developing ones are looking up to developed economies to bring businesses into their economy and give a momentum to their growth. But for all this to happen smoothly there has to be the ease of doing business meaning that the economy should be such that it not only makes it convenient to do business with some common and simple rules and regulations so as not only have growth but sustainable growth. For this there is a growing need for the changed reforms and rules. The various aspects that can be looked into for creating this ease of business can be the government policies, taxation laws, legal aspects, accounting systems, money market, capital market and not to forget the cultural aspects. In the Indian context we see many changes happening in the new government policies, revised taxation laws in the form of passing of the Goods and Service Tax (GST) and the convergence of the existing accounting standards with the International Financial Reporting Standards (IFRS) in the form of new IndAS being released by Institute of Chartered Accountants of India (ICAI) which is the governing body responsible for setting the accounting standards. Accounting systems, which include accounting concepts, reporting practices and principles reflect the culture, philosophy, goals, and objectives of their different users. A good financial reporting system supported by strong governance, high quality standards and firm regulatory framework is the key to economic development. Sound financial reporting statements based on sound accounting standards underline the trust that investors and other interested parties place in financial reporting information. And so it plays an important role in the economic development of the country. A number of multi-national companies are establishing their businesses in various countries with emerging economies which is creating need to have simple common rules to carry business with ease. This would also result in a growing need for the entities to fulfill their capital requirements from the global markets outside their own country. So everything needs to be integrated so as to bring the ease of business and the benefits that flow with it to the economies both developed and underdeveloped in their own ways.

Sound financial reporting structure is imperative for economic well-being and effective functioning of capital markets. Economic globalization has created the demand for shared common set of international accounting principles, standards, and practices. The use of different accounting frameworks in different countries, with inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion creates many restrictions on the companies on raising funds from the capital markets and also while making investments across the world leading to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalisation of capital markets call for a single set of high quality accounting standards. This has led to many countries joining hands for implementing one common set of standards called as International Financial Reporting Standards (IFRS) being adopted all over the world. The various stakeholders of international accounting viz, shareholders, government, lenders, investors, corporations etc require reliable and accurate data and information for many decisions required to be taken. Better the standards followed, more the reliance that can be placed on the financial data and the reports.

Increased international financial activity necessitates the alignment and harmonization of national accounting practices. In the twenty-first century, the main trend in international accounting is harmonization and uniformity in the accounting systems and practices. The harmonization of accounting concepts, reporting practices, and principles will allow for a level field of economic competition for all nations and would also lend comparability to the financial statements and the information which has till date been missing. Many countries across the world has either converted their reporting either on the parameters of IFRS or are on the path to transition to IFRS in the near future. India is also not far behind and ICAI the governing body has already released the new accounting standards known as IndAS which are converged with the IFRS though there are minor exceptions keeping with the systems as prevalent now but for the future it is hoped that there would be left no differences and the compliance with IFRS would be hundred percent i.e. only IFRS will prevail. But this is just one part of the transition the bigger challenge lies in the implementation part where companies would have to face some complexities as there are many criticalities and challenges while adopting the new accounting standards.

REVIEW OF LITERATURE

An attempt has been made to review and present some of the research studies relating to IFRS need and challenges in the adoption of IFRS in various countries across the globe.

Denis Posten. (2008) studied the IT costs associated with the adoption and implementation of the IFRS and concluded that adoption of IFRS would lead to increased cost of IT due to new set of requirements for data and new IT processes and also the personnel required to handle such systems.

Leuz and Verrecchia (2000) has discussed how the voluntary adoption of IFRS may not bring out the desired impact as the reporting may still not be transparent and companies may not disclose the true and fair information and this would render the information again as not being comparable and reliable. But incase of mandatory adoption of IFRS the companies may be forced to disclose their true and fair information and so may bring out the desired impact.

Larson and Street (2004) identified the various challenges associated in the implementation and adoption of IFRS such as complexity of standards, lack of understanding and instructions, inconsistencies between financial reporting and taxation, lack of complete clarity in the interpretation of the reporting standards and also lack of the proper training and change of mindset of the finance department employees engaged in such transition and implementation.

Guan, Hope, and Kang (2006) examined the differences in reporting for the companies that voluntarily adopted IFRS and the companies that are forced to adopt the same as the past research finds out that the decision to voluntarily adopt IFRS reporting is only one element of a broader strategy that increases a firm’s overall commitment to transparency.

Bielstein et al. (2007) suggests that if that mandatory IFRS adoption results in a greater increase in foreign investment for firms in countries with strong implementation credibility and an increase in comparability.

Roberts and Sian (2008) examined the fact that whether the proposed IFRS for Small and Medium-sized Entities (SMEs), developed by the International Accounting Standards Board (IASB), is suitable for micro-entity financial reporting

Daske et al.(2008) examined the impact of the IFRS on the on the market liquidity and finds out that the market liquidity increased with the introduction of IFRS but the benefits were more pronounced for the organizations that voluntarily adopted IFRS and where the firms have incentives to be transparent in an environment of mandatory IFRS adoption.

Holger Daske, Luzi Hail, Christian Leuz and Rodrigo Verdi (2009) studied the impact on the firms in various countries to see the impact of the IFRS adoption on the firms which mandatorily adopted IFRS and the ones which voluntarily adopted IFRS. They found that mandatory adoption of IFRS resulted into lot of positive impacts as it increased the transparency, stock market value, increased market liquidity and resulted in lower cost of capital. The results were better for the mandatory adoption due to strict regulatory environment as incase of voluntary adoption there were other non IFRS factors which resulted in enhanced value of the firms.

Christopher Wright and Stevan Hobbs (2010) discusses that IFRS adoption would reduce the existing complexities, increase transparency and would lead to better external and internal management reporting as transactions need to be reported on the basis of substance rather than the need to report under complex reporting structures as IFRS is principle based accounting over rule based accounting.

Ahmed, Neel, and Wang (2010) examined that the adoption of IFRS would increase managerial flexibility and discretion as there are no clear rules for may aspects of accounting rather broad principles which would give managers flexibility to draw their own interpretations.

Kathryn Winney, Daniel Marshall, Blaise Bender and John Swiger (2010) examined the roadmap for the implementation of IFRS on US companies and highlighted several blocks for the successful transition from USGAAP to IFRS by conducting a survey of industry executives, CEOs, accounting professionals and people from academia. They identified five convergence and adoption roadblocks and questioned the roadmap for adoption by Securities Exchange Commission (SEC).

Ibarra & Suez-Sales (2011) studies the compliance of selected Asian countries such as China, India, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Thailand and Vietnam with the IFRS as of 2009-10 by taking only small and medium sized enterprises since SME have the peculiarity of not being in the public domain.

Capkun et al.(2011) examines the impact of the accounting changes offered by IFRS during the 2005 mandatory adoption of IFRS in the European Union. It was observed that firms with large positive (negative) earnings under Local GAAP were more likely to report negative (positive) Local GAAP-to-IFRS earnings reconciliations when prepared. Subsequently, in reporting periods following the adoption of IFRS, firms that reported positive (negative) reconciliations were more likely to show a decrease (an increase) in earnings. There was however no evidence of stock markets reacting to earnings management under the IFRS transition, but find strong evidence in support of CEOs managing earnings reconciliations to increase their compensation.

Srivastava & Bhutani (2012) studied the extent to which IFRS has been adopted by the organizations, the challenges and opportunities the companies are facing especially the lack of understanding on the content of the accounting standards by the personnel.

Kapoor & Ruhela (2013) examined the various issues and challenges in adoption and implementation of IFRS in India. Some of the issues highlighted included lack of awareness and complete clarity on the standards, complex regulatory framework and multiple reporting which would create new risk for the organization.

Shuang Wu & Xiying Zhang (2014) highlighted the sensitivity of credit ratings to accounting information adding that mandatory adoption of International Financial Reporting Standards is associated with greater sensitivity of credit ratings with accounting information than as compared to voluntary adoption of IFRS.

OBJECTIVE OF THE STUDY

The first objective of the study is to understand the need for the adoption of IFRS in India and the second objective is to identify the challenges in the adoption of IFRS in India.

RESEARCH METHODOLOGY

The study has been done by administering the qualitative questionnaire on the senior management employees having experience in IFRS reporting. The objective of the study is to evaluate the need of adopting IFRS in India and the challenges faced by top level management during implementation. Analysis of the data obtained from 42 respondents towards the research questions on the adoption of IFRS in accounting practices in India and its implementation focusing on the need and challenges has been done before arriving at the conclusions.

NEED OF IFRS IN ORGANIZATIONS

Previous studies have revealed that there is a need of uniform standards for handling financial matters at a global level, to improve clarity and comparability. Respondents in the present study have also answered in a same manner when asked about the need of IFRS in their organizations. When asked about the financial reporting, around 44 percent of the respondents stated that one major reason for the need for IFRS is the uniformity and the comparability of the financial statements as respondent A pointed out that, 'due to investment purposes in other countries, a single set of standards should be there so that there is comparability and uniformity in the financial statements that are prepared by organizations. Many others also gave the reason of uniformity and comparability as one major need for going in favour of IFRS. As with countries across the world going in favour of globalization and the need to function in many countries, felt the need for set of books in accounting and the financial reports coming out it to be uniform and comparable so that the analysis and performance can be analysed easily. Some also pointed out that if the statements are comparable and uniform it be easier for companies looking for funding from abroad or companies looking to invest their funds abroad, while if the statements are based on different set of standards then there would be no ease for such companies both for funding and investment requirements.

Around 29 percent of the respondents stated that IFRS is needed as it would lead to improvement in financial reports with the standards being in conformity with the international requirement for global standards suitable for countries all over the world. As IFRS is designed by the accounting and finance experts from various countries, the reporting would be in sync with the global requirements. And around 12 percent people were of the opinion that there would be transparency in reporting as when there are same accounting standards then there would be greater transparency as financial reporting would be on one set of common standards and so companies would be encouraged to make full disclosures leading to greater transparency. But the percentage of people who felt there would be greater transparency as Mr. X stated that since IFRS is principle based accounting unlike rule based accounting, this would give management enough scope to manipulate the books as there would be greater flexibility under principle based accounting. Around 15 percent of the respondents believed that adopting IFRS will lead to reducing the costs as complex accounting procedures in case of multinational companies which requires different set of books to be maintained as per the different accounting norms applicable for different countries and then finally consolidating as per the rules of accounting applicable for the home country of the company, would help in curtailing some of the costs in such complex accounting. Respondents reported that IFRS need arises since uniform accounting practices leads to better economic decision through better management of the cost of capital, better distribution & allocation of resources leading to overall better decisions for the company in terms of investment and funding.

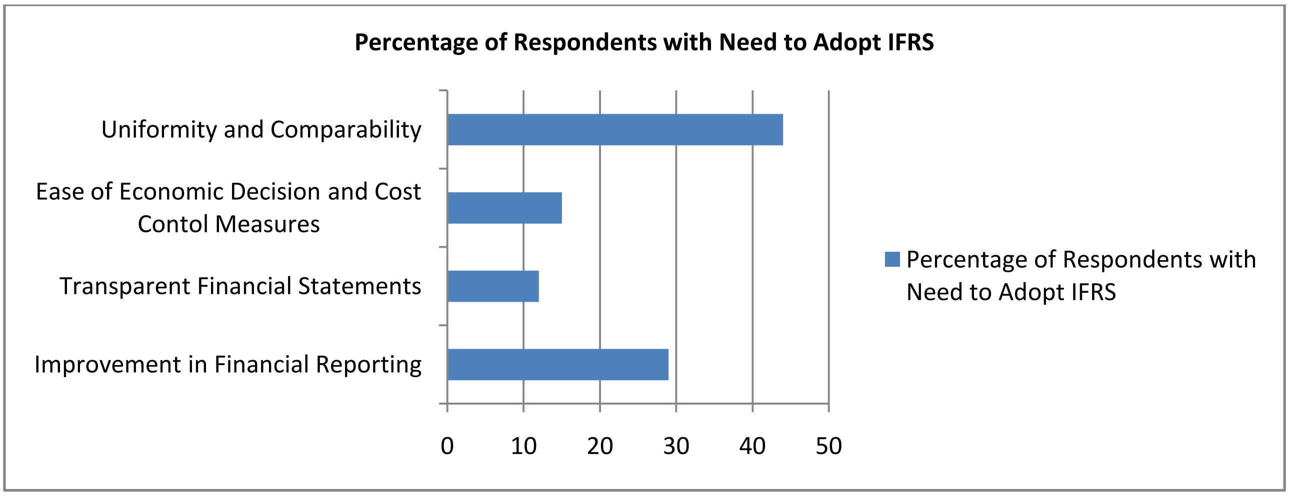

Table 1: Percentage of Respondents with Need to Adopt IFRS

CHALLENGES IN ADOPTION OF IFRS

The various challenges that came out while interviewing the respondents were lack of proper education and training of the accounting personnel, overlapping and complex regulatory norms which requires overhauling of laws and regulations, increase in the impairment cost, difficulty in assessment of the fair value, increase in cost for the compliance, change in the IT systems and other non specified challenges which the respondents felt would be clear once it's been some time into the implementation of IFRS.

Very few respondents agreed that they have any incentive in terms of encouragement of adoption of IFRS from decision makers. The biggest challenge highlighted was lack of training and education for employees as 28 percent respondents stated there was not only the lack of trained professionals being available but also there was no proper training being available for understanding the new standards. The next biggest challenge was overhauling of laws and regulations as 20 percent of the respondents stated that to comply with the new standards there is a strong need to revise the Income Tax Laws, SEBI, Companies Act so that there is no contraction when complying with IFRS for example many times it is observed that when there is change in accounting standards and accordingly change in the profits then there is no clarity as to how certain tax treatments would be done. Around 18 percent of the respondents stated that determining fair value of assets and liabilities would be very difficult as is always the case when deciding the fair value which is very dynamic in nature and can have different values. Around 16 percent of the respondents feel that the biggest challenge would be the increased cost of implementing the IFRS as there would be need for scarce finance professionals who would have knowledge of IFRS, increased costs for the training of employees, increased audit fees and other increased costs. Around 12 percent of the respondents feel that there would be major change in the IT systems as there would be new requirements such as change in the triggering of the systems for booking sales, expenses and so on. Around 6 percent of the respondents feel that there can be several other challenges such as difficulty in documentation, difficulty in comprehension of the accounting standards as one standard may lead to several interpretations and the problem of the statements not lending itself to comparability may exist.

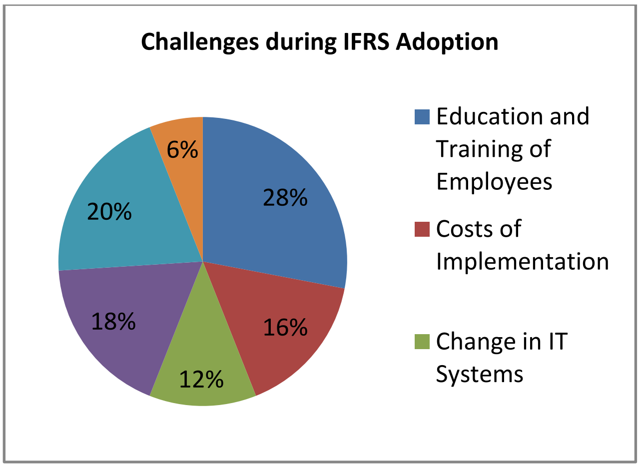

Table 2: Challenges in Adoption of IFRS

Also, most of the respondents agreed that complex structure of this accounting norm is difficult to implement in a big business but easy in small businesses. As far as IT and software systems are concerned it was felt by many respondents that there would be a need for extensive changes in the IT systems. Further, the concept of fair value measurements in IFRS as contraction of the historical cost concept in Indian GAAP, has resulted in changes in accounting procedures and reporting. Few also responded that bringing integrity and fairness in the reporting of the statements internationally and nationally could have its own challenges as integrity compliance usually handled by top management, auditors and regulators in any country.

CONCLUSION

In keeping with the various needs for implementation of IFRS most important need being harmonization of reporting, lending comparability and convenience to MNCs, India has converged its own accounting standards into IFRS with new accounting standards being known as Ind AS. There has also been given deadlines to the companies to converge its reporting in lines with IFRS in phases starting from April 2016. Though the transition is not going to be a smooth process as will be several challenges before India becomes fully compliant with IFRS. There are several challenges on one hand with respect to knowledge dissemination both to the preparers of financial statements to the users of financial statement and the immense benefits on the other hand for the companies, investors, government, regulators, capital market and many other areas of business and business environment. The major challenge though in implementing is that people, both users and preparers of financial statements need to understand the principles, similarities and differences under the converged standards and how the same would impact the reporting to reap the benefits of one common international set of standards applicable all over the world. The challenge is to train and equip adequate professional and accounting personnel who will be involved in the preparation of the financial reporting and limited training needs should also be addressed for the users of such financial statements. But with time as the challenges as to the shortage of trained personnel, increased IT costs, compliance issues and cost of implementation is taken care of, there would be immense benefits to the companies in complying with IFRS. However challenge as to the changes required in the laws and regulations is something which only time will tell whether consistencies is also brought into such rules and regulations as this depends not on the micro factors but on macro factors which are outside the control of the companies and businesses. In the end it can be concluded by saying that the benefits of IFRS would propel the companies and the country to overcome the challenges in being fully compliant with IFRS.

Limitations

1. For study senior management, 42 respondents were interviewed to understand the impact of IFRS standards on the organization, so findings based on a small sample size may not represent the impact on all companies in the country.
2. Auditors and finance consultants were not interviewed in this study which could have presented some other different finding.
3. Also the viewpoints of investors and other stakeholders were not considered for the study.

REFERENCES

[1] Armstrong, C., Barth, M.B., Jagolinzer, A. & Riedl, E.J. (2006). Market Reaction to Events Surrounding the Adoption of IFRS in Europe. European Accounting Review, Forthcoming

[2] Barth, M.E., Armstrong, C., Jagolinzer, A.D. & Reidl, E.J. (2008). Market Reaction to the Adoption of IFRS in Europe (working paper Series of SSRN)

[3] Borker, D. R. (2012. Accounting, Culture, and Emerging Economies: IFRS In The BRIC

[4] Countries. Journal of Business & Economics Research, Vol. 12.

[5] Daske, H., Hail, L., Leuz, C. & Verdi, R. (2008). Mandatory IFRS Reporting around the World: Early Evidence on the Economic Consequences. Journal of Accounting Research, 2008, 46(5), pp. 1085-142.

[6] Daske, H. (2006). Economic Benefits of Adopting IFRS or USGAAP - Has the Expected Cost of Equity Capital Really Decreased Economic Benefits of Adopting IFRS or USGAAP, Chicago GSB Research Paper No. 12, ECGI - Finance Working Paper No. 198/2006

[7] De Franco, G., Kothari, S. P. & Verdi, R. S. (2011). The benefits of financial statement comparability, Journal of Accounting Research, 49 (4), 895–531.

[8] Epstein., B.J. (2009). The Economic Effects of IFRS Adoption. The CPA Journal. New York: Vol. 79, Issue. 3; pg. 26, 6 pgs

[9] Enriques, L. & Volpin, P. (2007). Corporate governance reforms in continental Europe. Journal of Economic Perspectives, 21, 117–140

[10] Itatridis, G. (2010). IFRS Adoption and Financial Statement Effects: The UK Case‖, International Research Journal of Finance and Economics, 38, pp. 165-172

[11] Kapoor. B. & Ruhela, J. (2013). IFRS Implementation: Issues and Challenges for India. VSRD International Journal of Business and Management Research, Vol 3(2), pp 2319-2194

[12] Mohammad, C. M., Aziz, A. & Kahkashan, A. (2011). IFRS – Impact on

[13] Indian Banking Industry. International Journal of Business and Management, 6(3),

[14] 277-283

[15] Posten, P. (2008). A big deal? CA Magazine. Toronto. Vol. 141, Issue. 7; pg. 57, 4 pgs

[16] Pounder, B. (2008). Institute of Management Accountants' Inside Talk Webinar Series: What U.S. accountants should know about IFRS

[17] Ray, D. (2012). Applicability of International Financial Reporting Standards in India:

[18] Some Key Issues and Challenges. Journal of Expert Systems, 15

[19] Srivastava, A. & Bhutani, P. (2012). IFRS in India: Challenges and Opportunities. IUP Journal of Accounting Research & Audit Practices, Vol. XI, No. 2, pp. 6-32

[20] Vander Tas, L. (1988). Measuring harmonization of financial reporting practice. Accounting and Business Research, 18, 157–169.

[21] Wang, H.S. & Welker, M. (2011). Analyst following and forecast accuracy after mandated IFRS adoptions. Journal of Accounting Research (December): 1305-1357

[22] www.icai.org

[23] www.ifrs.org

[24] www.sebi.gov.in

[25] www.economictimes.com