Global Convergence with International Financial Reporting Standards (IFRS)

CA.Seema Gupta*

The emergence of transnational corporations in search of money, not only for stimulating growth, but to maintain on-going activities has demanded flow of capital from all parts of the globe. This has brought millions of new investors into the capital markets whose interests are not constrained by national boundaries.

Each country has its own set of rules, regulations and reporting standards. When an entity decides to raise capital from the markets other than the country in which it is located, the rules and regulations of that other country will apply. This will require that the enterprise is in a position to understand the differences between the rules governing financial reporting in the foreign country as compared to its own country. Translations and re-instatements of financial statements are of extreme importance in a rapidly globalizing world.

International Financial Reporting Standards (IFRS) - Background

The task of facilitating the movement towards increased comparability and harmonization world-wide was taken by International Accounting Standards Committee (IASC) [presently known as International Accounting Standards Board (IASB)], an independent body that was formed in 1973 by the professional accounting bodies in the United States and eight other industrialized countries. The goal of the IASC Foundation and the IASB is to develop, in the public interest, a single set of high-quality global accounting standards. In pursuit of this goal, the IASB works in close cooperation with stakeholders around the world, including investors, national standard-setters, regulators, auditors, intellectuals and others who have an interest in the development of global standards. Between 1973 and 2001, the International Accounting Standards Committee (IASC) released International Accounting Standards. The IASC restructured its organization in years 1997 to 1999, which resulted in the formation of IASB. Subsequently, IASB published its Standards in a new series of pronouncements called International Financial Reporting Standards (IFRS).

Why Global Convergence with IFRS?

In general terms, 'convergence' means to achieve harmony in relation to IFRS; in precise terms, convergence can be considered "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRS".

International analysts and investors would like to compare financial statements based on similar accounting standards, and this has led to the growing support for an internationally accepted set of accounting standards for cross-border filings. A strong need was felt by legislation to bring about uniformity, comparability, transparency and adaptability in financial statements. Having multiplicity of accounting standards around the world is against the public interest. It creates confusion, encourages error and facilitates fraud. The cure for these ills is to have a single set of high quality global standards. The goal of the IFRS is to create single set of accounting standards that can be applied anywhere in the world, allowing investors to compare the performance of business entities across geographic boundaries.

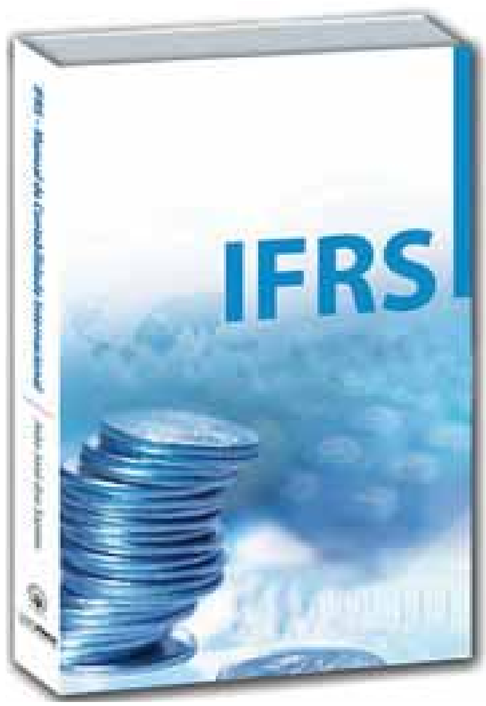
The harmonization of financial reporting around the world will help to raise confidence of investors in the information they are using to make their financial decisions. If accounting for

*The author is Asst.Director, ICAI

the same events and information produces divergent reported financial statements due to adoption of different set of accounting standards, then it is self-evident that accounting will be increasingly discredited in the eyes of users of the financial statements. Also for the companies with multiple listings in both domestic and foreign country, the convergence is very much essential.

Challenges in the way of Global Convergence

IFRS poses a great challenge to the drafters of financial statements and auditors. There is an urgent need to understand the complexities in IFRS implementation. Cultural, legal, and political obstacles may exist in the convergence path. With the assistance of the appropriate authorities, these intricacies can be minimized. Legislators, regulators, and standard-setting bodies need to be aware of the technical faults in the current convergence process and, where appropriate, they should take action to ensure reasonable progress. Reconciliation and restatement of financial statements is costly, not only in monetary terms but also in terms of resources. There are disagreements in some countries with the requirements of certain specific IFRS. The complicated nature of some IFRS is perceived as a barrier to convergence in many countries. All entities will have to consider



their own roadmap and gear up for complying with IFRS differences. Convergence to IFRS will be quite challenging and entities should ensure that their convergence plans are designed in a phased manner.

IFRS adopted as Global Standards

The use of IFRS as a universal financial reporting language is gaining momentum across the world. Every major nation is moving towards adopting IFRS to some extent. Large number of authorities requires public companies to use IFRS for stock-exchange listing purposes, and in addition, banks, insurance companies and stock exchanges may use them for their statutorily required reports. Therefore, over the next few years, thousands of companies will adopt the international standards. The increased use of IFRS is not limited to public-company listing requirements or statutory reporting. Many regulatory and government bodies are looking to IFRS to fulfill local financial reporting obligations related to financing or licensing.

IFRS are used in many parts of the world, including the European Union, Australia, South Africa and Russia. More than 100 countries have required or permitted the use of IFRS since 2001 and the number is expected to increase to 150 by 2011. The Group of 20 leader countries (G20) reaffirmed their commitment to global convergence in accounting standards in September 2009 in a meeting held at Pittsburgh (United States), calling on 'international accounting bodies to redouble their efforts to achieve a single set of high-quality, global accounting standards within the context of their independent standard-setting process, and complete their convergence project by June 2011'. Some of the major countries that are seeking to converge with IFRS by 2011 include Canada, Korea, India and Brazil.

Indian Scenario

In the era of globalization, India cannot insulate itself from the developments taking place worldwide. High quality financial reporting is fundamental for an effective integrated capital market. Few Indian companies are already listed on overseas stock exchanges and many more are in the process of getting themselves listed. Also, the recent stream of overseas acquisitions by Indian companies makes a compelling case for adoption of high quality standards to convince foreign enterprises about the financial standing of Indian acquirers. Convergence with IFRS would require several changes in Indian laws and decision processes.

In India, the Institute of Chartered Accountants of India (ICAI) is on the way towards convergence of its Accounting Standards (AS) with global reporting standards. Accounting Standards Board (ASB) was established by the ICAI in 1977 to frame high quality accounting standards in line with the international expectations. The ICAI, being a member of the International Federation of Accountants (IFAC), considers the IFRS and tries to integrate them, to the extent possible, in the light of the laws, customs, practices and business environment prevailing in the country. Today, accounting standards issued by the Institute have come a long way. As the world continues to globalize, discussion on convergence of national accounting standards with IFRS has increased significantly. At present, the ASB of ICAI formulates the AS based on IFRS. However, these standards remain sensitive to local conditions, including the legal and economic environment. AS issued by ICAI depart from the corresponding IFRS in order to ensure consistency with legal, regulatory and economic environment of India.

Recognizing the growing need of full convergence of Indian Accounting Standards with IFRS, the ICAI has constituted a Group in liaison with government and regulatory authorities and this group has constituted separate core groups to identify inconsistencies between IFRS and various relevant acts. The ICAI has already started the process of issuing IFRS equivalent AS and revising the existing standards and Guidance Notes to bring them at par with IFRS. ASB has, so far, issued thirty two Accounting Standards. In total, seventeen existing standards are under revision in line with IAS/IFRS, out of which, exposure drafts of ten revised standards are still open for public. IFRS Task Force has also been formulated to examine various issues involved in the convergence process. The Task Force has proposed for adoption of IFRS, in a phased manner, for listed entities and public interest entities from accounting periods commencing on or after April 1, 2011. On 22nd January 2010, the Ministry of Corporate Affairs had issued a press release setting out the roadmap for convergence with IFRS for certain defined entities with effect from accounting periods commencing on or after April 1, 2011. The roadmap requires IFRS to be made applicable in a phased manner. (An abstract of the roadmap is given separately).

The ICAI has also classified IFRS into four broad categories as part of its convergence strategy, which can be detailed as follows:

- First category describes IFRS which can be adopted immediately or in the immediate future in view of no or minor differences (for example, construction contracts, borrowing costs, inventories).
- Second category includes IFRS which may require some time to reach a level of technical preparedness by the industry and professionals, keeping in view the existing economic environment and other factors (for example, share-based payments).
- Third category includes IFRS which have conceptual differences with the corresponding Indian Accounting Standards and where further dialogue and discussions with the IASB may be required (consolidation, associates, joint ventures, provisions and contingent liabilities).
- Last category comprises of IFRS which would require changes in laws/regulations because

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IFRS Roadmap for Indian Companies An Abstract

IFRS Roadmap - Background

A meeting of the Core Group constituted by the Ministry of Corporate Affairs for convergence of Indian Accounting Standards with International Financial Reporting Standards (IFRS) was held on 11th January, 2010. The meeting was attended by various officials from the Institute of Chartered Accountants of India (ICAI), Ministry of Finance, Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA), Reserve Bank of India (RBI), Comptroller and Auditor General (C&AG), Pension Fund Regulatory and Development Authority (PFRDA), Industry representatives and other experts. The Core Group discussed the report submitted by the Sub-Group headed by Mr. Malegam to finalize the roadmap for achieving convergence of Indian Accounting Standards with IFRS by April, 2011. The amendments required in the Companies Act, 1956, the related Schedules - VI and XIV and Accounting Standards Rules for the purpose of convergence were also discussed. There were detailed deliberations on the implementation challenges especially those related to legal and accounting framework and transitional issues.

Two Separate Sets of Accounting Standards

The core Group decided that there will be two separate sets of Accounting Standards under Section 211(3C) of The Companies Act, 1956, which are as follows:

- **Indian Accounting Standards converged with the IFRS**

  These are the standards which are being converged by eliminating the differences of the Indian Accounting Standards vis-à-vis IFRS. These standards shall be applied for all companies falling under Phase I to Phase III.

- **Indian Accounting Standards notified in the Companies (Accounting Standards) Rules, 2006**

  These are the standards used, at present, by Indian Companies under the Companies Act, 1956. Companies not falling within the threshold limits prescribed for IFRS compliance in the respective phases shall continue to use these standards in the preparation and presentation of financial statements.

Phases for Implementation

On 22nd January 2010, the Ministry of Corporate Affairs had issued a press release setting out the roadmap for convergence with IFRS for certain defined entities with effect from accounting periods commencing on or after April 1, 2011. The roadmap requires IFRS to be made applicable in a phased manner. The press release suggests that the IFRS will be implemented, in three phases, starting from April 1, 2011 as shown in the table given below:

Phase	Date for conversion	Coverage
I	Opening balance sheet as at 1st April, 2011	Companies which are part of NSE Index - Nifty 50 Companies which are part of BSE Sensex - BSE 30 Companies whose shares or other securities are listed on a stock exchange outside India Companies, whether listed or not, having net worth of more than Rs. 1,000 crore
II	Opening balance sheet as at 1st April, 2013	Companies not covered in phase I and having net worth exceeding Rs. 500 crore.
III	Opening balance sheet as at 1st April, 2014	Listed companies not covered in the earlier phases.

Note: *If the financial year of a company commences at a date other than 1 April, then it shall prepare its opening balance sheet at the commencement of immediately following financial year.*

Separate Roadmap for Insurance Companies, Banking Companies and Non-Banking Finance Companies

The Core Group approved the Roadmap in respect of Insurance Companies, Banking Companies and Non-Banking Finance Companies on 29th March, 2010. The Core Group referred to the earlier Roadmap for Convergence agreed to, in its meeting held on 11th January, 2010 in respect of companies, other than insurance companies, banking companies and Non-Banking Finance Companies. The recommendations of the Core Group can be summarized as under:

- **Insurance companies**

All insurance companies will convert their opening balance sheet as at 1st April, 2012 in compliance with the converged Indian Accounting Standards.

- **Banking companies**

(a) All scheduled commercial banks and those urban co-operative banks (UCBs) which have a net worth in excess of Rs. 300 crores will convert their opening balance sheet as at 1st April, 2013 in compliance with the first set of converged Indian Accounting Standards.

(b) Urban co-operative banks which have a net worth in excess of Rs. 200 crores but not exceeding Rs. 300 crores will convert their opening balance sheets as at 1st April, 2014 in compliance with the first set of converged Indian Accounting Standards.

(c) Urban co-operative banks which have a net worth not exceeding Rs. 200 crores and Regional Rural banks (RRBs) will not be required to apply the first set of Accounting Standards i.e. the converged Indian Accounting Standards (though they may voluntarily opt to do so) and need to follow only the existing notified Indian Accounting Standards which are not converged with IFRSs.

- **Non-Banking Financial companies**

(a) NBFCs which are part of NSE – Nifty 50 or are part of BSE - Sensex 30, and NBFCs whether listed or not, which have a net worth in excess of Rs.1,000 crores will convert their opening balance sheet as at 1st April, 2013 if the financial year commences on 1st April (or if the financial year commences on any other date, then on the date immediately following 1st April, 2013) in compliance with the first set of converged Indian Accounting Standards

(b) All listed NBFCs and those unlisted NBFCs which do not fall in categories specified in (a) and which have a net worth in excess of Rs. 500 crores will convert their opening balance sheet as at 1st April 2014 if the financial year commences on 1st April (or if the financial year commences on any other date, then on that date following 1st April 2014) in compliance with the first set of Accounting standards (i.e converged Indian Accounting Standards).

(c) Unlisted NBFCs which have a net worth of Rs. 500 crores or less will not be required to follow the first set of accounting standards (i.e the converged Indian accounting standards), though they may voluntarily opt to do so, but need to follow only the notified Indian accounting standards which are not converged with the IFRSs.

Commitment towards convergence with IFRS

The Ministry of Corporate Affairs reiterates its commitment to carry out the convergence of Indian Accounting Standards by April, 2011. The Ministry will carry out the exercises for necessary amendments in the Companies Act, the related Schedules - VI and XIV as well as the Accounting Standards Rules would also be carried out simultaneously so that the necessary legislative changes can take place to facilitate convergence. In a written reply to a question, Ministry has informed the Government that the converged Indian Accounting Standards are proposed to be made applicable to companies registered under the Act in a phased manner with effect from 1st April, 2011.

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compliance with such IFRS is not possible until the regulations/laws are amended (for example, accounting policies and errors, property and equipment, first-time adoption of IFRS).

In our country, IFRS convergence is subject to direct or indirect control of several regulators, such as National Advisory Committee on Accounting Standards (NACAS) established by the Ministry of Corporate Affairs (MCA), the Reserve Bank of India (RBI), the Insurance Regulatory and Development Authority (IRDA) and the Securities and Exchange Board of India (SEBI). Further the Indian Companies Act, 1956 provides guidance on accounting and financial reporting matters. The IFRS requirements of Schedule VI of the Act, which currently prescribes the format for presentation of financial statements for Indian companies, is substantially different from the presentation and disclosure requirements under IFRS. Convergence with IFRS will also require significant changes from the tax authorities [Central Board of Direct Taxes (CBDT)] on treatment of various accounting transactions.

Conclusion

The convergence of financial reporting and accounting standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders. It improves the ability of investors to compare investments on a global basis and, thus, lowers their risk of errors of judgment. It has the potential to create a new standard of accountability and greater transparency, which are of significant value for market participants including regulators. Focused on realistic economic representation, financial reporting should address the legitimate needs of key stakeholders and provide a comprehensive overview of financial information. Every stakeholder should gain from active participation in shaping the successive phases of the convergence process.

The convergence with IFRS is now at a very crucial stage in India. There is a need to develop an enabling regulatory framework and infrastructure that would assist and facilitate IFRS convergence. The government would need to frame and revise laws in consultation with the NACAS and the ICAI. Similarly, regulators such as IRDA, RBI, SEBI and CBDT would have to consider accepting IFRS in place of the existing set of prescribed accounting rules. Convergence is lengthy process and it may take years to reach the important goal of a single set of accounting standards.