# IFRSs: Emerging Opportunities and Challenges for India

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This article investigates the rationale behind the International Financial Reporting Standards (IFRSs) and its impact on the financial and accounting world. The adoption of IFRSs puts a big question to us in the present globalized environment as to how to develop internationally acceptable accounting standards that are also acceptable locally. It focuses on the emerging challenges and opportunities in adapting the IFRSs in Indian context. The article also provides a brief comparison of Indian Accounting Standards with IFRSs and explores the usages and benefits of Extensible Business Reporting Language (XBRL) in the emerging modern corporate world.

It is perceived that the adoption of International Accounting Standards (IASs) or "International Financial Reporting Standards" (IFRS) by the corporate bodies in the developing countries is not only imperative, but also gives an opportunity to have access in the capital markets at global level. It is an international trend, which is recognized as 'best practice' around the world. More and more companies the world over are speaking the same accounting language. Because the Accountancy and Financial Reporting activities play a pivotal role in the world of trade and commerce for smooth running of Industry and Business. Capital markets are increasingly becoming competitive and hence the number of companies complying with IFRS is likely to grow in future. According to Gernon & Wallace (1995) model, any accounting institutions and practices should be related to their respective environment of that country. Those five environments are of cultural as well as non-cultural factors such as 1) Societal environment, 2) Organizational environment, 3) Professional environment, 4) Individual environment and 5) Accounting environment, which are separate but interacting slices, which together constitute the accounting ecology. The accounting treatments basically differ on various economic, legal, social and cultural factors of that concerned country. Hence there are major countries that follow their own country-specific Generally Accepted Accounting Practices (GAAP) standards rather than the IFRS.

On the other hand, the issues that arise in implementation of International Accounting Standards (IASs) have been mulled over by various authors (Chand, 2001; Hove, 1989; Perera, 1989). These studies raise considerable issues on technical problems and the inappropriateness of IASs especially to developing countries. Anyhow, the desirability of international accounting standards, rather than purely local ones in the modern global village, is being increasingly perceived as a need. Historically, a number of countries have made important contributions to the development of accounting and financial reporting. In the 14th and 15th century, the Italian method of book keeping by double entry spread first to the rest of Europe and eventually around the whole world. In the 19th century, the modern accounting profession developed first in Scotland and England. As a result, English has become as the world's language of accounting. Britain took the lead in accounting matters, and followed by United States. In the later part of nineties, cross border trading, investments and mergers had been on the rise and there was a remarkable increase in these activities.

## Objectives

Therefore the International Accounting Standards Board has created a set of standards to provide international guidance on the accounting and reporting standards. Accounting bodies throughout the world are striving to achieve a reasonable degree of uniformity in the accounting policies by prescribing certain accounting standard with respect to collection and presentation of accounting information. Because the availability of relevant and reliable financial information to support informed decision making and efficient allocation of resources in both the public and private sectors is

necessary for economic stability and growth.

The objective of the financial statements is to provide information about the financial position, performance and changes in financial position of any entity to the stakeholders. This information would be useful to a wide range of users for the purpose of making economic decisions. The modern international business depends upon well-established accounting and financial reporting standards. The landmark statements of International Accounting Standards issued by the Board of the International Accounting Standards Committee (IASC) between 1973 and 2001 are designated as "International Accounting Standards"(IAS). The objectives of the committee were to formulate, publish and to promote the use of the accounting standards worldwide. To work for the improvement and harmonization of regulations, accounting standards and procedures relating to financial statements, the International Accounting Standards Board (IASB) again announced in April 2001 that its accounting standards, which would be, designated "International Financial Reporting Standards" (IFRS). Also in April 2001, the IASB announced that it would adopt all of the International Accounting Standards issued by the IASC. However, the Interpretations of International Accounting Standards issued by the International Financial Reporting Interpretations Committee (IFRIC) (formerly, the "Standing Interpretations Committee" (SIC)) do not have the same status as IAS.

## International Financial Reporting Standards (IFRSs):

It has been considered (Murphy, 1999) that companies listed on any foreign stock exchanges may find reporting their financial in IFRSs to be more advantageous to them than those companies which does not have listing on any foreign stock exchange. The term International Financial Reporting Standards (IFRSs) has both a narrow and a broad meaning. Narrowly, the IFRSs refer to the new numbered series of pronouncements that the IASB is issuing, as distinct from the International Accounting Standards (IASs) series issued by its predecessor. More broadly, IFRSs refers to the entire body of IASB pronouncements, including standards and interpretations approved by the IASB and IASs and SIC interpretations approved by the predecessor International Accounting Standards Committee. IFRS are continually reviewed and updated to take account of the changing business environment and new challenges that emerge from time to time. As of now (December, 2005), there are seven new IFRS - International Financial Reporting Standards developed by International Accounting Standards Board. These are:

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**IFRS 1** First-time Adoption of International Financial Reporting Standards, June 2005

**IFRS 2** Share-based Payment, February 2004

**IFRS 3** Business Combinations, March 2004

**IFRS 4** Insurance Contracts, August 2005

**IFRS 5** Non-current Assets Held for Sale and Discontinued Operations, March 2004

**IFRS 6** Explorations for and Evaluation of Mineral Assets, June 2005

**IFRS 7** Financial Instruments: Disclosures, August 2005

Framework for the Preparation and Presentation

The IFRS 1 First-time Adoption of International Financial Reporting Standards specifies how entities are to make the transition to IFRSs in an entity's first IFRS financial statements. This is applied beginning on or after January 2004. The Standards does not apply to entities that previously issued financial statements. Under the latest IFRS 2, share-based payment is a transaction in which an entity acquires goods and services either as consideration for its equity or by incurring liabilities for amounts based on the price of its shares or equity. The entity should recognize a corresponding increase in the goods or services received in an equity-settled share-based payment transaction or a liability if the goods or services were acquired in a cash-based payment transaction. The goods and services acquired in the share-based payment transaction do not qualify as assets but as an expense. A number of disclosures also have to be made in the financial statements. The nature and extent of the share-based payment system that existed during the period should be disclosed. How the fair value of the goods or services or the fair value of the equity was granted should also be disclosed. The effect of share-based transactions on the equity's profit or loss for the period and on the company's financial position should be disclosed as well.

IFRS 3 is applicable to the accounting for business combinations for which the agreement date is on or after 31 March 2004. An entity is permitted to apply the requirements of IFRS 3 to goodwill existing at or acquired after, and to business combinations occurring from, any date before

the dates mentioned above. The other IFRS 2, 4 and 5 are required to be applied for annual periods beginning on or after 1 January 2005. IFRS 6 permits an entity to develop an accounting policy for exploration and evaluation assets without specifically considering the requirements of paragraphs 11 and 12 of IAS 8 Accounting Policies. Thus, an entity adopting IFRS 6 may continue to use the accounting policies applied immediately before adopting the IFRS. This includes continuing to use recognition and measurement practices that are part of those accounting policies. It is effective for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.

IFRS 7 adds certain new disclosures about financial instruments to those currently required by IAS 32; and replaces the disclosures now required by IAS 30; it puts all of those financial instruments disclosures together in a new standard on Financial Instruments: Disclosures. The remaining parts of IAS 32 deal only with financial instruments presentation matters. An entity must group its financial instruments into classes of similar instruments and, when disclosures are required, make disclosures by class. The two main categories of disclosures required by IFRS 7 are; firstly the Information about the significance of financial instruments and secondly the Information about the nature and extent of risks arising from financial instruments.

Whether to value assets at cost or at fair market value on the balance sheet is controversial. There tends to be a mixed model. Some assets are valued at historical cost while others are valued at market cost or fair value. Generally, historical costs are used for non-monetary items, although in many countries real estate and certain fixed assets are periodically reviewed. Standards for reporting on intangible assets vary significantly among regions. But under IFRS, companies can capitalize more intangible assets on the balance sheet, generally on a cost basis, than would be permitted. However, under no current standards can intangibles such as intellectual capital, know-how and customer loyalty appear on the balance sheet. These items do not meet the accounting definition of an asset, because the company does not have unilateral control over them.

Another change under the current IFRS is that the uniting of interest's method for the treatment of business combinations is now prohibited. All unidentifiable assets, liabilities and contingent liabilities acquired are recognized at 100 percent of fair value. Goodwill is not amortized but tested for impairment and is expected to be recorded as an asset. Negative goodwill is recognized in the profit and loss statement immediately. Restructuring cost is only recognized to the extent that a liability exists at the acquisition date. Standards must keep pace with the world as it changes and those standards that no longer serve a purpose have to be revised or discarded and replaced by better ones based on better principles. Therefore, there will always be changes in standards. ICAI should endeavour to promote awareness of these changes and to take the action needed to ensure that they are understood and applied locally.

## Extensible Business Reporting Language

The International Accounting Standards Board a founding member of eXtensible Business Reporting Language (XBRL) is developing a taxonomy, which reflects IFRS. It will thus be available to enable those reporting under IFRS in different countries to use XBRL package. It is a standard format or language designed for business functions or financial reporting, which allows members of the financial community and their technology.

It is the electronic version of business information based on the use and flexibility of the eXtensible Mark-up language for data integration process. It helps to exchange information between applications and to meet the needs of different users. It is said that XBRL will be accounting base in the corporate world. In few years time, it will change the very way of business reporting is being done today. XBRL allows better analysis of business reports, investors and regulators will be assisted by computers. It is an open meta-data standard that provides a format for tagging financial information and allows users to extract, exchange, analyze and display financial information. XBRL benefits comparability by helping to identify data, which is genuinely alike and distinguishing information, which is not comparable. It allows very efficient handling of business data by computer software for search, select, exchange, view etc.,

XBRL now exists in two forms— for financial reporting and for General Ledger (GL) that can import and export transaction data to any other that supports XBRL. The impact of adoption of XBRL on the business-reporting world is real time reporting. It benefits to all the stakeholders as a vehicle for transparency and it reduce costs, faster and in-

crease efficiency, more reliable and accurate handling of data for decision making.

Along with IFRS, the system of XBRL package has also proved its capabilities by the success of streamlining the integration of business reports and automates the corresponding financial and business analysis across the globe. Whatever the language of the country concerned, it solves the problems through efficient preparation of financial statements in many forms and reliable extraction of specific detailed information from different forms of financial statements. Microsoft became the first corporation to publish its financial statements on the Internet using XBRL framework in 2002. The Tokyo Stock Exchange accepts filings by companies in XBRL format. Morgan Stanley filed XBRL coded documents with Securities Exchange Commission (SEC) in 2002. In India, Satyam Computers Services Limited has become India's first direct participant member at the XBRL international consortium in May 2005. It will approach accounting bodies and academic institutes to evaluate adoption of this standard and to contribute towards developing it in India.

## Indian Perspective

In India, the accounting and legal systems have been developed on British pattern. However, the Companies Act and other related statutes to the industry and Commerce were amended a number of times to meet country's changing requirements. At present after the deregulation of the economy in 1991, it is trying to bring its accounting standards closer to the IFRSs, subject to applicable local laws, customs and business norms. The increase in FDI in India has further necessitated the use of internationally accepted accounting practices and led to a rapid adaptation of the IFRSs. In India, the regulatory framework governing corporate disclosure includes the Companies Act 1956 and Securities and Exchange Board of India 1992. The annual accounts are prepared according to section 211 and schedule VI of the Companies Act. Presently, Indian accounting standards are of good quality in most instances, in fact are practically the same as IAS. A switch to IAS would be a more in form than substance.

Anyhow, adopting IAS will be of tremendous help in attracting foreign capital and thereby lowering cost of capital to Indian companies. It is suggested that the cost of capital is lowered for firms that adopt international accounting standards. A number of leading companies like Infosys and Bharathi Tele Ventures among them have voluntarily adopted IAS or US GAAP. It is significant to note that India has ceded its power of policy formulation, which is actually in the hands of the WTO, IMF and the World Bank (Thapar, 2001). The survey of a sample of annual reports of Indian listed companies suggests the fact that Indian companies do not voluntarily follow IFRSs (Bikram, 2005). This implies that, most likely, the companies do not perceive these standards to be very suitable to them. The comparison of Indian Accounting Standards with the IASs reveals that the Indian standards require more disclosure than the International Standards in cases of Accounting for leases; Earning per share; Consolidated financial statements; Accounting for investments in associates; Financial reporting of interests in joint ventures etc.

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## Emerging Opportunities and Challenges for India

Prior to 1991, the global flow of information, technology, capital, goods, services and people has never been greater. Late 90s, unprecedented growth is being witnessed in the developing world. These are just several challenges and opportunities businesses face today. Think globally, act locally is imperative for survival and growth in the economy. In an increasingly competitive global marketplace, the ability to operate profitably in diverse geographic markets, and to shift operations flexibly between countries may be essential to the success of any business. It also creates vast opportunities for Indian management professionals all over the world. But operating globally generates a wide variety of practical, legal, and HR and finance issues. Multinational firms must comply with host countries' laws on tax, pensions, business practices and human resources. One country's entrepreneur may be another's antitrust violator. Hence, continuous improving performance has become a persistent need for companies striving to remain competitive and effective in this fast changing environment. The country's low-cost, high-quality human resources afford Indian companies a unique competitive advantage. But to fully leverage this advantage, they need to attract more foreign capital from global financial markets.

Reporting corporate performance in a way that complies with all the complex corporate reporting regula-

tions and laws of each country in which you operate has never been easy. And now, new regulations and standards such as IFRS have made the task even more challenging. Meeting these new reporting standards will — at least over the short-term — almost certainly add to your company's headaches. High quality corporate reporting is too important to be determined solely by the shape of externally imposed regulation. To stake its own claim to reporting excellence and public trust — your company must foster a culture that views reporting transparency as a worthy end in itself, independent of rules and regulations. In recent times there has been a paradigm shift in many economies in the way that corporate governance, business ethics and compliance are approached. It is a shift that continues to be driven by demanding performance expectations, increasing stakeholder demands and growing public scrutiny after some spectacular failures around the globe. Potentially, this is a highly positive development.

## Summary and Conclusions

Much has been heard about the financial scandals and corporate frauds that have shaken the financial world in the past especially in Europe and the United States. Such failures are causing regulators, governments and stakeholders. This will have serious impact on corporates worldwide. In order to prevent such repetitions, to rebuild public confidence in financial reporting, there has been a major overhaul of a number of accounting and auditing standards in recent years.

The face of liberalisation, privatization and globalization of economies have widened the horizon of trade, commerce and industry worldwide. General Agreement on Trade in Services (GATS) and World Trade Organization (WTO) has mandated to achieve greater degree of liberalization in all the service sectors. Powerful new technologies and communications devises have opened the world for an explosion in cross-border commerce and capital creation. Many economies are converging towards globally integrated system. Therefore, it is very clear that the adoption of IFRS could have a huge positive impact on the Indian economy by affording more Indian companies access to foreign capital and lowering the cost of capital generally.

The growth rate in respect of trade and commercial services in Asian countries is above the global average and service segment has become the single largest contributor to GDP ahead of agriculture and industry. The emerging regime for global financial regulation is likely to continue to be regulated in the future. Hence the Manufacturers, service providers will have to interact with the global level market-hub. In India too, the service sector has emerged as the new engine of economic growth as has been witnessed in developed countries like USA and UK. But it is argued that the culture of India is characterized by high power distance, the country has a high preference for uniform accounting standards. Hence, IFRSs may not be suitable to the Indian environment (Chand, 2001).

China has already become the safest area for investment with the best prospect for return on investment. For many MNCs it is a global production base and manufacturing centre. Devid Wu of PricewaterhouseCoopers and Company based in Beijing says that what is hot in China is IFRS. Because over the past 25 years, China has moved from a socialist planned economy to a market economy. Hence its sound financial rules are absolutely fundamental. Thousands of companies in China are using IFRS today to woo global investors. That's why it has attracted huge FDI and able to achieve 8 to 10 percent GDP growth over the last two decades. Under such circumstances, why cannot India achieve? Therefore India should redefine its objectives by making radical structural reforms in the democratic economy. Investors also want companies to report on a broad set of non-financial measures, which, combined with financial reporting might provide a better basis for judging corporate performance. The International Accounting Standards Board and the Financial Accounting Standards Board have agreed to collaborate. In the context of the emerging global economy such convergence is imperative. Therefore a desire for a new single set of accounting standards has been expressed frequently worldwide as Globally Accepted Accounting Principles. While adapting IFRSs in Indian context, it should get sufficient participation from industries, accounting academics, voluntary organizations of academics, environmentalists, ecologists and humanists. And the ICAI should carefully consider the suitability of the IFRSs in Indian context further. ❐

**Multinational firms must comply with host countries' laws on tax, pensions, business practices and human resources**