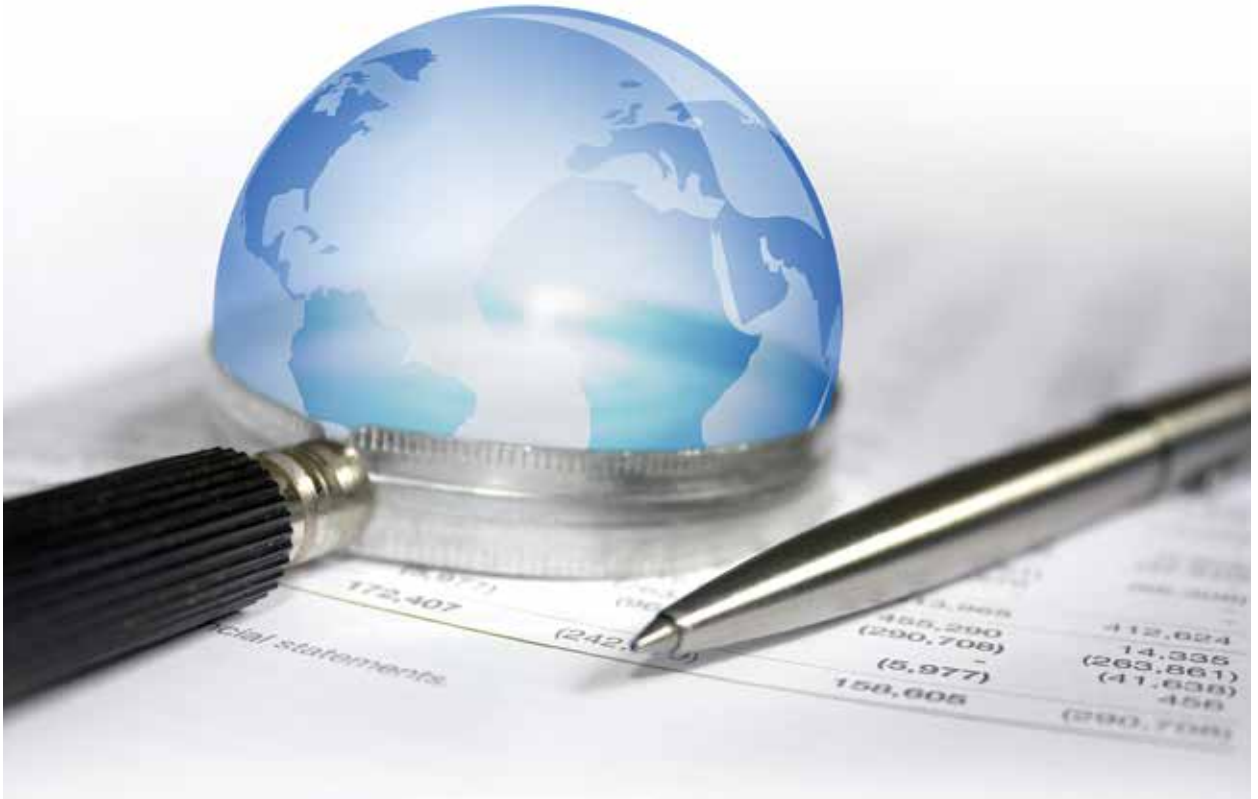
Global Outlook and Indian CA Professional



I am very fortunate that my position as a board member of the International Accounting Standards Board in the last four and half years, has enabled me to examine the global economic outlook from a different perspective. In this short article, I would like to offer my perspective on the current state and future of financial reporting, and the path that I believe India must follow to optimise its role in the global economy. Read on...

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It has been over half a decade since the global financial crisis began. It now seems that we are beginning to see the beginnings of a recovery. However, it is clear that we are still on shaky ground. Uncertainty prevails; central banks around the world are employing highly expansionary policies to make sure there is still an economy tomorrow. What these policies will

bring for the day after tomorrow is less certain. Many observers are worried that the prevalence of short-term horizons in the financial markets is detrimental to long-term investment and economic growth.

Financial reporting has a role to play in ensuring that the managements of companies discharge their responsibilities properly. Management must tell investors what resources the company acquired, why it acquired them, and how it used those resources. Management must tell what obligations the company incurred, why it incurred them, and how it satisfied those obligations. Information of this kind is not only useful to buy, hold and sell decisions, it also helps investors decide how to vote on management's actions.

The ability to rely on the figures shown in financial statements helps build confidence, the key ingredient in any successful financial market. The financial crisis has only served to highlight how difficult it is to rebuild investor confidence when investors are uncertain about the information available to them. Investors flee uncertainty and run to quality during bad times. Therefore, it is clear that in today's highly interconnected global marketplace, the use of a single set of high quality International Financial Reporting Standards, offering transparency and comparability, would be of enormous benefit to investors. To achieve this, of course, is the goal of the IASB.

Use of IFRS around the world

So how much progress are we making? Who is using IFRS? How are our standards being adopted, and through what type of endorsement mechanism? In the past, we have formed estimates of progress based on our own knowledge and the experiences of the large accounting firms.

Still, up to now, our knowledge has not been very precise. As a result, people often doubt whether progress has really been as great as we think. Some believe that many countries have adopted locally modified versions of IFRS. They claim that the use of unmodified IFRS is actually relatively limited.

Since last year,we have been working to compile a more detailed view of which jurisdictions have adopted our standards and how. We conducted a survey among the accounting standard-setters around the world. We then supplemented the survey results with information drawn from other sources, including securities regulators and the large accounting firms. Finally, we asked the relevant authority within each country or jurisdiction to validate our conclusions.

In June this year, we published the first batch of 66 profiles on the IFRS website. This first batch includes all members of the G20, including India, and a further 46 jurisdictions that responded to our initial survey results.

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These initial findings are both fascinating and very encouraging and, although this is a qualitative assessment, lead to some obvious conclusions.

First of all, there is almost universal support for moving to IFRS as the single set of global accounting standards. 95% of the 66 jurisdictions have made a public commitment in support of moving to a single set of high quality global accounting standards. Furthermore, with the exception of Switzerland, every jurisdiction stated that IFRS should be that single set of global accounting standards. This includes those jurisdictions that have yet to determine how to fulfil this public commitment, such as the United States.

Secondly, 55 jurisdictions, or more than 80% of the profiles, report IFRS adoption for all (or in five cases almost all) public companies. Nearly all of the remaining 11 non-adopters have made significant progress in their transitional plans towards IFRS adoption.

Thirdly, those jurisdictions that have adopted IFRSs have made very few modifications to IFRSs. Moreover, where such modifications have occurred, they are regarded as temporary arrangements to assist in the migration from national GAAP to IFRSs. In almost all of these cases, the IASB has active projects on its agenda to address such transitional adjustments. Examples include projects on macro hedge accounting, agriculture, equity method in separate financial statements, and revenue recognition.

So, contrary to what some might believe, it appears from our studies that IFRS adopters seem to be able to resist the temptation to alter our standards and that consistency of application is not as grave a problem as many of our critics would suggest. What then, are the reasons for this?

Part of the reason is that the technical nature of accounting standards make them relatively easy to

accept. IFRS aims to achieve a neutral description of economic reality rather than to shape economic reality.

It is true that accounting standards can sometimes be subject to fierce controversy. Yet most accept that accounting standards are essentially technical rather than political. For this reason, most jurisdictions accept that the standard setting is best done by an independent board, provided that proper procedures for due process and accountability are in place.

Clearly, not all of our constituents agree with every part of our standards. However, even when this is the case, they almost always resist the temptation to alter them. Most of our constituents accept that if local adaptations were to become rife, the benefits of having a global standard would be undermined.

The financial crisis has demonstrated the need for the highest levels of transparency in our economic standards. The profiles show that our standards have come a long way to provide transparency to investors around the world.

India

Of course, several large economies have yet to commit to IFRS. India continues to follow its own path towards adoption. It has been widely recognised that the existing regulatory system and GAAP requirements, in India, need a revamp to keep up with the requirements of a large and rapidly developing economy and member of the G20.

The fact remains that if India is going to benefit from global accounting standards, it needs to commit to adopting IFRS. A first step would be the immediate passing of the Companies Act, which would hopefully lead to the implementation of IndAS at the earliest opportunity. Once IndAS comes into force, the remaining differences with IFRS can be worked out in a mutually cooperative manner.

To address this, India has made a number of policy commitments aimed at reforming its regulatory infrastructure. Progress is being made in the implementation of a number of areas in line with the G20's reform agenda. These include the adoption of Basel capital adequacy norms. However, neither adoption nor convergence with International Financial Reporting Standards has yet been achieved.

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The benefits are clear, adoption of IFRS and subsequent use of the standards by Indian companies would facilitate a much greater level of transparency for investors both domestically and abroad. This is becoming more important; state owned industries in India face an increasing need to be deregulated and privatised if greater levels of foreign investment are to be attracted to the country. A sound financial sector regulation will support investor and market confidence in the Indian economy and help channel investment for strong and sustainable growth.

It is the responsibility of each jurisdiction to determine the path and timetable for adopting IFRSs. In India's case, it looks as if this may be a gradual approach, but we must be mindful not to be over cautious. It is all too easy to overestimate the costs of adoption, but excellent work has already been achieved in converging standards. Also, a step by step approach to adoption can have its drawbacks, such as missing out on the comparability that our standards seek to achieve. The longer this process takes, the harder it becomes.

Timing is becoming more critical. India's economy expanded at 5 per cent in the financial year ending in March, its slowest pace in a decade, while concerns about a growing current account deficit have weighed on the rupee. According to the latest data from the Securities and Exchange Board of India (SEBI), in the fiscal year ended this March, total inflows from Foreign Institutional Investors totalled Rs. 1,683.7bn ($29bn), the highest inflow since the market was liberalised in 1992.

India has shown its ability to demonstrate leadership. Our CA professionals are highly respected around the world. One of the few major projects that the IASB has embarked upon this year is a review of its existing standard concerning agriculture. It was lobbying, primarily by India and Malaysia, that brought this onto the agenda. We should take confidence from this.

However, as the government's reform agenda is still to speed up and interest rates have risen in recent months, in March, inflows into debt and equity markets fell to ₹149.2 bn compared to ₹284.4 bn in February.

Increased investment into India would help two of the most pressing problems that we currently face – the depreciation of the rupee and the unsustainable current account deficit.

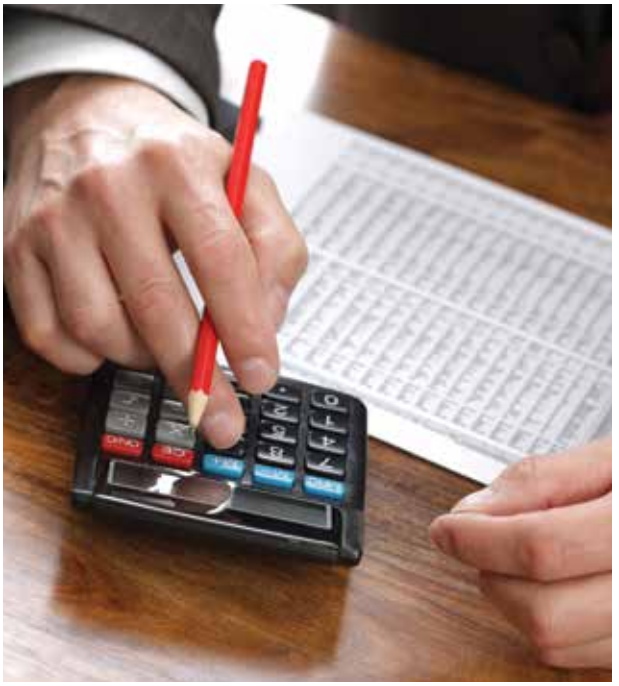
SEBI has recently suggested measures to make it easier for investors to send money into India. However, with 84% of the stocks in the Nifty 50 index reporting under Indian GAAP, any type of peer comparison with other international markets will still make it very difficult for investors to conduct a proper risk assessment.

There is a precedent for this situation. In Korea, the move to IFRS in 2011 has helped to reduce the so-called 'Korean discount' that international investors would charge, in part due to the unfamiliarity with the previous Korean accounting rules. Today, those same international investors are able to compare and contrast a company with its international peers in more than 100 countries around the world.

The extent to which investors apply an "Indian Discount" to stocks today is unclear, but knowing what we do about the lack of disclosure requirements under Indian GAAP, there is a high risk that global investors are misinterpreting Indian company accounts.

In addition to boosting our economy, we also need to have confidence in our ability to influence. I have long suspected that a lack of confidence has been one of the reasons India has held back from adopting IFRS. There is perhaps a fear of a loss of control over our own destiny, or that our voice will not be heard amongst the many others at the table.

I see no reason to fear this. India has shown its ability to demonstrate leadership. Our CA professionals are highly respected around the world. One of the few



major projects that the IASB has embarked upon this year is a review of its existing standard concerning agriculture. It was lobbying, primarily by India and Malaysia, that brought this onto the agenda. We should take confidence from this.

Our businesses want and need high quality accounting rules for areas such as leasing, insurance and impairment, as well as a sound Conceptual Framework. IFRS can deliver all of these things, but for India to benefit fully, and to have its own needs addressed, it must be a collaborator, rather than a passive bystander in this process. From 2014, when my term expires, there is not going to be an Indian Chartered Accountant on the IASB board. This loss of direct representation is indeed a worrying development, but I believe that India can begin to regain influence if it acts decisively and quickly about its stance on IFRS at the earliest opportunity.

I firmly believe that the day when accounting standards are synchronised globally is not too far away. We have everything to gain by adopting IFRS, and indecision and delay will only serve to cost us. As movements and organisations develop, their rules naturally become more rigid and structured, making it harder for newcomers to influence and change accepted norms. IFRSs will be no different, and India should be more decisive in its actions to take advantage of the opportunity to influence their development whilst we still have the opportunity to do so. ■