Towards Globalised Accounting Framework – A Reality Check

The accountancy profession all over the world has been going through turbulent times and the profession has responded to these challenges from time to time in an appropriate manner. The accountancy profession is responsible for the preparation and presentation of financial statements. The accountants, whether as Preparers or Auditors, have to ensure that the financial statements present a true and fair view about the financial position of the entity. It is therefore useful to review the fundamentals of accounting principles and see whether accountancy profession is ensuring compliance of the responsibilities cast upon it by the Society. The author has tried to reiterate some of the fundamental principles relevant in the field of accounting and then tried to raise certain issues for the consideration of ICAI members. Read on…

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Principles of Accounting

Accounting Standards deal with Recognition, Measurement and Disclosure of the relevant items. The changeover to new Accounting Standards sometimes raises issues pertaining to Recognition of certain items in terms of its timing and the manner of its recognition. The measurement of the amount to be recognised in accounts continues to be based on cost. However, the disclosure of various items in the financial statement in

a particular manner is generally decided based on the needs of the users and the legal system of the country.

The basic principles of accounting have been Accrual, Going Concern and Consistency. The Substance over Form has also been a fundamental feature of accounting principles. These principles continue to remain the same. However, the implementation of the principle of Substance over Form has received much greater importance under IFRS. This aspect raises certain issues which are considered later.

Users of Financial Statements

We must recognise that there are diverse groups which study financial statements and the objectives of these diverse groups may not be exactly similar. Consequently, the expectations of each of the group of users from the financial statements are sometimes so different that it is difficult to meet these expectations from a single set of financial statements. The users of the Financial Statements are Shareholders, Investors, Employees, Business Associates, Regulators, Government Authorities and the Public. The expectations of these diverse groups of users are so different that one set of financial statements can never satisfy the needs of these users at the same time. Consequently, one or the other group of users is always critical of the contents and disclosures in the financial statement.

Accounting Standards

Accountancy is the language of communicating the results of business activities and the grammar of such language is set in the form of Accounting Standards. The Accounting Standards lay down the basis on which the results of the business activities would be communicated to the readers in the form of financial statements. It is, therefore, natural to expect that the Accounting Standards are based on sound principles and play the pivotal role of laying down proper rules of the game for correct accounting and presentation of financial statements.

In the past, we have seen International Accounting Standards and US GAAP coupled with National Accounting Standards set by various countries. This was resulting in differences in accounting treatment for similar items in different countries. This gave rise to the introduction of International Financial Reporting Standards (IFRS) on the global scene. We now find that IFRS also undergoes frequent changes based on the issues raised by various countries arising out of implementation of these standards.

India has decided to converge with IFRS keeping in mind the legal framework and regulations prevailing in the country, the local practices and the economic development of the country. Certain Carve-outs have been made and the converged standards have been promulgated under the Companies Act by the Ministry of Corporate Affairs as Indian Accounting Standards (Ind AS) for the companies in India. The exact date of implementation of these standards is expected to be announced by the government, once the issues arising out of these standards in terms of taxation have been appropriately considered.

IFRS

The spread of business activities across the Globe by many companies from different countries necessitated the creation of a common bench mark in Accounting. This prompted the popularity of International Financial Reporting Standards. The response of the investing community to the emergence of these standards was naturally very positive and certainly pushed many countries to look at IFRS much more seriously.

The acceptance of IFRS by various countries can be broadly categorised in three ways. Some countries have adopted IFRS completely and some other countries have taken the route of converging the IFRS to the local usage and conditions. However, there are many countries which are still considering about the course of action they will follow in this regard. Adoption of IFRS in totality makes the financial statements easily comparable across the countries. However, the level of economic development in a country and the legal system being different in various countries, creates practical difficulties in complete adoption of IFRS. Therefore, some countries make suitable modifications to the IFRS and follow the converged accounting standards. The details about the names of the countries who have taken up one of these routes are not listed here since such information is fairly known to all.

India and IFRS

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Way Forward

The Globalised Accounting Framework has been evolving over a period of time and it will continue to evolve. The accountancy profession will have to remain in the forefront in creating and maintaining the integrity and credibility of this Accounting Framework. The following issues need to be tackled, to retain the supremacy of the accountancy profession in laying down and maintaining the credibility of the Accounting Standards.

Unity in Diversity: IFRS has tried to bring about the uniformity in approach while dealing with the principles of accounting and has laid down the accounting standards which are expected to be followed globally. While the objective is laudable and desirable, it may have to be realised that the economic development within a country and the legal system, regulations and the practices prevailing in that country would play a major role in deciding whether such a country would adopt the IFRS in totality or converge these standards, keeping in mind the legal system and economic environment in the country. In case one studies the approach adopted by various countries in the implementation of IFRS and one tries to study the possible reasons for the same, it becomes obvious that the level of economic development and the legal framework in a country requires that country to take the particular approach.

The business objectives set by the Management in terms of business growth and profitability in many cases may create situations where the financial statements prepared on the basis of accounting principles may not be showing results which are in tandem with the business objectives. In such cases, the role of accountants become extremely important since they have to prepare the financial statements based on Accounting Standards and not get carried away on the basis of the expectations arising out of the business objectives.

Changes in IFRS: The accounting standards happen to be the grammar of accounting principles. Naturally, the accounting standards need to be reasonably stable in order to enable the preparers and users of the financial statements, to understand and implement them properly and diligently. In case there are constant changes in accounting standards, then the preparers as well as users take time before they comprehend the changes. Consequently, the implementation of the accounting standards may suffer over a period of time. When there are constant changes made in IFRS, it would be difficult for various countries to keep pace with the changing standards on a continuous basis. This would be true for those who have fully adopted IFRS and even for those who have converged them, since the converged standards will also need changes to keep pace with the changes in IFRS. The ever changing accounting standards can create an impression that the rules of measurement and the goal post itself are moving constantly.

Substance over Form: This has been the fundamental principle of accounting for a long period in the past. The IFRS have taken it to its logical conclusion. Consequently, the principles and practices laid down in IFRS in respect of certain matters may be different as compared to the legal position prevailing in the country. The concept of consolidation of the accounts of subsidiary companies with the accounts of holding company in India is an illustration. The term Holding Company and Subsidiary Company is defined under the Companies Act. However, the meaning given to these terms in IFRS are different and, therefore, can create conflict with the legal situation. There may

be few other illustrations where the legal form and contents of a commercial agreement may indicate a particular type of accounting treatment. However, the principle of Substance over Form will necessitate the entity to account for the particular transaction in a completely different manner, if the contents of the commercial agreement indicate the things differently.

Fair Value Approach: The valuation of assets including Fixed Assets is expected to be done in IFRS by adopting Fair Value Approach. Of course, the option to keep Fixed Assets on cost basis does exist. This may result in the situation that the valuation of assets at the end of each quarter/year could vary substantially depending upon the inflation and economic situation of the country, in case the entity decides to show Fixed Assets at Fair Value. One has to keep in mind that the fundamental principle of Going Concern remaining the same, the valuation changes could reflect the current market conditions, which themselves might change quickly. This also may give rise to the emergence of a new set of professionals called Valuers.

Principles/Practices based Standards: The review of various accounting standards indicate that many of the accounting standards are such that the principles of accounting have determined the practices that are followed and have stated these principles in the Accounting Standards. Similarly, there may be certain accounting practices which have found their way into formulating the accounting standards.

Sense of Ownership about the Standards: The accounting standards would be faithfully practiced in a country where the people at large and the professionals and businessmen would feel a sense of ownership about such standards. The absence of the sense of ownership in these standards would make the implementation more difficult.

Role of Ethics and Value Systems in Accounting: The accounting standards lay down the principles and practices that are expected to be followed in the preparation and presentation of financial statements. These are put into practice in various diverse business situations and, therefore, the frame of mind of the people who implement these standards play a very important role. There are some people who will do something which the accounting standards permit them to do. However, there may be another set of people who do something because such a practice is not expressly prohibited in the accounting principles and standards. The second set of people give rise to creative accounting. This is where the Role of Ethics and Value System play an important role in accounting.

Business Objectives and Accounting: The business objectives set by the Management in terms of business growth and profitability in many cases may create situations where the financial statements prepared on the basis of accounting principles may not be showing results which are in tandem with the business objectives. In such cases, the role of accountants become extremely important, since they have to prepare the financial statements based on Accounting Standards and not get carried away on the basis of the expectations arising out of the business objectives.

Off Balance Sheet Items: The financial statements of an entity should reflect the strength and weakness of the entity and, therefore, the financial statements should reflect the correct position about its assets and liabilities. However, the trend of having certain important items Off Balance Sheet, in a way, vitiates the purpose and completeness of financial statement. One has to, therefore, identify as to the manner in which the implications of these Off Balance Sheet items on the financial statements is brought out clearly to the readers. This seems to be a big challenge to the proposition that the financial statements should reflect a True and Fair view about the financial position of the entity.

Expectation Gap: Those who read the financial statements, have certain expectations about the

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information that should be provided by such financial statements. Whenever the expectations of the reader or user are not fulfilled by the financial statements, such persons feel that there is an expectation gap. Such expectation gap needs to be analysed further. The professional body of accountants in a country, say ICAI, publishes the Accounting and Auditing Standards. The Accounting Standards have now become a part of the Companies Act. In case the accounting and auditing standards do not meet the expectations of the Society, then such expectation gap needs to be analysed and understood by the profession of accountants collectively. Then the profession has to work towards moderating the expectations of the Society through the process of public education and ensure that the unwarranted criticism about the accounting principles is properly responded. In case the accountancy profession is not able to moderate the expectations of the Society, then the accountancy profession has to modify its standards to meet these expectations. This is always an evolving process and the public at large should have the confidence that the accountancy profession is seriously attending to this subject. The compliance of the accounting principles and its manifestation through the presentation of financial statements should match the promises made by the accountancy profession through the promulgation of Accounting and Auditing standards. In case there is a gap between these two, then it results in a serious matter, raising concerns about the performance of the accountants.

Dealing with Failures: In the past few years, failures of certain corporates and stalwarts have raised issues about the efficacy of the principles and practices pertaining to accounting and auditing. The accountancy profession should be able to analyse and understand the reasons for such failures and identify whether it was the result of non-performance of an individual professional or was it the result of ineffective principles of accounting or auditing. In case such failures bring out that the principles of accounting need to be improvised, then the accountancy profession should undertake the process of improving the standards immediately. However, if it is the failure of an individual professional to implement the existing principles, then the profession should clearly bring out that the Accounting Principles are perfect and it is only the individual professional who is at fault.

Accounting Leading to Accountability and Credibility: The principles of accounting converted into Accounting Standards are intended to create a Framework in which the results of the business activities are faithfully and diligently communicated to the readers through financial statements. Such financial statements must create a confidence in the minds of its users and public at large that the financial strength reflected in these financial statements of the entity reflect the correct position. The credibility of financial statements prepared should be the hallmark of the work done by the accountancy profession. The accounting standards should lead to accountability of the accountants to the Society, resulting in the creation of financial statements which are absolutely True and Fair. Such accountability will enable the accountancy profession to achieve the credibility which is so essential for its existence.

Utility to the Society: Globalised accounting framework should create an environment in which the financial statements presented under this framework should fulfill the needs of the Society. A profession which fulfills the needs of the Society can only last forever. In case a profession does not fulfill the needs and expectations of the society, then such a profession may not be able to retain its prestigious position in the Society.

Conclusion

I have tried to raise certain issues for the consideration of our members, with a hope that the deliberations on these issues should enable the Accountancy Profession to emerge as a strong player in maintaining the quality and integrity of the financial statements. It is not enough to say that we are doing so much. We must find out whether we are doing all that is required to be done. ■