 ISSN : 2230-9519 (Online) | ISSN : 2231-2463 (Print)

The Changing Financial Reporting System: Confronts for Global Consistency

Ritu Wadhwa

Finance, Amity Business School, Amity University, Noida, UP, India

Abstract

With the augmentation of Indian Economy and increasing assimilation with the international economies, Indian company is hoisting capital internationally. In the current era of globalization and liberalization, the World has become aprofitable village. The globalization of the business world and the attendant formation and the regulations, which support it, as well as the growth of e-commerce make it crucial to have a single globally accepted financial reporting system. IFRS has dictated a sharperudition curve for many, and learning would be much more during the transition. Uniformity will not be accomplished overnight. It will take some time for all market contestants to be recognizable with IFRS, and the usual forces for consistency – peer pressure and dogmatic enforcement – will not act in the usual way at first. This paper has been developed to broadcast the lessons erudite to a wider audience. As a mounting number of developing countries and countries with economies in transition are boarding on the IFRS execution process,the requirement for sharing knowledge and lessons learned is becoming even more critical. It is my belief that policymakers, regulators, standard-setters and educators will find this paper to be a timely reference and a useful tool fortackling practical implementation challenges of IFRS.

Keywords

Accounting, Regulation, IFRS, U.S. GAAP, U.S. Equitymarkets, Mandatory Disclosure, Political Economy

I. Introduction

The exemplar shift in the economic environment in India during last few years has piloted to growingnotice being dedicated to accounting standards as a means towards ensuring persuasive and translucent financial reporting by any corporate. A number of multinational companies are founding their businesses in various countries with promising economies and vice versa. The entities in emerging economies are more and more accessing the universal markets to realize their capital needs by getting their securities listed on the stock exchanges outside their country. Capital markets are, thus, becoming incorporatedunswerving with this Worldwide trend.

The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This mystification leads to ineffectiveness in capital markets across the world. Therefore, increasing complexity of business transactions and globalization of capital markets call for a single set of high quality accounting standards. High standards of financial reporting strengthen the trust investors place in financial and non-financial information. Thus, the proposal for a single set of globally accepted accounting standards has provoked many countries to follow convergence of national accounting standards with IFRS.

Many developing countries endeavor to muster financial resources from domestic and international sources to achieve their economic and social development objectives. The accessibility of appropriate information on probable investment targets has a bearing on efforts to mobilize investment for financing economic and social development. Such information plays an important role in making critical investment decisions and conducting risk assessment. It also contributes to improved investor confidence and decreased cost of capital. Over the years, attracting financing needed for economic development has become more aggressive. Economic resources have become more mobile across borders. Enterprises that provide potential investors with reliable and comparable financial statements are more likely to attract domestic and international investment.

While IFRS are espoused in a given sway, they become part of present laws and regulations. However, the requirements of pertinent national laws and regulations might not be revised in due time to identify the introduction of IFRS. In some cases, situations arise where IFRS rations challenge applicable provisions in national laws and regulations. Relevant institutions needed for making sure a smooth transition to a global set of financial reporting standards might be inexistent or feeble. Meticulous enforcement of such comprehensive standards at the national level poses practical challenges due to deficiency of adequately resourced enforcement institutions and lack of enough coordination mechanisms among pertinent institutions.

Knowing the considerable control that corporate reporting has on investment decisions, developing countries and countries with economies in transition are joining greater magnitude to lucidity in corporate accounting and reporting. They are taking pains to build up the different apparatus of the accounting infrastructure in their respective jurisdictions so that financial resources can be assembled and utilized more proficiently. However, different countries have been using different national accounting standards, making it hard and costly to evaluate investment opportunities in different countries. In addition, the faster pace of globalization, the rising interdependence of international financial markets and the increased mobility of capital have added to the anxiety and demand for the harmonization of accounting and financial reporting frameworks and related standards around the world.

II. Review of Literature

Over the past 35 years financial regulators worldwide have proposed and worked toward establishing an international standard of financial reporting. The need for such a standard has never been disputed but how to adopt has been the question. More than 100 countries have already adopted or converged with IFRS. The United States is still using Generally Accepted Accounting Principles (GAAP). James Turley, chairman and CEO of Earnest and Young states," In the last 18 months, we relearned how globally connected we all have become… It is absolutely imperative to have one global standard". (Cited in

Money Management Executive, 2009). Examining the progress of establishing IFRS as the global standard requires the study of its history, convergence and adoption level of other countries and confirmation of need. History International Financial Reporting Standards (IFRS) are principal based standards that are issued by the International Accounting Standards Board (IASB). IFRS include International Accounting Standards (IAS) that was issued between 1973 and 2001 by the International Accounting Standards Committee (IASC). In April of 2001 the IASB took over the responsibility for setting International Accounting Standards.

Cai & Wong (2010) in their study of global capital markets summarized that the capital markets of the countries that have adopted IFRS have higher degree of integration among them after their IFRS adoption as compared to the period before the adoption. Paananen& Lin (2009) gave a contrary view to prior research that IFRS adoption ensures better quality of accounting information. Their analysis of German companies reporting showed that accounting information quality has worsened with the adoption of IFRS over time. They also suggested that this development is less likely to be driven by new adopters of IFRS but is driven by the changes of standards.

Lantto & Sahlstrom (2009) in their study of key financial ratios of companies of Finland found that the adoption of IFRS changes the magnitude of the key accounting ratios. The study also showed that the adoption of Fair Value Accounting rules and stricter requirements on certain Accounting issues are the reasons for the changes observed in Accounting Figures and financial ratios. Chand & White (2007) in their paper on convergence of Domestic Accounting Standards and IFRS, demonstrated that the influence of Multinational Enterprises and large international accounting firms can lead to transfer of economic resources in their favour, wherein the public interests are usually ignored.

The study carried out by Callao et al (2007) on financial data of Spanish firms revealed that local comparability is adversely affected if both IFRS and local Accounting Standards are applied in the same country at the same time. The study, therefore calls for an urgent convergence of local Accounting Standards with that of IFRS. Barth et al (2008) in their study of financial data of firms from 21 countries examined whether application of IAS/ IFRS is associated with higher accounting quality. The findings of the study confirmed that firms applying IAS/IFRS evidence less earnings management, more timely loss recognition and more relevance of accounting numbers. The study also found out that the Firms applying IAS/IFRS experienced an improvement in accounting quality between the pre-adoption and post adoption period.

This paper makes a number of contributions to the existing literature. First, our study contributes to the literature on the consequences of disclosure by examining the effect of mandatory IFRS adoption (Daske et al. [2008], Horton and Serafeim [2009],) on analysts (Asbaugh and Pincus [2001], Wang [2008]) and thus on the information environment (Lang et al. [2003]). Moreover, we contribute to the literature which documents that the extent to which GAAP differs between countries or another reporting regime (Bae et al. [2008]; Guan et al. [2006]; Ashbaugh and Pincus [2001]) determinesforecast accuracy. However, unlike previous research, we capture the actual differences between GAAP, on a firm specific basis rather than employing a country-wide measure.Furthermore, our results contribute to the literature on disclosure externalities (Foster [1980], Leuz and Wysosci [2008]). By expanding our focus, beyond merely those firms that mandatorily adopt IFRS, to include those firms that voluntarily adopt IFRS early and those yet to adopt IFRS, we find the existence of externalities. To our knowledge, this study, along with Daske et al. [2008], is the first toconsider externalities of IFRS on firms that have previously applied or not yet applied IFRS.

It is evident from the literature review, significant number of studies carried out in different countries have tinted the benefits of having single set of financial reporting standards across the globe. Few of the studies have also brought out the procedural aspects of implementation of IFRS. Some of the studies have given a contradictory view wherein the articles talk about the difficulties and complications faced in implementing.

III. Objectives of the Study

The present paper has been prepared keeping in view the following objectives:

1. To assess the feasibility and benefits of execution of IFRS in India.
2. To study the challenges to global system owing to realization of IFRS in India.
3. To study the areas that needs to be developed in order to successfully implementing IFRS in India.
4. To discuss the ways through which these problems can be addressed

IV. Methodology of the Study

The study has been conceded out on the basis of literature survey and secondary information. Various Research papers and journals, analytical study reports and newspaper articles have been surveyed in making this study.

V. Outline of IFRS Roadmap

According to the new roadmap, Ind AS is to be executed for preparing consolidated financial statements of listed and unlisted companies starting from April 1, 2016. The standalone financial statements have to be prepared as per the present accounting standards that will be upgraded over a period of time.

It would be relevant for entities with more than Rs.500 crore net worth from the accounting year starting on or after April 1, 2016, with previous year comparatives in Ind AS for the year 2015-16.

VI. Benefits of IFRS Adoption For Global Consistency

Implementing IFRS by Indian corporate is going to be very challenging but at the same time could also be rewarding.

A. Complete Transparency

IFRSs will perk up the comparability of financial information and financial performance with global peers and industry standards. This will result in more transparent financial reporting of a company's activities which will benefit investors, customers and other key stakeholders in India and overseas.

B. Universal Peer Standards for Financial Reporting

The acceptance of IFRS is likely to result in better excellence of financial reporting due to unswerving application of accounting

ISSN : 2230-9519 (Online) | ISSN : 2231-2463 (Print)

principles and enhancement in reliability of financial statements. This, in turn, will escort to increased confidence and reliance placed by investors, analysts and other stakeholders. Advanced financial reporting could be constructive in compelling a firm's present and potential employees of its financial reliability, so that as key users of firm's accounting information they can trust the firm as a trustworthy employer. The growing use of pay for performance plans and the requirement for international tradability of employees stocks and stock options further highlight the need for decent accounting rules.

C. Synchronization with International Financial Market

Increasingly, Indian accountants and businessmen feel thecall forfor convergence with IFRS. Capital markets provide an imperativeelucidation for this amendment. Some Indian companies are already listed on overseas stock exchanges and many more will list in the future. Worldwide acceptable accounting standards will then become the language of communication for Indian companies. Better admittance to and decrease in the cost of capital hoisted from global capital markets since IFRS are now acknowledged as a financial reporting framework for companies seeking to raise funds from most capital markets transversely the globe.

D. Economic Growth and Opportunities for Accounting Professional

Convergence with IFRS and to a internationally accepted standards will result in growth in international business, higher cross border capital flows and transactions and will provide an thrust to economic growth. IFRS convergence will also do good to the large pool of Indian accounting professionals who can build up IFRS skill and provide these skills to global market place.

However, the perceived benefits from IFRS adoption are based on the experience of IFRS compliant countries in a period of mild economic conditions. The current decline in market confidence in India and overseas coupled with tougher economic conditions may present significant challenges to Indian companies.

VII. Confronts IN Administring THE TRANSITION TO IFRS

As evidenced by the worldwide experience, the adoption of IFRS would also pretense momentous challenges for corporate India. There are certain specific challenges for IFRS to implement and adopt the IFRS process. These are:

A. Legal and Regulatory Environment

Unlike several other countries, the accounting structure in India is deeply affected by laws and regulations. The triumph of the convergence efforts in India will depend on the co-operation received by ICAI from the government, regulator (RBI, SEBI and IRDA), tax authorities, courts and tribunals. For example, the central government has to prescribe IFRS as accounting standards under section 211 of the Companies Act 1956. Regulators like SEBI, RBI and IRDA would need to believe IFRS in replacement of the present set of specific accounting rules prescribed by them. Equivalent amendments in taxation laws also may be mandatory (for example, tax treatment of unrealized gains due to fair value measurement). A rule would need to be enacted that accounting treatment in any proposal/scheme submitted to any court for approval would need to comply with IFRS.

B. Measurement of Business Performance and Education of Investors and Boards

Due to the noteworthy differences between Indian GAAP and IFRS, espousal of IFRS is likely to have a significant impact on the financial position and financial performance of most Indian companies. Also, the use of fair value measurement will increase the income statement volatility. Management would need to re-evaluate internal performance management metrics and incentive structure to align them to IFRS. Similarly considerable time and efforts would need to be spent on educating and communicating to investors, lenders, the analyst community and those charged with corporate governance of the entity.

C. Dearth of Skilled and Qualified Sources

Currently India has extremely inadequate pool of resources that have any form of training or experience in IFRS. Adoption of IFRS by approximately 5000 listed companies by 2012 would result in momentous demand for IFRS resources. Considerably all of these resources would need to be generated internally by training existing staff. Moreover auditor would need to train their staff to audit IFRS financial statements. The ICAI and other large professional services firms that have an experience of IFRS due to their global presence would play a key role in training corporate India and accounting professional. In the medium term it is important that training in IFRS be incorporated in colleges, universities and professional accounting syllabus of ICAI, to broaden the pool of trained resources.

D. Greater Complication in Financial Reporting Process

Implementation of IFRS would result in reflection of several factors that were previously not relevant in the preparation of Indian GAAP financial statements. For example, in addition to significant use of judgment, while applying the principle based IFRS, companies would need to increasingly use fair value measures in preparation of financial statements. The use of fair value under IFRS is pervasive and would affect most entities. Companies, auditors, users and regulators would need to get familiar with fair value measurement techniques. Thus, in the initial period it will increase the complexity in the financial reporting process and may make financial statement more difficult to understand for certain class of users.

E. Significant One Time Cost

It is likely that most companies will incur significant one-time cost relating to adoption. These costs may include training internal corporate staff, cost of modifying IT systems, increased audit costs, cost of educating various constituents such as investors, analyst and Board members. Some of these costs will represent the cost of internal sources, while certain other costs will represent cost of external advisors.

VIII. Conclusion and Suggesstion

Despite of various confronts, adoption of IFRS in India has extensively changed thecontents of corporate financial statements because of:

- More sophisticateddimensions of performance and state of affairs, and
- Improved disclosures leading to betterprecision.

With the speedy liberalization development experienced in India over the past decade, there is now a massive presence of multinational ventures in the country. Furthermore, Indian companies are also investing in foreign markets. This has engendered an interest in Indian GAAP by all concerned. In this circumstance, the role of Indian accounting standards, which are becoming nearer to IFRS, has assumed a great implication from the point of view of global financial reporting.Convergence of accounting standards in all countries, including India, is duly acknowledged as the prospect of global accounting standards. In past, diverseobservations of the part of financial reporting made it complicated to support convergence of accounting standards, but now it appears to be aembryonic international consent that financial reporting should give high quality financial information that is analogous, dependable and translucent, in order to serve theneeds of investors.

The translation to IFRS from Indian AS will fetch anabsoluteamendment in the financial reporting.It will surely face the "resistance to change" i.e. accountants , analyst will take time to assume as it requires massive training and proficiency which directly adds to a company's cost as well but it will give India an edge. It will also give aexemplar shift to the corporate Governance that is currently in India

India has cultured that acclimatized IFRS is not just an accounting exercise. It is a evolution that
necessitates everyone concerned to learn a new language and new way of working. While formulating accounting standards on the basis of IFRS, one should consider that, in certain cases, it may cause undue hardship to the industry, at least at the beginning. In other words, Indian industry may not be equipped to apply the provisions of the standards instantly and some intermediary measures are needed to be initiated for them.

References

[1] Aubert, François, Grudnitski, Gary,"The Impact and Importance of Mandatory Adoption of International Financial Reporting Standards in Europe", Journal of International Financial Management & Accounting, 22, (1) pp 1, 2011.

[2] Pawan Jain,"IFRS Implementation in India: Opportunities and Challenges", World Journal of Social Sciences Vol. 1, No. 1, pp. 125 - 136, 2011.

[3] Armstrong, S, Christopher, Barth, E, Mary, Jagolinzer, D, Alan, Riedl, J, Edward,"Market Reaction to the adoption of IFRS in Europe", The Accounting Review, 85(1) pp. 31-61, 2010.

[4] Ashbaugh, H,"Non-U.S. firms' accounting standard choices", Journal of Accounting and Public Policy, 20, pp. 129-153, 2001.

[5] Ashbaugh, H, M. Pincus,"Domestic accounting standard, International Accounting Standards, and the Predictability of earnings," Journal of Accounting Research, 39 (2001): pp. 417-434.

[6] Bhattacharjee, Sumon, Islam, Zahirul, Muhammad,"Problems of Adoption of International Financial Reporting Standards (IFRS) in Bangladesh", International Journal of Business and Management, 4 (12). pp. 165-175, 2009.

[7] Barth, E, Mary, Landsman, R, Wayne, Lang, H, Mark, "International Accounting Standards and Accounting Quality", Journal of Accounting Research, 46 (3) pp. 467, 2008.

[8] Bae, K. H., Tan, H., Welker M.,"International GAAP Differences: The Impact on Foreign Analysts", The Accounting Review, 83, pp. 593–628, 2008.

[9] Armstrong, C., Barth, M., Jagolinzer, A., & Riedl E. (2007). "Market Reaction to Events Surrounding the Adoption of IFRS in Europe", Working paper, Harvard Business School and Stanford University, 2007. [Online] Available: http://ssrn.com/abstract=903429.

[10] Ashbaugh, H., Pincus M.,"Domestic Accounting Standards, International Accounting Standards, and the Predictability of Earnings", Journal of Accounting Research, 39, pp. 417-434, 2001.

[11] Lantto, Anna-Maija, Sahlström, Petri,"Impact of International Financial Reporting Standard adoption on key financial ratios", Accounting and Finance, 49, pp. 341–361, 2009.

[12] Armstrong, Chris S., Barth, Mary E., Jagolinzer, Alan D., Riedl, Edward J.,"Market Reaction to the Adoption of IFRS in Europe", Accounting Review Forthcoming, 2009.

[13] Carmona, Salvador, Trombetta, Marco,"On the Global Acceptance of IAS/IFRS Accounting Standards: The Logic and Implications of the Principles-Based System", Journal of Accounting and Public Policy, 27(6), 2008.

[14] Ramanna, Karthik, Sletten, Ewa,"Why do Countries Adopt International Financial Reporting Standards?", Harvard Business School Accounting & Management Unit Working pp. 09-102, 2009.

Ritu Wadhwa is Assistant Professor at Amity Business School, Amity University, Noida. She has 13 years of teaching & Research Experience. Her research area includes IFRS and corporate finance. She has done MBA (Finance) from GGSIP University and currently pursuing her Ph.D from Gautam Buddha University.