

Impact of International Accounting Standards in Private Sector

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ABSTRACT

IFRS have been adopted by the European countries, but this change yet to be introduced in India. However, ICAI, Ministry of Corporate Affairs (MCA) and other regulatory bodies are continuously taking corrective action for the convergence of IGAAP with IFRS as the plan of implementation of IFRS from April 2013 did not go as expected. It infers from this study that the dream of convergence with IFRS from April 2013 has not come true for want of a well planned change process. After reviewing the various studies in this area, analyzing the effect of IFRS on financial statements of selected companies and ascertaining of Chartered Accountants' views about convergence, we propose a model for proper implementation of IFRS in India. The model consists of three major phases: educating the stakeholders, implementation of IFRS and controlling for feedback and corrections. It is the primary responsibility of the management to maintain strong internal control to safeguard the recording of all financial operations of the business. The ostensible objective of these accounting standards is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in the company's economic performance. The accounting standards reduce the accounting alternative in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises.

INTRODUCTION

As we need a language to communicate with others, likewise, business requires a language to communicate with its owners, managers and other stakeholders. This is called accounting language. Accounting is a “business

language” which helps in informing the financial results of an enterprise to owners, managers and other stakeholders by financial statements timely prepared by enterprises. Accounting is also held as the soul of a business as it is utterly difficult to carry on any business without proper accomplishing of its affairs (Praveen, 2009). Accounting process requires proper attention and regulation because if it is not properly regulated then it can mislead the owners, managers and stakeholders. It can also present the distorted picture of business rather than true and fair view of business if it is not properly done. In order to maintain transparency, reliability, consistency, adequacy and comparability of financial reporting, it is necessary to know about some accounting principles and policies. Companies have to follow certain principles or rules as their statutory duty and the same are known as Accounting Standards (AS). These standards are written policies or rules which are issued by expert bodies or regulatory bodies to comply the various aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements. Auditors check the conformity of these rules and examine the financial results in a way that financial statements provide “true and fair view” of actual transactions (Indapurkar et al., 2009).

It is the primary responsibility of the management to maintain strong internal control to safeguard the recording of all financial operations of the business. The ostensible objective of these accounting standards is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in the company's economic performance. The accounting standards reduce the accounting alternative in the preparation of financial statements within the bounds

of rationality, thereby ensuring comparability of financial statements of different enterprises (Bragg, 2011).

The London based group, namely, the International Accounting Standards Committee (IASC), responsible for developing International Accounting Standards (IAS), was established in June 1973. Between 1973 and 2001, the IASC released International Accounting Standards. Subsequently, International Accounting Standard Board (IASB) came into being in India in place of IASC from April 2001. Now IASB has announced its standards in a series of pronouncements called International Financial Reporting Standards (IFRS). Every major nation is moving towards adopting them to some extent. Various regulatory and government bodies are looking to IFRS to fulfill local financial reporting obligations related to financing or licensing (ICAI, 2009).

The Institute of Chartered Accountant of India (ICAI) as the accounting standards-formulating body in the country is known to have made efforts to formulate high quality accounting standards and has been successful in doing so. Indian Accounting Standards have been changing in the course of time. As the world continues to become globalized, discussion on convergence of national accounting standards with IFRS has increased significantly. In India, so far as the ICAI and the governmental authorities such as the National Advisory Committee (NAC) on accounting standards established under the Companies Act, 1956 and various regulators such as SEBI and RBI are concerned, the aim has always been to comply with the IFRS to the extent possible with the objective to formulate sound financial reporting standards (Singhal and Tulshan, 2009). The ICAI, being a part of the International Federation of Accountants (IFAC), considers the IFRS and tries to integrate them, to the possible extent, in the light of the laws, customs, practices and business environment prevailing in India.

Accordingly, the accounting standards issued by the ICAI are based on the IFRS. However, where departure from IFRS is warranted keeping in view the Indian conditions, the Indian Accounting Standards have been modified to that extent (ICAI, 2009).

Financial Reporting

Basically, financial reporting is the process of preparing, presenting and circulating the financial information in various forms to the users which helps in making vigilant planning and decision making by users. The core objective of financial reporting is to present financial information of the business entity which will help in decision making about the resources provided to the reporting entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided.

Evolution of Accounting Standards

The American Institute of Chartered Accountants (now it is known as American Institute of Certified Public Accountants) can be considered as the primary founder of the accounting standards. During the year 1932-34, the institute collaborated with the New York Stock Exchange to frame five “rules or principles” of accounting to reduce the deviation in accounting policies, recommend some disclosures for significant items of financial statements, and give some valuable suggestions to enhance the reliability or credibility of financial results. A revolution came in the accounting word in 1959, when American Institute of Certified Public Accountants (AICPA) established the Accounting Principles Board (APB) with the crucial objective to provide a solid base for accounting. In 1973, Financial Accounting Standards Board (FASB) came in existence

in place of Accounting Principles Board (APB). To maintain uniformity in financial accounting practices, United Kingdom has established an Accounting Standards Committee (ASC) with the purpose to frame accounting standards which comply with accounting objectives. Prior to the year 1970, accounting standards were not fascinated and very few academicians or professionals paid their attention in its processing. But nowadays, the setting board of standards or committee plays vital role in a number of countries such as New Zealand, India, United Kingdom, Canada, United States, Australia, etc. In the same way, International Accounting Standards Committee (IASC) was set up in 1973, to frame International Accounting Standards (IASs). Now the International Accounting Standard Board has come in place of IASC. The IASC or IASB comprises the accounting professional bodies of various countries including the Indian Institute of Chartered Accountants (ICAI, 2009).

Evolution of International Financial Reporting Standards

The IASC issued International Accounting Standards during the year 1973-2001. IASC restructured their organization during the year 1993-1997 and came with new name and fame as International Accounting Standards Board (IASB) which came into effect on 1st April, 2001. IASB announced its standards in a series of pronouncements which came to be titled as International Financial Reporting Standards (IFRS). However, IASB does not discard the standards developed by IASC. Those standards continue to be designated as “International Accounting Standards” (ICAI, 2009). Therefore, we can state that IFRS means the standards issued by IASB and IAS means the standards issued by IASC. Similarly, interpretation of standards is issued by Standards Interpretation Committee (SIC) and the

International Financial Reporting Interpretations Committee (IFRIC) of the IASB. Few nations have adopted it and some are going to adopt IFRS in future. European Union countries have made it mandatory from the year 2005 and India planed to converge with IFRS from the year 2011 (Singhal and Tulshan, 2009).

India and IFRS

At present, the ASB of the ICAI formulates IFRS based Accounting Standards. Hence, the Accounting Standards issued by the ICAI depart from the corresponding IFRS in order to

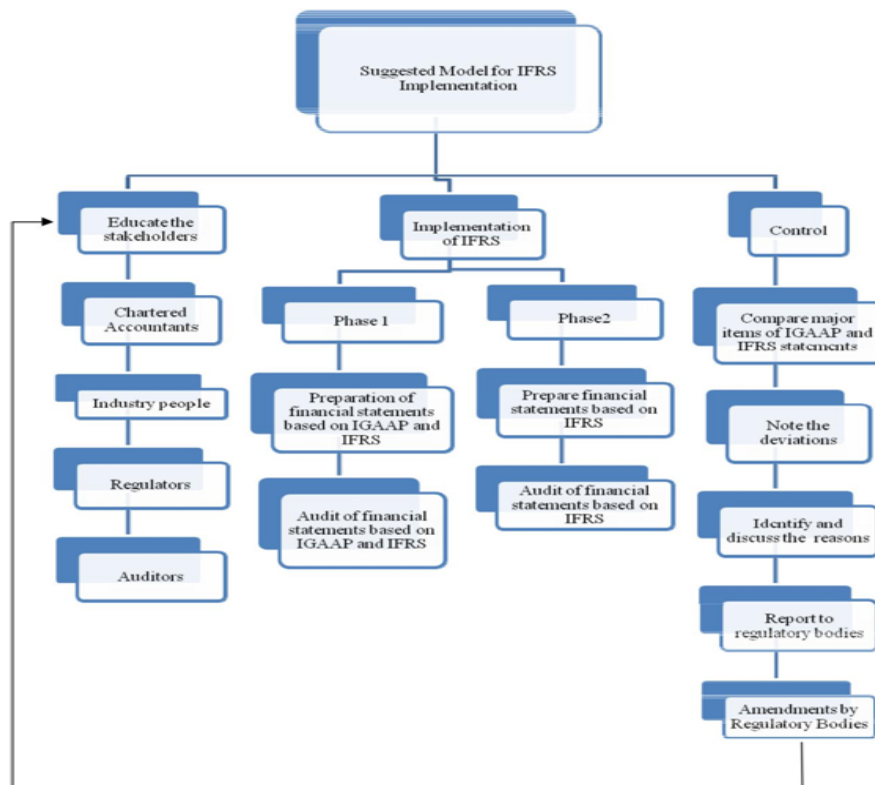
ensure consistency with the legal, regulatory and economic environment of India. At a meeting held. The Council of ICAI in its meeting held in May 2006 viewed that full IFRS may be adopted at a future date, at least for listed and large entities. The Accounting Standards Board (ASB) in its meeting held in August 2006, endorsed the Council’s view that there would be several advantages of adopting IFRS. Keeping in view the degree of difference between IFRS and Indian Accounting Standards, as well as the fact that convergence with IFRS would be an important policy decision, the ASB formed an IFRS task force. The objectives of the task force were to explore the approach for achieving convergence with IFRS, and laying down a road for achieving convergence with IFRS with a view to make India IFRS compliant (ICAI, 2009).

It was decided that IFRS would be adopted by Indian entities from 1st April 2011. For the first IFRS compliant financial statements, it is necessary that the comparative financial statements should also comply with IFRS. As a result, impacted Indian entities required to start preparing IFRS compliant accounts from 1st April 2010 and preferably much earlier. With an objective to ensure a smooth convergence with IFRS, the ICAI took up the

matter of convergence with IFRS with national advisory committee on accounting standards (NACAS). The NACAS was established by the Government of India, Ministry of Corporate Affairs and various regulators including IRDA, SEBI and RBI (UNCTAD, 2006). ICAI formulated a work-plan for the effective implementation

IFRS from 1 April 2011. Further, ICAI conducted various IFRS training programs for its members and others concerned parties to train them to implement IFRS. But due to some impediments, IFRS did not apply in India from 1st April 2011.

Model for implementation of IFRS



LITERATURE REVIEW

Gassen and Sellhorn (2006) analyzed the determinants and consequences of voluntary IFRS adoption by publicly traded German firms during the period 1998-2004. The study inferred that the voluntary adoption of IFRS for German firms was influenced by size, international exposure, and dispersion of ownership. In addition, it was attractive for young firms to adopt IFRS. Comparing a sub-sample of these voluntary IFRS adopters with comparable German-GAAP (HGB) firms, it was revealed that IFRS firms have more persistent and more conditionally conservative earnings. They found that IFRS adopters experience lower levels of

information asymmetry on the German equity market relative to their German counterparts and the level of share price volatility to be significantly higher for IFRS firms. The researchers argued that IFRS earnings of higher quality do not necessarily imply that they are a more efficient contracting device.

Goodwin and Ahmed (2006) examined the impact of Australian equivalents to international financial reporting standards (A-IFRS) on the accounts of small, medium and large-sized firms. The study noted that the transition to A-IFRS has not been onerous for small firms. Most of the small firms were unaffected by A-IFRS and those that were affected had fewer changes to make to net

income and to equity than both medium and large-sized firms. Results of the study also indicated that the average small firm had a net income and equity increase from A-IFRS. Subsequent analysis revealed that the primary reason for these increases were tax benefits and deferred tax assets from tax losses, recognized under the less stringent recognition rules and reversal of goodwill amortization. A-IFRS did not put a material effect on total assets for the average firm, but had increased liabilities for all firm sizes.

Hope et al. (2006) investigated the importance of IFRS in context of global accounting standards harmonization and as well as to know what institutional factors influenced a country's decision to voluntarily adopt IFRS. The study noted that a significant negative association between the adoption of IFRS and investor protection. It was also found that countries with weak shareholder protection (i.e., poor disclosure rules and anti-director rights) were more likely to adopt IFRS than were countries with strong shareholder protection. This study suggested that standard setters should highlight the benefits of uniform reporting standards across countries.

Perramon and Amat (2006) analyzed the first results of IFRS implementation for the income statement for a sample of Spanish non-financial listed companies. The results confirmed that the introduction of international accounting standards might influence the profit results most likely primarily due to the application of fair-value for derivative instruments and new rules for accounting for goodwill. The empirical test revealed that the adoption of IFRS in Spain had a diverse effect on the net profit, which made it difficult to predict its impact on the other listed Spanish companies. It was concluded that the adoption of international accounting standards might influence similarly the Spanish companies of different size and profitability. The researchers argued that the new accounting rules would facilitate not only the process of international harmonization of financial statements of companies, but also promote the proficient

performance of financial markets and capital flows worldwide.

Schadewitz and Vieru (2006) examined the implementation and valuation impacts of mandatory transition to IFRS, using samples of Finnish first-time IFRS users. The relevance of firms' IFRS pre-reporting (pre-reporting is recommended by the Committee of European Securities Regulators, CESR) was evaluated by studying the association between the amount of disclosed IFRS-related information during the implementation phase and the impact of IFRS on certain accounting figures in the reconciliation report. The results showed that on average, IFRS adoption significantly increased reported earnings and total assets of companies. However, IFRS pre-reporting seemed to be somewhat associated with IFRS impacts on company equity and assets, but not with reported earnings. The study shows that companies had supplied enough relevant information to the market about IFRS impacts before the release of the reconciliation report. However, since IFRS pre-reporting was usually quite descriptive and without strong connection to changes in accounting figures, investors might have sufficient means to interpret financial statements prepared accordingly FAS. Therefore, the adoption of IFRS in Finland had been quite transparent without causing any major surprises.

Statement of the Problem

A new concept always comprises of favorable and unfavorable aspects like two sides of a coin. Same is true with IFRS which is globally recognized as a new concept. The favorable aspects are the opportunities and unfavorable are the threats or challenges associated with its implementation. Capital market expansion, economic growth driver, improvement in accuracy and reliability of accounting information, facilitation of merger or acquisition, better corporate governance, better risk management, saving costs and a helpful tool for the

accounting professionals etc. are the opportunities areas whereas fair value principle, time value of money, burden of training employees, retention of key employees, cost of training, requirement of change in company law, banking law, SEBI regulation etc. are the major challenges in the transition of Indian accounting standards (IAS) to IFRS.

IFRS have become mandatory in a number of countries of the world and many more are ready to adopt these in coming few years. No comprehensive research has so far been done to find out the opportunities and challenges in the transition of IAS to IFRS. That is why not much literature has been generated on this concept. The present research is designed to find out the challenges forming barriers in the implementation of IFRS in India. The work will also endeavour to explore answer to the following research questions and ways to meet them:

1. How will IFRS affect the financial statements prepared by an organization?
2. What challenges will IFRS complied accounting statements pose for the users of information contained therein?
3. What will be the opportunity areas for the companies maintaining their accounts according to IFRS?
4. How to overcome the obstacles in transition to IFRS?

Research Objectives

In order to obtain the most appropriate answers to the above questions, we have framed some research objectives mentioned as follows:

- 1) To examine how IFRS affect the financial statements prepared by an organization?.
- 2) To explore the challenges and impediments faced by auditing and accounting personnel of the companies in adopting IFRS.

Nature and Sources of Data

The present study is based on primary as well as secondary data and information to achieve its research objectives. The sources of secondary data primarily include the published annual reports based on IGAAP and IFRS both in respect of selected companies which are purposively decided in the process of study. The variables taken for the study are current ratio, quick ratio, debt/equity ratio, debt to total assets ratio, proprietary ratio, operating profit

Statistical Procedures and Techniques

The primary data collected through sample survey and the secondary data sourced from sampled company financial statements available on their web sites are subjected to statistical analysis with the help of SPSS 13.0 software. The main statistical techniques used for subjecting the primary data include frequency distribution, percentages, mean, SD, t test, f test and Factor Analysis. Frequency distribution is used to present the classification of respondents according to their selected demographic characteristics including gender, age, experience, nature of job and areas of specialization. The frequency distribution is also used for respondents' responses towards various statements forming part of the questionnaire to know the reasons for favouring or resisting IFRS, perceived benefits and challenges of convergence etc. SD is used to check the variation of responses of respondents from the average value of their responses. T test is used to find out the

statistically significant mean differences of the responses of males and females with regard to different issues subjected to analysis through the primary survey. For the similar purpose, f test is used where the demographic characteristics get classified into more than two categories. Further, Factor Analysis is used as a data reduction technique to short list the factors which may constitute as the perceived benefits of convergence with IFRS.

The main statistical techniques used for subjecting the secondary data include percentages, mean, median, SD, skewness, kurtosis, minimum and maximum value and paired t test. The relative percentage change in the values of ratios and items of financial statements have been worked out to measure the effect of IFRS. Mean and median is used to find out the average value for different ratios and items of financial statements such as current ratio, quick ratio, debt equity ratio, current assets, fixed assets, net profit and so on. The analysis of variance

from the mean is brought out with the help of SD for different ratios and items of financial statements. To check the normal distribution of data, we have used skewness and kurtosis. Minimum and maximum is used to find out the range for different ratios and items of financial statements. The paired t-test is used to measure the statistically significant

difference among the means of IGAAP and IFRS based ratios and major items of financial statements.

Reliability Analysis

To measure the reliability of responses of sampled data, we used Cronbach's alpha test. Basically, reliability is the property by which consistent results are achieved when we repeat the measurement of sampling. In theory, an alpha coefficient of .60 and above is considered to be a good reliability estimate and it does indicate good internal consistency. The outcome of this analysis has been shown as per Table 3.1.

Reliability Analysis of the Questionnaire

No.	Factors	Value of Cronbach Alpha
1	Benefits of convergence with IFRS	0.81
2	Challenges of convergence process	0.71
3	Perspective on IFRS provisions	0.69
4	Miscellaneous aspects of convergence process	0.77

It can be seen from Table 3.1 that the values of Alpha Coefficients for different factors have been found ranging between 0.69 and 0.81. Hence the factor wise Alpha Coefficient values, being higher than 0.60

justify the reliability of the questionnaire for data collection and further analysis of data to be believed as truthful.

Scope and Relevance of the Study

The present research work studied the convergence with IFRS in terms of their challenges, opportunities, risk and rewards in the context of Indian corporate sector. Further these aspects are examined from the stand point of the auditing and accounting personnel of the companies involved in convergence with IFRS. We have taken overall effect of IFRS on the financial statements of companies instead of examining each IFRS separately. The locale of the study is the metropolitan cities of India where most of the companies are headquartered, registered or located and listed with the stock exchanges.

Limitations of the Study

As it is true of all research works, the present study has also some limitations in so far as the applications of its results are concerned. The full control of error is difficult to exercise in a study of this kind, though all care has been taken to delineate the effect of IFRS on the financial statements of Indian companies and to achieve other objectives of the present research by following a carefully thought out process of research. Our thesis work will be subjected to several limitations due to lack of availability of relevant research literature as the subject of study is of recent origin and also due to reliability of information because not all respondents were fully groomed in the intricacies of IFRS and their implementation. These limitations are:

1. The literature reviews being based on scanty research work may not provide the needed thread to achieve step by step progress of research in this area of research.
2. This thesis has examined and discussed the effect of IFRS only on the key financial ratios and major items of financial statements which were

purposely selected and therefore, the research work cannot be taken as all encompassing.

3. Though the sample of respondents is fairly large, yet the valuable inputs from those who remained excluded might have been missed.
4. The results of the study comprise an outcome of the statistical inferences drawn by application of selected statistical tools and techniques which have their own inherent limitations.

Findings based on financial statements

The genesis of present study was to bring out the effect of transition to IFRS on the financial positions, financial performance and cash flow statements of an entity. The major findings are summarized as follows:

- i. A study of the effect of IFRS on financial statements of selected companies has revealed that the means of quick ratio (QR), debt/equity ratio, proprietary ratio, net profit ratio are positively affected by implementation of IFRS. But, an adverse effect has been revealed by the workings of the means of current ratio (CR), debt to total assets ratio, operating profit ratio, return on capital employed and return on equity (ROE) ratios. However, no significant differences are noted for all these ratios worked out on the basis of pre and post convergence financial statements.

- ii. It can be seen from the results that average of PPE & IA, trade & other receivable, reserves, CA, QA, TA, equity, CL, TL, debt and capital employed infer positive variation, while the average of goodwill produces negative variation due to harmonization with IFRS. Furthermore, the results show that there is no significant difference in the mean values of all these items of financial statements except the item of

'Reserve' that presents a significant difference at five percent level of significance in their mean values after IFRS reporting. The results of our study are also consistent with the study by Sen *et al.* (2013) which discovered that adoption of IFRS had significant impacts on current ratios, return on equity ratio, inventories, long term liabilities and shareholders' equity accounts.

iii. The results reveal that the averages of all items of income statement have registered positive changes by the implementation of IFRS. The results of t-test reveal that there is also no significant difference in the mean values of these items of Profit & Loss account. All this leads us to infer that profit figure will register an increase due to harmonization with IFRS but the change is not statistically significant.

iv. It is found that IFRS cause great effect on the items of cash flows. While some items, such as cash used in investing activities, net borrowing, cash in beginning and cash at end are adversely affected and the others, such as cash from operating activities, income tax paid, interest/dividend received and interest paid are positively affected due to the convergence process.

Recommendations

A journey through the entire research process encompassing analysis of primary and secondary data, review of literature and interactions with professionals has led us to recommend a suitable model for IFRS implementation. The recommendations include two sub sections, 'model for implementation of IFRS' and some 'general suggestions'.

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