



Financial Reporting: Issues and Challenges in India

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Abstract

Financial document is a reporting. Development of any organization not merely depends on financial report but depends on accurate, consistent and understandable of a financial report. India today has become an international economic force. To stay as a leader in the international market, India opts to the changes and complies with the financial reporting in a language that is desirable, understandable to all of them. The International Financial Reporting Standards (IFRS) aims to make international financial reporting comparisons as easy as possible because each country has its own set of accounting rules. This paper primarily deals with the Issues and Challenges faced in the process of convergence in Indian perspective and remedial measures taken to address the challenges to move ahead with a phased implementation of IFRS and convergence.

Key words: *community, accounting, International, standardization, Challenges*

Introduction

The objective of financial statements is to provide understandable, reliable and relevant information about an entity that can be conveniently used for taking economic decision. The essence of high quality financial accounting is reaching to community with the help of sound financial reporting system through properly finished financial statements. In order to ensure consistency and comparability in financial reporting some standardization in reporting practices is required throughout the globe in today's era of cross border trade and commerce. This paper aims at analyzing the need of standardization in financial reporting and it has explored the role of different prominent regulatory bodies in the process of standardization of accounting. An attempt has been made to compile

information from reliable sources in furnishing a text for common understanding on regulatory development in the field of accounting.

Objectives of the Study:

A critical review of functioning of different regulatory bodies on financial reporting has been analysed and to focus on the emerging Challenges in financial reporting in Indian context and how to reconcile the IFRS.

Methodology:

For the purpose of the present study, mainly literature survey and secondary data has been used. The required secondary data was collected from the authorized Annual Reports and Official Website of ICAI and IFRS, various Journals and Research Papers, diagnostic



study reports and newspaper articles have been surveyed in making this study.

Standardization of Financial Reporting

Standardization is the process of ensuring uniformity. This is done by permitting one way of doing a thing out of several possibilities. Any kind of standardization restricts freedom of choice and gives precedence to uniformity over diversity. The reason for standardization of accounting procedures is that these are concerned with measurement. It is easy to see that the principles of measurement should be such as to produce same results irrespective of when, where or who is measuring.

Accounting Standards

Accounting Standards are policy documents issued by professional bodies of accountants. The standards aim at improving the quality of financial reporting by promoting comparability, consistency and transparency, in the interests of users of financial statements. Good financial reporting not only promotes healthy financial markets, it helps reduce the cost of capital because investors can have faith in financial reports and consequently perceive lesser risks. As far as possible, the standards reflect consensus of opinion of accountants, reporting enterprises and users of financial statements, e.g. investors, borrowers, lenders, employees and Government., regarding appropriate accounting principles and methods to be applied in

various areas of accounting for recognition, measurement, presentation and disclosure of financial elements, i.e. assets, expenses / losses, revenue / gains, liabilities and equity in financial statements of a reporting enterprise.

The standard policies are intended to reflect a consensus on accounting policies to be" used in different identified area, e.g. inventory valuation, capitalization of cost, depreciation and amortizations and so on. Since it is not possible to prescribe a single set of policies in any area to be appropriate for all enterprises for all time, the standards mostly permit more than one alternative. It is therefore not enough to comply with the standards and state that they have been followed: one must also disclose the accounting policies actually used in preparation of financial statements (AS 1, Disclosure of accounting policies). For example, an enterprise should disclose which of the permitted cost formula (FIFO, LIFO, weighted average etc.) has actually been used for ascertaining inventory cost.

In addition to improving credibility of accounting data, standardization of accounting procedures improves comparability of financial statements, both intra-enterprise and inter-enterprise. Such comparisons are very effective and most widely used tool for assessment of enterprise performances by users of financial statements for taking economic decisions, e.g. whether or not to invest, whether or not to lend so on. The intra-enterprise comparison involves comparison of financial statements of



same enterprise over number of years. The intra-enterprise comparison is possible if the enterprise uses same accounting policies every year in drawing up its financial statements. For this reason, AS 1 requires disclosure of changes in accounting policies. The inter-enterprise comparison involves comparison of financial statements of different enterprises for same accounting period. This is possible only when comparable enterprises use same accounting policies in preparation of respective financial statements. The disclosure of accounting policies allows a user to make appropriate adjustments while comparing the financial statements.

Against the benefits of standardization, it has got certain limitations too which is also explored in this study. The aim is to reduce the negative effects as far as possible.

- a) Fair accounting is not possible unless some judgment is exercised. Standardization may apparently create an environment of rigidity that is not conducive to application of judgment.
- b) Accounting treatment prescribed may not always be the best possible treatment in all circumstances. Alternative views with strong arguments may exist. The compliance with standards therefore does not necessarily mean that the best possible accounting treatments have been applied in preparation and presentation of financial

statements, but it may create such an illusion for users of financial statements. .

- c) The world of finance changes very fast. The standards need to be updated to keep pace with these changes. In case this is delayed and an old standard is applied blindly in new circumstances, the result may be irrational and unfair.
- d) Compliance with the standards involves costs, e.g. cost of recruitment and retention of new staff, cost of training existing employees etc. The compliance cost of the standards can be quite considerable.

Role of Regulatory Authorities

First formal attempt to standardize accounting and reporting practices started in USA in 1932, when the American institute of accountants (presently the AICPA) formulated five principles of accounting in collaboration with the New York Stock Exchange. The Accounting Principles Board (APB) was established in 1959 by AICPA to carry on research in this area.

Following are the important regulatory authorities established in different years which were engaged in setting standardization in accounting principles and practices.

Securities and Exchange Commission (SEC)

US Congress enacted Securities Act, 1933 and Securities Exchange Act, 1934.



SEC was established in 1934. Since that time the financial regulations are being enforced in America through Securities and Exchange Commission (SEC) that is a small independent regulatory body having quasi-judicial powers. The primary function of SEC is to ensure that the investors are furnished with information needed for informed investment decisions.

An SEC registrant has to comply with generally accepted accounting principles (GAAP). The meaning of 'true and fair view' in America is 'fair presentation in conformity with GAAP'. The SEC was empowered to set the US GAAP. SEC has issued a large number of 'Accounting Series Releases' presenting the financial reporting regulations and its opinions on accounting matters.

Financial Accounting Standards Board (FASB)

FASB was established in USA in 1973 for taking the place of Accounting Principles Board (APB) and since then it has been issuing accounting standards to apply in United States as solutions to the specific practical questions. FASB standards have been enriched with the studies on specific problems of accounting conducted by American Accounting Association (AAA), associations of financial executives and analysts, stock exchanges and the SEC. SEC permitted FASB to establish the financial accounting standards. SEC considers the principles, standards and practices promulgated by FASB.

FASB has issued more than 150 statements of accounting standards. It is being assisted by a committee named as Emerging Issues Task Force (EITF) to examine the newly apparent problems and formulate proper guidance in those respects for general acceptability of the standards.

International Accounting Standards Committee (IASC)

The arguments in favour of standardizing accounting policies in one country also apply to standardization between countries. This is more so in the present age of cross border investments. To address the problem of standardizing accounting internationally, the International Accounting Standards Committee (IASC) was formed in June 1973 with its headquarters in London. The IASC was established by the professional accounting bodies of Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the UK, Ireland and the USA. Later more than 150 professional accounting bodies (in more than 110 countries), which were the members of International Federation of Accountants (IFAC), became the members of IASC. The goals and objectives of IASC were:

1. Developing International Accounting Standards (IASs) that meet the needs of capital markets in different countries;
2. Ensuring that the IASs meet the financial reporting needs of the developed and newly industrialized countries;



3. Developing other documents that meet other financial reporting needs those are important internationally;
4. Working for greater comparability between national accounting requirements and IASs;
5. Promotion of the use of IASs.

The International Federation of Accountants (IFAC) was formed in 1977 to promote the accounting standards issued by the IASC, called International Accounting Standards (IAS). The membership of IFAC is made up of 153 professional accounting bodies (including the Institute of Chartered Accountants of India) spread over 113 countries.

The IASC was in its form and operation up to year 2001 and by that period it 41 international accounting standards (IASs).

International Organization for Securities Commissions (IOSCO)

The International Organization for Securities Commissions (IOSCO) is another organization which made an agreement with the IASC for review of the IASs and to recommend a set of core IASs and enforce them for cross-border listings- In December 1998, IOSCO recommended 30 core IASs and in May 2000, IOSCO endorsed the core standards for their use by the multinational corporations to prepare their financial statements for cross border offerings and listings subject to some supplemental treatments.

International Accounting Standards Board (IASB)

There was pressure from US SEC and IOSCO on the organizational arrangement of IASC. The US SEC argued that there was less objectivity and independence in the standard setting process of IASC. Accordingly some reforms were made in the structural arrangement of international standard setting. In March 2001, IASC Foundation was formed as a non-profit corporation for acting as the parent entity of another newly formed entity: International Accounting Standards Board (IASB).

The London based IASB is an independent standard setter. It has assumed responsibilities for setting International Financial Reporting Standards (IFRSs) with effect from 1st April 2001. Soon after its establishment, IASB adopted a conceptual framework, which was issued by IASC in 1989- Framework for the Preparation and Presentation of Financial Statements. IASB believed that this framework will assist to develop standards in the coming years and to improve harmonization of national and international standards by reducing the number of alternative treatments allowed in the international standards.

So, IASB replaced IASC in 2001. Since then IASB has amended some IASs and proposed to amend some other IASs and replaced certain IASs with the new IFRSs and has adopted or proposed certain new IFRSs on topics for which there were no IASs. From the viewpoint of adoption of international standards by



a country, the whole set of applicable IASs and IFRSs-should be taken into consideration. Standards issued either by IASC or IASB are considered at par on the whole and they are called international standards in general.

Concepts and needs of International Accounting Standards

International standards meet the comparability criteria to the multinational companies. The comparability project of International Accounting Standards Committee (IASC) gained strength because it was enthusiastically supported by the stock exchange regulators of different countries. The agenda of the meetings of IASC council from 1990s dealt with 'comparability of financial statements' and the objective of securing comparable standards was desired to be achieved. By the end of year 1991, the number of options in standards was well reduced for improvement of the existing standards. Literally these were efforts made to transform the comparability project into an improvement project by implementing the changes in different phases of comparability. IASC associated with stock exchange regulators and national and regional accounting standard setters to complete the programme of modernization of the international standards.

Variant uses of international standards by different countries

IASC standards were used in different ways in different countries. Either they were adopted as national standards, or

they were used as a basis of comparison with the existing national standards, or they were used as input to the legislative process of financial reporting regulation.

The IASC-member countries did not adopt the IASs uniformly because: The strength of the professional accounting institutions of a country guided to generate an accounting treatment that conforms to IAS. Acceptance of IASs depended not only on the accounting profession, but also on the attitude of the government regulatory agencies. IASC did not have any power of enforcement and hence adherence to IASs has been far from satisfactory. A country that was having a weak or a newly established accounting profession was not be able to fully develop, issue and enforce domestic standards and then conform to the IASs.

Global capital markets have become increasingly integrated, and cross border investments and borrowings have increased. Investors are looking for more consistency in financial information from companies of different countries. The accounting standard setting bodies are looking to eliminate the national differences in accounting so that the financial statements from anywhere in the world can be easily read and understood by the business and financial communities.

The detailed regulations of the US GAAP could not regulate many unprofessional conducts of corporate executives and auditors. The large accounting debacles of ENRON etc, revealed a long list of deficiencies in the US GAAP The strict compliance with detailed accounting



rules could not produce transparency on many matters like revenue recognition, valuation of goodwill and other intangible assets, off balance sheet financing through special purpose entities, treatment of derivative instruments. This situation was responsible for transition from detailed rule-based regulations to broader principle-based regulations as evolved by IASC and IASB.

Considering this background the IASs and IFRSs are becoming the most globally applied set of accounting standards and many countries are moving to international standards-Based on current laws, many countries have already adopted or will adopt international standards. IASs and IFRSs have replaced or will replace local GAAP for statutory reporting purposes.

International Financial Reporting Standards (IFRSs)

International Financial Reporting Standards (IFRS) is a set of accounting standards, developed by the International Accounting Standards Board (IASB, London) that is becoming the global standard for the preparation of public company financial statements. IFRS, together with International Accounting Standards (IAS), are a "principles-based" set of standards that establish broad rules rather than dictating specific accounting treatments.

In April 2001 the International Accounting Standards Board (IASB) adopted all IAS and began developing new standards called IFRS. It is

noteworthy that an (AS remains in effect unless replaced by an IFRS.

The International Financial Reporting Standards (IFRSs) are increasingly being recognized as Global Reporting Standards. Approximately 117 nations permit or require IFRS for domestic listed companies, such as Australia, New Zealand, and Russia including listed companies in the European Union. Other countries, including Canada and India, are expected to transition to IFRS. Mexico plans to adopt IFRS for all listed companies starting in 2012. Some estimate that the number of countries requiring or accepting IFRS could grow to 150 in the next few years. Japan has introduced a roadmap for adoption that it will decide on in 2012 (with adoption planned for 2016). Still other countries have plans to converge (eliminate significant differences) their national standards with IFRS.

Need for Convergence with IFRSs

In the present era of globalization and liberalization, the World has become one economic village. The globalization of the business world and the attendant structures and the regulations, which support it, as well as the development of e-commerce make it imperative to have a single globally accepted financial reporting system. A number of multinational companies are establishing their businesses in various countries with emerging economies and vice versa. The entities in emerging economies are increasingly accessing the global markets to fulfill their capital needs by getting their securities listed on the stock



exchanges outside their country. Capital markets are, thus, becoming integrated consistent with this World-wide trend. More and more Indian companies are also being listed on overseas stock exchanges. Sound financial reporting structure is imperative for economic well-being and effective functioning of capital markets.

Present and future of acceptance of international standards

At present IASs and IFRSs are being used in more than 100 countries and approximately 40% of the Global Fortune 500 companies use them. International standards are required for the listed companies across all the European Union countries and majority of the countries in Asia Pacific region including China. For some large countries like Brazil, Canada, Korea and India the IFRSs-adoption-date has been announced. The US SEC has allowed the foreign registrants in US stock exchanges to report under IFRSs without reconciling to US GAAP.

This is expected that (i) all major countries will adopt international standards to some extent by 2011; (ii) substantial majority of the Global Fortune 500 companies will report under international standards; (iii) the American companies will opt for using either international standards or US GAAP by 2014.

International standards are more significant for the large listed companies. But the small unlisted companies may continue to use the domestic accounting

rules. So, it is expected that when these companies will get stock market listings, the national rules will move closer to international rules by way of reducing or completely eliminating the differences between national and international standards. However, the national standard setters may take longer time for convergence with international standards. Until it happens, the national standard setters have to provide financial reporting expertise to support IASB.

The Indian viewpoint

India is lagging behind other Asian countries in conforming to international standards. The new Indian accounting standards tend to follow the IASB standards. The Securities and Exchange Board of India (SEBI), which is a member of IOSCO, is under pressure to improve the Indian standards and bring them in line with international standards. The ICAI has issued a Concepts Paper on full convergence of India's financial reporting standards with international standards by April 1, 2011. Although there are differences between Indian GAAP and IFRSs, the gap has been narrowing especially in the case of standards issued since the late 1990s.

Convergence strategy in India

IASs and IFRSs are to be adopted for the public interest entities such as the listed companies, banks and insurance entities and large-sized entities from the accounting periods beginning on or after 1st April, 2011. In respect of entities other than public interest entities, termed as 'small and medium sized



entities' (SMEs), a separate Indian standard for SMEs may be formulated based on the IFRS for Small and Medium-sized Enterprises, when it is finally issued by the IASB, after modifications, if necessary. While discussing about convergence strategy with a view to meet the objectives of standards, the word 'convergence' needs to be clearly understood- In general terms, 'convergence' means to achieve harmony with IFRSs; in precise terms convergence can be considered "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRSs". In this context, attention is drawn to paragraph 14 of International Accounting Standard (IAS) 1, Presentation of Financial Statements, which states that financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs. It does not imply that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRSs only when IFRSs are adopted word by word. The IASB accepts in its 'Statement of Best Practice: Working Relationships between the IASB and other Accounting Standards-Setters' that "adding disclosure requirements or removing optional treatments does not create noncompliance with IFRSs. Indeed, the IASB aims to remove optional treatments from IFRSs."

This makes it clear that if a country wants to add a disclosure that is

considered necessary in the local environment, or removes an optional treatment, this will not amount to noncompliance with IFRSs. Thus, for the purpose of this Concept Paper, 'convergence with IFRSs' means adoption of IFRSs with the aforesaid exceptions, where necessary. For a country to be IFRS-compliant, it is not necessary that IFRSs are applied to all entities of different sizes and of different public interests. Even the IASB recognizes that IFRSs are suitable for publicly accountable entities. The IASB has, therefore, recently issued an Exposure Draft of an IFRS for Small and Medium-sized Entities (SMEs).

Near Final Indian Accounting Standards (Ind AS)

In the process of convergence with IFRS, India has started developing IFRS converged new set of Accounting Standards and the task of setting the same has been entrusted to the Institute of Chartered Accountants of India (ICAI) as earlier. So the developments have taken place in this direction is release of the near final Indian Accounting Standards (Ind ASs) finalized by the Council of the ICAI and sent to the National Advisory Committee on Accounting Standards (NACAS). These are subject to any changes, which may be made by the Government before their notification.

Revision in schedule VI

Along with the development of new IFRS and the process of convergence with IFRS by India, recently the Government



of India has vide notification No. SO 447(E), dated 28-2-2011 replaced existing Scheduled VI to the Companies Act 1955 with new Scheduled VI. The new Scheduled VI shall come into force for the Balance Sheet and the Profit and Loss Account to be prepared for the financial year commencing on or after 1-4-2011.

The revised Schedule VI has nothing to do with a converged Indian Accounting Standards (Ind ASs). The new set of Ind ASs is uploaded on website of Ministry of Corporate Affairs on 25th February 2011 but the date of applicability has not yet been notified by Government. As per the newly prescribed format of Schedule VI, horizontal format of Balance Sheet known as conventional or customary form of Balance Sheet has been deleted. Accordingly, now onwards only vertical format is to be used. This revised schedule VI is based on existing Accounting Standards and not on Ind AS and it is applicable on all companies in India. Accordingly as and when date of implementation of Ind AS will be notified a separate set of Schedule VI would be issued in respect of companies preparing their financial statement as per Ind AS.

Conclusion

There has been a serious attempt to standardize financial reporting practice through the globe mainly aiming at ensuring comparability and reliability in financial statements. It is demanding in today's global market. To enforce standardization in accounting practices several regulatory and standardization

bodies have been formed in last many years for framing suitable guidelines and standards in international levels. The latest development is the release of IFRS as common global reporting standard. India is also in the process of convergence to IFRS but in this process the recent revision of Schedule VI with new format of Balance Sheet and Income Statement is an important mandate in financial reporting in India. As this newly prescribed format of financial statement is not as per the International standards it may be considered that presently India is passing through some intermediary regulatory development and the country is also highly expecting the early implementation of IFRS converged Accounting Standard along with a properly matched or reconciled Schedule VI of Companies Act.

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