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March 2009

## Theme 208
## CONVERGENCE OF ACCOUNTING STANDARDS

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SIB STUDENTS' ECONOMIC FORUM

MARCH 2009

# Theme No. 208 : CONVERGENCE OF ACCOUNTING STANDARDS

Considerable divergence exists with regard to accounting policies and practices prevalent in different countries. The globalization of economic activity has resulted in an increased demand for high quality internationally comparable financial information. Hence the need for convergence of accounting practices across the countries is now recognized.

Financial information about the status of a business enterprise is conveyed through financial statements such as balance sheet, profit and loss account, cash flow statement and explanatory notes and schedules. These statements are prepared as per provisions of applicable laws, customs, usages and business environment, but all these are gradually to be in conformity with the 'Generally Accepted Accounting Principles' (GAAP) which include accounting principles, standards, conventions, rules, guidance notes and explanations. The accounting principles include regularity, prudence, continuity, periodicity, and disclosure. Acounting Standards form the core of the GAAP of any country.

**What is meant by Accounting Standard?**

The term 'Accounting Standard' is generally defined as an authoritative statement on how particular type of transactions and other events should be reflected in financial statements. Accounting standards are authoritative standards for financial reporting developed through an organized standard-setting body. They specify how transactions or other events are to be recognized, measured, presented and disclosed in financial statements.

In India, Accounting Standards Board (ASB), a committee formed by Institute of Chartered Accountants of India (ICAI), is entrusted with the task of formulating accounting standards (AS) applicable in India. So far ICAI has issued 32 Accounting Standards. An Accounting standard will comprise statement of concepts and fundamental accounting principles related to the Standard, definition of the terms, presentation and disclosure requirements in complying with the Standard, class of enterprises to which the standard will be applicable and the effective date of the Standard. In the USA, the accounting standards are prepared by the Financial Accounting Standards Board (FASB) and these become the integral part of US GAAP. International Accounting Standards Board (IASB), based in London, has formulated International Accounting Standards (IAS) for global application aimed at harmonization and convergence of accounting standards across the world. IASB has so far formulated 41 IAS and has now come out with new series of 8 International Financial Reporting Standards (IFRS). IAS together with IFRS constitutes global accounting standards.

**What do the terms 'harmonization' and 'convergence' of accounting standards refer to?**

Harmonization envisages prevalence of different standards in different countries so long as they are in harmony with each other, without any conflict logically. Convergence on the other hand refers to the imposition of a more rigid and narrow set of rules, a process by which all members agree to follow the same or very similar accounting practices. Now, the term harmonization is losing ground to convergence. One of the main objectives of the IASB is to bring about convergence of national accounting standards and IAS/IFRS to high quality solutions. Accounting convergence means developing new or revised standards for worldwide use.

**How does convergence affect various interest groups?**

The pressure to adapt to global standards comes from investors, multinational corporations, accounting profession and government and revenue authorities.

Convergence will be beneficial to the investors and the financial analysts. It will increase comparability of the financial information and provide a more level playing field. Thus, global investors need reliable, understandable and comparable information to make better informed investment decisions.

Convergence will be immensely beneficial to the MNCs. The efforts for consolidating financial statements will be simplified if statements were prepared on a uniform basis. Lack of convergence imposes an immense financial burden on these corporations. Convergence helps in performance appraisal of subsidiaries located in different countries and appraisal of foreign companies for potential take-over.

Convergence of accounting practice would foster internationalization of the accounting profession. This will enable professionals in one country to carry out their professional duties in another country and will reduce operational challenges of accounting firms.

Convergence will help government and revenue authorities to understand and control the MNCs operating in their respective countries. There are problems of transfer pricing and the resultant avoidance of taxes by the MNCs. Differences in accounting provisions complicate the task of revenue authorities dealing with foreign income. Computation of cost of inventories, depreciation, impairment of assets, and amortization of goodwill and other intangible assets are some of the issues that have a decisive impact on reported earnings.

Convergence eliminates cost involved in preparing multiple reports to meet regulatory requirements of different countries. It helps efficient allocation of resources, as it would eliminate barriers to cross-border listings. On the whole, overall higher economic growth will be facilitated.

**What are the problems and challenges in implementation of convergence?**

The economic and legal environment of the country exercises a decisive influence on the implementation of IFRS. Where market mechanism is not deep in determining prices, reliable fair value measurement may not be possible. Besides, there are long established laws and regulations governing corporate reporting, including parliamentary legislation on commercial codes and company acts. Problems also arise where the laws and regulations were enacted decades before the introduction of IFRS. In India, the Companies Act was enacted in 1956 and still does not provide for consolidation of financial statements. Such statements are prepared in India by listed companies in accordance with the listing agreement.

The enforcement of standards is one of the most critical elements in effective implementation of convergence. This responsibility rests with a number of institutions - the stock exchanges, banking and insurance supervisory authorities, the capital market authorities and the professional bodies.

There are also technical issues to be resolved in the matter of convergence. The international standards are lengthy and complex and need to be interpreted in a uniform manner. Translation of standards into domestic language is another hurdle. Implementation of IFRS requires considerable preparation both at the country level and the entity level.

**What are the efforts of the international organizations towards convergence?**

There are organizations at national, international levels and voluntary organizations working towards convergence of accounting standards. The UN has taken initiative towards disclosure of accounting and non-accounting information by the MNCs. The primary objective was to protect the developing nations against the MNCs, as there was lack of information about the working of these corporations.

The need for convergence began with the setting op of International Accounting Standard Committee (IASC) in 1973, which was renamed as IASB in 2000. The IASB consists of professional accountancy bodies from leading economies. The IAS/IFRS announced by IASC / IASB are slowly being adopted as global benchmarks of accounting standards.

In 2002, “Norwalk Agreement” was reached between the FASB, the US Standards setting body, and the IASB, for working towards convergence of IFRS and the US GAAP. In 2007, the US SEC (Securities Exchange Commission) decided to exempt foreign private issuers who file financial statements in accordance with IFRS from the requirement of US GAAP reconciliation. It was also decided to allow US issuers to prepare financial statements in accordance with IFRS instead of US GAAP.

**What are the prospects of convergence in accounting standards?**

The EU was the first major jurisdiction to make IFRS mandatory for its listed companies since 2005, and it remains by far the largest jurisdiction applying IFRS. In Canada, the use of IFRS will be required in 2011 for profit oriented publicly accountable entities. The Asian countries such as China and Korea have already revised accounting practices to conform with IFRS. Australia, Hong Kong, Sri Lanka and New Zealand will be completely adopting IFRS from 2011. India has also announced adoption of IFRS from April 1, 2011, though at present differences exist between IFRS and Indian AS. Malaysia, Pakistan and Thailand have adopted selected IFRS quite closely, but significant differences exist between other IFRS and national standards. It is expected that by 2011, over 150 countries will converge their accounting standards with IFRS.

## IAS/IFRS – Current Standards vs. Indian AS

| Number | Description | Corresponding Indian GAAP |
|---|---|---|
| **IFRS-1** | First time adoption of IFRS | ---- |
| **IFRS-2** | Share-based payments | ---- |
| **IFRS-3** | Business combinations | **AS-14** |
| **IFRS-4** | Insurance contracts | ---- |
| **IFRS-5** | Non-current assets held for sale and discontinued operations | **AS-24, AS-10** |
| **IFRS-6** | Exploration and evaluation of mineral resources | —— |
| **IFRS-7** | Financial instruments: disclosures | **AS-32** |
| **IFRS-8** | Operating segments | **AS-17** |
| **IAS 1** | Presentation of financial statements | **AS-1** |
| **IAS 2** | Inventories | **AS-2** |
| **IAS 7** | Statement of cash flows | **AS-3** |
| **IAS 8** | Accounting policies, changes in accounting estimates, and errors | **AS-5** |
| **IAS 10** | Events after the reporting period | **AS-4** |
| **IAS 11** | Construction contracts | **AS-7** |
| **IAS 12** | Income taxes | **AS-22** |
| **IAS 16** | Property, plant and equipment | **AS-10, AS-6** |
| **IAS 17** | Leases | **AS-19** |
| **IAS 18** | Revenue | **AS-9** |
| **IAS 19** | Employee benefits | **AS-15** |
| **IAS 20** | Accounting govt. grants and disclosure of govt. assistance | **AS-12** |
| **IAS 21** | Effects of changes in foreign exchange rates | **AS-11, AS-30** |
| **IAS 23** | Borrowing costs | **AS-16** |
| **IAS 24** | Related party disclosures | **AS-18** |
| **IAS 26** | Accounting and reporting by retirement benefit plans | ---- |
| **IAS 27** | Consolidated and separate financial statements | **AS-21** |
| **IAS 28** | Investments in associates | **AS-23** |
| **IAS 29** | Financial reporting in hyperinflationary economics | —— |
| **IAS 31** | Interest in joint ventures | **AS-27** |
| **IAS 32** | Financial instruments: Presentation | **AS-31** |
| **IAS 33** | Earnings per share | **AS-20** |
| **IAS 34** | Interim financial reporting | **AS-25** |
| **IAS 36** | Impairment of assets | **AS-28** |
| **IAS 37** | Provisions, contingent liabilities and contingent assets | **AS-29** |
| **IAS 38** | Intangible assets | **AS-26** |
| **IAS 39** | Financial instruments: recognition and measurement | **AS-30** |
| **IAS 40** | Investment property | **AS-13** |
| **IAS 41** | Agriculture | —— |

*Your comments and feedback on this publication may be sent to Staff Training College, The South Indian Bank Ltd., Thrissur, Kerala 680 001 or by E.mail: ho2099@sib.co.in* www.southindianbank.com

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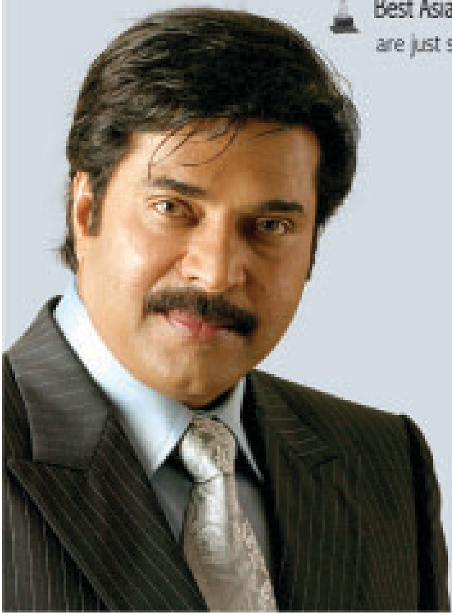

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