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IFRS: Impact on Indian banks

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Abstract

The Institute of Chartered Accountants of India (ICAI) is the formulating body of the accounting standards in our country. As we globalize, the significance of convergence increases with International Financial Reporting Standards (IFRS). In today's scenario of global business village India cannot afford to insulate itself from the developments and modifications taking place worldwide. These new set of accounting standards is more principles based as compared to the earlier standards that were basically a principle based. The objective of the present paper is to examine the structure, importance and advantages of IFRS in India; to study the process of convergence and how IFRS will affect the Indian banks. There are significant differences between the accounting treatments laid down in the existing Accounting Standards as against the treatments envisaged in the converged Indian Accounting Standards. These differences necessarily will have an impact on the depiction of profit and financial position of an enterprise.

Keywords: international financial reporting standards, accounting standards, Indian banks

Introduction

Economic development of a country requires a sound financial reporting system sustained by good governance, clearly defined quality standards and established regulatory frame work. The Institute of Chartered Accountants of India (ICAI) is the formulating body of the accounting standards in our country. As we globalize, the significance of convergence increases with International Financial Reporting Standards (IFRS). In today's scenario of global business village India cannot afford to insulate itself from the developments and modifications taking place worldwide. These new set of accounting standards is more principles based as compared to the earlier standards that were basically a rule based. There are significant differences between the accounting treatments laid down in the existing Accounting Standards as against the treatments envisaged in the converged Indian Accounting Standards. These differences necessarily will have an impact on the depiction of profit and financial position of an enterprise.

IFRS are a set of accounting standards developed by the International Accounting Standards Board (IASB) that is becoming the global standard for the preparation of public company financial statements. IFRS is a refined system of financial reporting with improved corporate governance and increased free flow of capital across the globe which can be comparable across international boundaries.

The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting. They are progressively replacing the many different national accounting standards.

Objective of the study

The objective of the present paper is

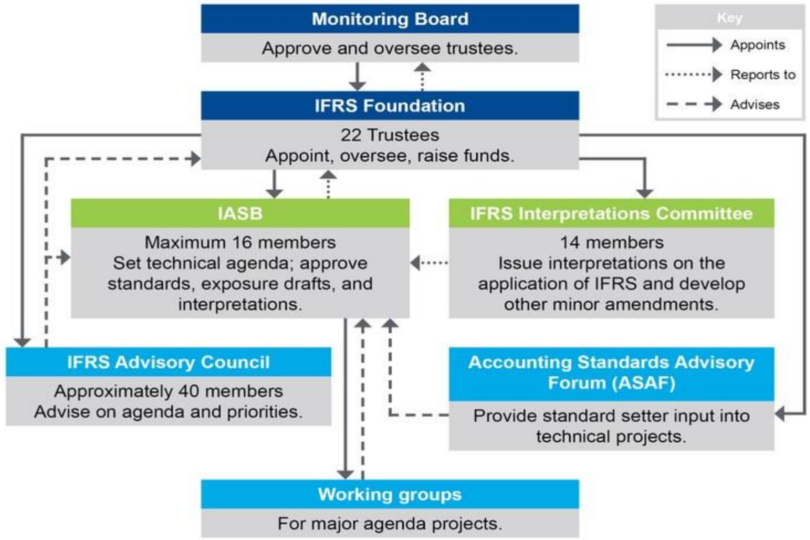
- To examine the structure, importance and advantages of IFRS in India;
- To study the process of convergence and how IFRS will affect the Indian banks

Research Methodology

The present study is descriptive work which covers the concept, importance and advantages, process of convergence, challenges and impact on Indian banks. This paper will provide an insight on the future prospects by following the convergence process. The data have been collected from purely secondary source like various websites and journals, as well as published books.

Who issues international financial reporting standards?

With the view of making the financial statements more reliable and transparent, the London based group namely the International Accounting Standards Committee (IASC), responsible for developing International Accounting Standards, was established in June, 1973. Between 1973-2001, the International Accounting Standards Committee (IASC) released International Accounting Standards. Between 1997 and 1999, the IASC restructured their organization, which resulted in formation of International Accounting Standards Board (IASB). These changes came into effect from 1st, April, 2001. The International Accounting Standards Board (IASB) is the independent, accounting standard-setting body of the IFRS Foundation. IASB publishes its standards in a series of pronouncements called International Financial Reporting Standards. The Foundation is governed by a board of 22 trustees.



By 2018, it is expected that all companies in major markets will be using IFRS. This requirement will affect about 7,000 enterprises, including their subsidiaries, equity investors and joint venture partners. The increased use of IFRS is not limited to public-company listing requirements or statutory reporting. Many lenders and regulatory and government bodies are looking to IFRS to fulfill local financial reporting obligations related to financing or licensing.

Approximately 120 nations and reporting jurisdictions permit or require IFRS for domestic listed companies, although approximately 90 countries have fully conformed to IFRS as promulgated by the IASB and include a statement acknowledging such conformity in audit reports.

Importance of IFRS

A strong need was felt by legislation to bring about uniformity, rationalization, comparability, transparency and adaptability in financial statements. The better way for getting rid of problems faced by different methods of standards is to have a single set of global standards, of the highest quality, set in the interest of public. The following are the major importance of International Financial Reporting Standards:

1. A business can present its financial statements on the same basis as its foreign competitors, making comparisons easier.
2. Companies with subsidiaries in countries that require or permit IFRS may be able to use one accounting language company-wide.
3. Companies may need to convert to IFRS if they are a subsidiary of a foreign company that must use IFRS, or if they have a foreign investor that must use IFRS.
4. Capital market regulators must be aware of only one set of accounting standards and the companies will experience efficiency in raising capital and reduced information processing cost.
5. The companies will no longer required to prepare its financial statement under different GAAP and make the task of listing shares in foreign exchange easier.

Advantages of the IFRS

a) The world's economies are becoming more integrated and having one accounting system will make life a little less complicated for both the companies and the investors.
b) As multinational businesses continue to grow and expand, a thorough knowledge of IFRS is now essential for internationally active, growing businesses.
c) There seems to be worldwide consensus surrounding the need for one global set of high-quality accounting standards and that IFRS is currently best positioned to fulfill that need.
d) In today's global economy the consistency of one reporting standard will make it more efficient for investors to research and compare financial statements globally and more effectively.
e) IFRS adoption leads to higher market liquidity, more investment flows through foreign mutual funds, and more favourable terms in private debt contracting, greater analyst coverage, and lower stock return synchronicity.

Process of convergence with IFRS in India

India has also mandate the IFRS for financial reporting statement from 1st April 2011 but still India have been not succeeded to resolve its issues relating to conversion with IFRS such as taxation. After enactment of Companies Act 2013 the ministry of corporate affairs has focused to implement IFRS.

Phase I 1st April 2016: Mandatory Basis

a) Companies listed/in process of listing on Stock
b) Exchanges in India or Outside India having net worth > INR 5 Billion
c) Unlisted Companies having net worth > INR 5 Billion
d) Parent, Subsidiary, Associate and Joint Venture of above

Phase II 1st April 2017: Mandatory Basis

a) All companies which are listed/or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges)
b) Unlisted companies having net worth INR 5 Billion > INR 2.5 Billion
c) Parent, Subsidiary, Associate and Joint Venture of above

- Companies listed on SME exchange not required to apply Ind AS.
- Once Ind ASs are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements.

- Companies not covered by the above roadmap shall continue to apply existing but the professionals are still having difference on how to get fair value of assets and liabilities. Therefore India needs to develop its conference regarding to IFRS convergence. Also need to develop some training programs for IFRS policies. For the purpose of successful conversion of IFRS with Indian Corporate, India needs to have efficient professionals to operate in this field. Apart from this, IFRS require the fair market value applications in financial reporting this may create significant differences in financial information currently presented in financial reports.

Problems and Challenges

India has several constraints and practical challenges to adoption and compliance with IFRS. So there is a need to change some laws and regulations governing financial accounting and reporting in India.

1. **Difference in GAAP and IFRS:** Adoption of IFRS means that the entire set of financial statements will be required to undergo a drastic change. The differences are wide and very deep routed. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.
2. **Training and Education:** Lack of training facilities and academic courses on IFRS will also pose challenge in India. There is a need to impart education and training on IFRS and its application.
3. **Legal Consideration:** Currently, the reporting requirements are governed by various regulators in India and their provisions override other laws. IFRS does not recognize such overriding laws. The regulatory and legal requirements in India will pose a challenge unless the same is been addressed by respective regulatory.
4. **Taxation effect:** IFRS convergence would affect most of the items in the financial statements and consequently the tax liabilities would also undergo a change. Thus the taxation laws should address the treatment of tax liabilities arising on convergence from Indian GAAP to IFRS.
5. **Fair value Measurement:** IFRS uses fair value as a measurement base for valuing most of the items of financial statements. The use of fair value accounting can bring a lot of instability and prejudice to the financial statements. It also involves a lot of hard work in arriving at the fair value and valuation experts have to be used.

Impact on Indian banks

Banks shall comply with Ind AS for financial statements for accounting periods beginning 1 April 2018, with comparatives for the periods ending 31 March 2018 or thereafter. Ind AS shall be applicable to both standalone financial statements and consolidated financial statements.

1. Banks shall apply Ind AS only as per the above timelines and shall not be permitted to adopt Ind AS earlier.
2. The boards of the banks should have the ultimate responsibility in determining the Ind AS direction and strategy and in overseeing the development and execution of the Ind AS implementation plan.
3. Banks are advised to set up a Steering Committee headed by an official of the rank of an executive director (or equivalent), comprising members from cross-functional areas of the bank to immediately initiate the implementation process.
4. The Audit Committee of the Board shall oversee the progress of the Ind AS implementation process and report to the Board at quarterly intervals.
5. Banks need to submit proforma Ind AS financial statements to the RBI from the half-year ended 30 September 2016 onwards.

The application of Ind AS is based on the listing status and net worth of a company. Ind AS will first apply to companies with a net worth equal to or exceeding 500 crore INR beginning 1 April 2016. Listed companies as well as others having a net worth equal to or exceeding 250 crore INR will follow 1 April 2017 onwards. From April 2015 companies impacted in the first phase will have to take a closer look at the details of the 39 new Ind AS currently notified. Ind AS will also apply to subsidiaries, joint ventures, associates as well as holding companies of the entities covered by the roadmap

Areas of impact

The Ind AS standards covers all aspects of financial statements. CRISIL believes the financial statements of a majority of companies it rates would be affected because of the following changes:

- Revenue recognition norms
- Changes in networth on account of fair valuation of instruments, property and acquired entities
- Treatment of intangible assets and goodwill
- Guidelines on consolidation of financial statements changes from the proportionate consolidation method for joint ventures to the equity method
- Changes in P&L on account of derivatives as well as foreign currency loan obligations
- Proposed dividend and deferred tax assets
- Employee based share payments
- Reclassification of actuarial gains and losses

Extent of impact

Though the above mentioned areas of accounting changes are likely to affect a majority of companies, the extent of impact will largely be driven by differences in reported net worth. A CRISIL study of 80 rated companies that have reported their first quarter results for the current fiscal as per Ind AS, shows only 8 of them have reported information on changes in Net worth as on March 31, 2016, under revised accounting standards. In 4 of these companies, the deviation in networth was 5% or more compared with Indian GAAP.

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