

Chapter 1

Introduction

The world of Accounting and Finance is ever-expanding. Accounting prepares the foundation for Finance. A Financial Reporting Framework may be defined as a set of measures or criteria that is applied to govern the ‘recognition’, ‘measurement’, ‘presentation’, and ‘disclosure’ of all material and relevant items appearing in the financial statements. Good accounting practices produce high-quality accounting information which is a pre-requisite to efficient financial decision-making. These days, accounting is not just a technical practice consisting of recording, measuring, and interpreting but has also evolved to be a social practice influencing individual and organisational behaviours, functioning, and developments (Carnegie, 2014). In most countries, the financial reporting frameworks contain a set of accounting standards that are required to be complied with by the reporting entities from the initial stage of accounting till the preparation of the financial statements. The evolution of accounting systems around the is not bound to any single origin or timeframe. From the days of Chanakya in Ancient India to the current times of the generally accepted accounting principles, the scope, purpose, and influencing abilities of accounting have widened immensely. The path-breaking decision of “liberalisation, privatisation, and globalisation” in India forced Indian companies to place more importance on developing global acceptability and marketability. With the potential expansion of the market and possibilities of foreign investments, both the entities and the regulatory bodies focused on increasing transparency and disclosures. All over the world, information asymmetry harms investment opportunities. Timeliness and transparency in financial information act as catalysts in attracting foreign investments (Wurgler,

2000). Comparability of financial statements becomes vital since it promotes both timeliness and transparency.

1.1 Comparability of Financial Information:

The term ‘Comparability’ is defined in the English Dictionary (Oxford Learner’s Dictionaries) as the fact of being similar to something else and able to be compared.

In the field of finance, comparability of Financial Statements refers to the extent of consistency in the financials between different entities which is an important measurement of the overall quality of accounting information (De Franco et al, 2011). Comparability in the case of financial statements may either be that of the same entity over time or between different entities at the same time. It may also be ‘De Jure’ or ‘De Facto’; while the first one measures the comparability of different accounting standards, the second one measures the comparability of accounting practices (Cole et al, 2009).

The Conceptual Framework published by the International Accounting Standards Board (IASB) also emphasises comparability and classifies it under the qualitative characteristics of financial information. Comparability enables the users of financial information to identify and assess the similarities and differences among financial items. The framework also explains that comparability may be achieved by faithful representation, which is a fundamental characteristic of financial information. It further goes on to clarify that to ensure faithful representation, financial reporting information should be ‘complete’, ‘neutral’, and ‘free from error’.

Readability of Financial Statements is a key factor in the global acceptability of a firm. However, The Financial Reporting Frameworks in countries differed from one another. While opening up the Indian market beyond domestic barriers, the difference in domestic accounting principles and reporting guidelines was a major challenge for lawmakers (Narayanswamy, 1996). To comply with local judicial requirements, a company had to draft its financials not only as per the financial reporting framework of its country of establishment but also that of every country where it had a place of business. Thus, the differences in accounting principles were turning out to be a worldwide setback to the comparability of financial information and globalisation (Hope, 2003). In order to address this issue of uniformity and facilitate international trade, conceptualisation, as well as the implementation of IFRS, became globally important (Ofoegbu & Odoemelam, 2018).

1.2 International Accounting Standards Board:

Back in 1973, the professional accounting bodies of The United States of America, the United Kingdom & Ireland, Australia, Canada, Germany, France, Netherlands, Japan, and Mexico joined hands to form the International Accounting Standards Committee (IASC). Thereafter, similar regulatory bodies from other countries also became members of this committee. The IASC Board proposed a body exclusively for conceptual frameworks, standards, interpretations, and other guidance. In 1997, the IASB acknowledged the requirement of convergence between domestic accounting practices and the proposed global accounting framework. As per the proposals of the Strategy

Working Party formed by the committee, the IASB revised its constitution and the standard-setting body was renamed as the IASB. As per the revised constitution, the IASB was required to function under a new International Accounting Standards Committee Foundation which was later renamed as the IFRS Foundation. IASB then emerged as the independent body which has the exclusive power to develop the IFRSs. Apart from the issuance of IFRS, IASB is also charged with the authority to approve the interpretations developed by the IFRS Interpretation Committee.

1.3 International Financial Reporting Standards:

The above problem which was hampering cross-border investments, was discussed at many international forums and the requirement of a high-quality single set of accounting standards was noted (G20 Leaders Declaration, 2012). In December 2013, the IASB which was the authorised body for setting the standards, published a statement claiming IFRS as the global language in financial reporting which makes the financial information more comparable, especially on the spatial scale (Pacter, 2014). The International Financial Reporting Standards (IFRS) were drafted with a mission to provide transparency by “*enhancing the international comparability and quality of financial information*” across the globe (IFRS Foundation, 2001). Over the years, many developed, developing as well as under-developed countries have adopted IFRS for several reasons, these include United Arab Emirates, Australia, Bahrain, Canada, Costa Rica, Kuwait, Lebanon, Mexico, European Union, Russia, United Kingdom, South Africa, Nigeria, South Korea, Qatar, Iran, Nepal, Bhutan, Sri

Lanka, Oman, Mauritius, Kenya, Jamaica, Jordan, etc. It may be interesting to note that as per Deloitte, IFRSs are mandatory for all entities irrespective of their size and nature of financial statements in ninety-eight jurisdictions. Among others, IFRSs are mandatory for some entities in nine jurisdictions and permitted in twenty-five other jurisdictions.

While most of the domestic standards are ‘rules-based’, one of the prime features of IFRS is that they are ‘principles-based’. Unlike ‘rule-based’ standards, they do not address and specify solutions to every controversial issue and leave enough scope for the applying entity to apply its own assumptions based on the prevailing situations. Thus, IFRS leave accounting choices to the extent they do not contravene the accounting principles established in the standards. This inherent flexibility in IFRS facilitates its global acceptance (Carmona & Trombetta, 2008).



Fig 1.1: Countries (marked in blue) where IFRS Standards are required for domestic public companies (Source: ifrs.org)

On the other hand, this also demands a sound understanding of the subject and economic conditions and proper reflection of the same on the accounting decisions to uphold the essence of IFRS.

The IASB has also identified that to make the IFRS truly global, there is a requirement for uniform accounting standards for small entities which may not have a cross-border outreach. Accordingly, the IASB has come up with IFRS for SMEs. However, the process of adoption of IFRS is still far from the expectations and deadlines. IFRS has been completely adopted in some countries while some countries are still in the process of adoption and some have decided not to adopt at all. As a result, the objective of comparability of financial information of firms listed in different jurisdictions is yet to be achieved (Felski, 2017, Phan et. al, 2020).

1.4 Accounting in India:

Accounting in India has evolved from time to time. The Arthasastra of Kautilya is considered to be one of the oldest written representations of accounting concepts. Historians acknowledged Kautilya's contribution to accounting under four heads – a. developing accounting principles, b. defining the scope and methods of accounting, c. coding down the financial rules, and d. emphasizing ethics to eliminate fraudulent accounting practices (Sihag B, 2004). From the ancient period of Rigveda, through the rules of the Mauryas, Mughals, Khiljis, Cholas, and the British, and finally to the modern era of digitalisation,

accounting practices have witnessed continual changes. The Institute of Chartered Accountants of India (ICAI), set up by The Chartered Accountants Act, 1949 is the highest accounting regulatory body in India since its inception. The responsibility of drafting accounting standards for the Indian financial environment lies with The Accounting Standards Board of the ICAI. Since 1979, the ICAI has released a total of thirty-two accounting standards (AS-1 to AS-32) out of which some were withdrawn later (AS-8), some were merged into one (AS-6 and AS-10) and nearly all were revised from time to time. Section 129 of The Companies Act, 2013 (and its corresponding sections in the earlier versions of the law, wherever applicable) requires all companies to prepare financial statements as per accounting standards notified under Section 133 of the said act. The Ministry of Corporate Affairs, in consultation with the National Advisory Committee on Accounting Standards, notifies the standards. Presently, Section 133 consists of both the old standards and the new Ind AS. While Ind AS has been made mandatory for all listed companies, the Indian “generally accepted accounting principles” (GAAP) is still being followed by most of the micro, small, and medium companies and non-corporate business entities in India.

1.5: Ind AS – The Convergence with IFRS in India

Addressing the global drive for uniform accounting principles and practices all over the globe, the regulatory bodies acknowledged the requirements in the Indian scenario. However, they also noted the fact that the international standards in many areas are not in line with domestic laws. These differences may lead to inappropriate applications, unnecessary complexities, and confused

interpretations (Basu & Mitra, 2019). considering the social, legal, and economic aspects, unlike most nations, India decided to go for convergence with IFRS rather than a straightway adoption¹.

Accordingly, the accounting standards board of the ICAI prepared a completely new set of accounting standards in the name of “Indian Accounting Standards”, popularly coined as the Ind-AS. The Ministry of Corporate Affairs through a press release² announced the road map for implementation of Ind AS and later notified the Companies (Indian Accounting Standards (IND AS) Rules 2015 which prescribed a phase-wise plan for transition from Indian GAAP to Ind AS³.

1. Concept Paper on Convergence, published by the ICAI.
2. MCA Press Release No. No. 11/10/2009 CL-V dated 2nd January 2015
3. Rule 4 of the Companies (Indian Accounting Standards (Ind AS)) Rules 2015

As per the above rules, all listed and unlisted companies, having a Net Worth of Rupees Five Hundred Crore or more and holding, subsidiary, joint venture, or associate of such companies were required to comply with Ind AS for the preparation of Financial Statements for the accounting year 2016-17 with comparatives for 2015-16. The Net Worth was to be calculated as per Section 2(57) of the Companies Act, 2013 where Net Worth means the aggregate of Paid up Share Capital, Reserves created out of Profits, and Security Premium Account, as reduced by accumulated losses, deferred expenditures and miscellaneous expenditures not written off. This net worth was to be calculated as on 31st March 2014 or the date of the first balance sheet, whichever is later. This Phase of implementation is popularly known as the Phase I (Deloitte, 2015).

The interesting point here to note is that since India had gone for convergence and set up a new reporting framework, Ind AS is unique in its nature. Theoretically, it is expected to materially differ from the Indian GAAP and also consist of certain deviations from IFRS as well.

The transition to Ind AS also faced some challenges, the worst of which was the COVID-19 pandemic. Like other nations, the Indian economy was also hit by the pandemic in the most disastrous manner. For the Financial Year 2019-20 and 2020-21, companies faced great difficulty to normally continue their business operations. During this phase, there remained volatility in the financial performance of entities operating in most of the industries across the globe.

1.6 Delineation of Scope:

Accounting standards are consistently modified to keep pace with the changing demands and scope of financial information. Academic researches work as a significant tool for standard setters and policymakers by providing helpful shreds of evidence (Palea, 2013). Most of the researches on IFRS-based financial accounting are performed from the positive accounting theory outlook and tends to find its effect from the capital market perspective (Kalnth & Mustafa, 2021).

The Positive Accounting Theory is a methodology introduced in 1986 by Watts & Zimmerman of the University of Chicago and Rochester to replace the

theoretical methodologies with extreme empiricism (Schiehl et al, 2007). If compared with other fields of study, research on Accounting in India is surprisingly very limited in quantity in spite of the growing complexities and changing applications all over the globe (Singh, 2004). However, in recent times, with events like convergence with IFRS, issuance of Ind AS, issuance of Income Computation and Disclosure Standards (ICDS), and the emergence of integrated reporting concepts, the scope of research has significantly expanded.

The transition to Ind AS was a major step in the Indian Accounting scenario. Though the Accounting Standards Board of the ICAI did not make any decisions regarding IFRS till 2006, the Indian GAAP was being revised from time to time in order to address global accounting issues. Further, the ICAI specified that the functions of the board include consideration of the corresponding international standards while drafting the accounting standards and integrating with them if possible (ICAI, 2007).

There were huge expectations for improvement in readability, transparency, and disclosures. On the other side, since Ind AS shifted the fundamental accounting concept from historical cost to partial fair value (Ghosh, 2019), there is always a concern among both companies and regulators regarding the impact of Ind AS on the financial position of the company.

Theoretically, Ind AS is said to be unique from the perspective that though it is based on IFRS, it includes major carve-outs which has been delicately made to fit it in the Indian context. In this way, India has made some severe departures from the IFRS rules and norms (Pal, 2015).

The big question that lies here is whether India can achieve the desired objective of comparability by introducing an IFRS-based framework instead of adopting the IFRS itself. Plenty of factors play an important role in the successful implementation of a financial reporting framework. Inappropriate or improper implementation may generate unexpected results and hamper the attainment of the desired objectives (Othman & Kossentini, 2015). A proper implementation can limit the opportunistic managerial discretions, reduce earnings management practices, and improve the quality of accounting information. However, the quality of information may not be similar across all countries. Researchers noted several macroeconomic factors that also affect the quality of accounting information.

In a developing economy like India, faithful representation of financial information has the risk of adding to the anxiety of the stakeholders. This invariably augments the market volatility and hampers the economy as a whole. On the other hand, attempts to curtail the said risk often compromise the faithfulness and transparency of financial information. It is a challenge for lawmakers to keep a balance between both while framing the accounting principles.

In this research, we wish to make a detailed comparison of the Ind AS and IFRS. This is expected to help in understanding where the first one prescribes treatments that are different than those in the second. The main goal shall be to

examine whether or not the transition to Ind AS had made any impact on the Financial Reporting of Indian adopting entities.

Answers will help us analyse how far we have been able to reach in the journey from Indian GAAP to IFRS. In addition, if we can find out how the transition to Ind AS affected the financial position of the adopting entities which are among the most-valued companies of the country, we will be able to have a clear understanding of how this movement towards Ind AS will impact the financial markets in India.

1.7 Chapter References:

1. Hope, O. “Disclosure Practices, Enforcement of Accounting Standards and Analyst Forecast Accuracy: An International Study.” *Journal of Accounting Research* 41 No. 2 (May, 2003): 235-272.
2. Wurgler, J. (2000), “Financial markets and allocation of capital”, *Journal of Financial Economics*, Vol. 58 Nos 1-2, pp. 45-65.
3. Narayanaswamy, R. (1996). Voluntary US GAAP disclosure in India: The case of Infosys Technologies Limited. *Journal of International Financial Management & Accounting*. Vol 7, pp. 137 – 166.
4. Ghosh, T. P. (2019). Impact of IFRS Convergence in India: An Evidence from First Time Adoption of Indian Accounting Standards. *Accounting & Finance Research*, Vol 8(1), pp 157-173.
5. Kaith, A. & Mustafa, G. (2021). Conceptual formation and explanation in IFRS-based financial accounting research. *Cogent Business & Management*, Vol 8(1)
6. De Franco, G., Kothari, S., & Verdi, R. (2011). The benefits of financial statement comparability. *Journal of Accounting Research*, Vol 49, pp 895–931.
7. Schiehl, E., Borba, J. A. & Murcia, F.D. (2007). Financial accounting: an epistemological research note. *Revista Contabilidade & Finanças*. Vol 18(45), pp 83-90.
8. D. Carnegie, G. (2014). The present and future of accounting history. *Accounting, Auditing & Accountability Journal*, 27(8), 1241–1249.
9. Sihag, B. (2004). Kautilya on the Scope and Methodology of Accounting, Organizational Design and the Role of Ethics in Ancient India. *Accounting Historians Journal*. Vol. 31. pp 125-148.
10. Pacter, P. (2014). Global Accounting Standards – From Vision to Reality. *The CPA Journal*. Issue 1.
11. Palea, V. (2013). IAS/IFRS and financial reporting quality: Lessons from the European experience. *China Journal of Accounting Research*, Vol 6(4), pp 247–263.
12. Carmona, S., & Trombetta, M. (2008). On the global acceptance of IAS/IFRS accounting standards: The logic and implications of the principles-based system. *Journal of Accounting and Public Policy*, Vol 27(6), pp 455–461.