

An impact study of IFRS

International Financial Reporting Standards (IFRS) ignites extreme passions equally amongst protagonists and antagonists. And why not? IFRS represents a tectonic shift in the grammar of accounting. Yet, there was no assessment done on the socio-economic impact of introduction of IFRS till the University of Oxford stepped in with a recent study.

The result, “Socio-Economic Impacts of IFRS on Wider Stakeholders in India”, by Dr Tomo Suzuki and Prof Jaypal Jain of Said Business School, University of Oxford, has been recently submitted to The Institute of Chartered Accountants of India (ICAI).

The authors have carried out several rounds of interviews with 371 stakeholders to reach a collective understanding on the impact of IFRS in India. Deploring the standard rhetoric used to project IFRS as “high quality, global accounting standards that enhance transparency, comparability and the efficiency of the financial markets in the public interest,” the authors point out as to why even the very introduction (forget convergence or full adoption) of IFRS should be considered as a matter affecting our national interest.

Warning stakeholders that the impact of IFRS is largely unexplored, more so for a developing country like India, the Report reveals, rather startlingly, that many including capital market participants did not find any significant benefits of IFRS. Further, vast majority of stakeholders considered the introduction of IFRS costly without corresponding benefits to them.

Promotion of IFRS

The Report points out how no one could articulate why and how IFRS convergence was necessary or better for globalization or, more importantly, desirable for India. Similarly the authors do not seem to be too impressed with the standard rhetoric that adopting IFRS would lead to more foreign capital inflows.

The Report points out that most members of the ICAI were unaware of the decision to converge with IFRS, while exposing the role of the then President of the ICAI (2007-08) in announcing convergence, “without proper consultation and procedure.” The paradox is ironical — IFRS, ostensibly sought to be introduced to enhance transparency in business was in effect smuggled in the most undemocratic manner!

Whose agenda?

Naturally all these raise an uncomfortable question — who is interested in this agenda of thrusting IFRS on us? How is it that the ICAI completely sold out to this idea without a debate?

The Report concedes that no one seems to understand how exactly IFRS has become so influential concluding that if politics dominates the introduction of IFRS in India, it could

be only at the cost of wider stakeholders, whose voices are structurally under-represented. The International Accounting Standards Board (IASB) — the global accounting body that set these standards — is a private body which is accountable to none. Yet, accounting norms are an instrument of political sovereignty and far too important to be left to such private bodies!

Serious questions

The Suzuki-Jain report is one of first studies to raise serious questions on the fundamental principles that drive IFRS. Conventional accounting measures profit on the income statement as an indicator of a company's performance while simultaneously excluding future profits by matching realized revenues against accrued cost. In contrast, Fair Value Accounting (FVA) defines profit on the Balance Sheet as an increase in net assets over a period. The discomfoting factor for many is when the fair value of assets is measured by estimated future cash flows; it could include unrealized future profit. The fundamental accounting principle of conservatism would get the short shrift.

The concern of the authors is “how often estimates are required, and how reliable they can be, not in the context of advanced financial economies but in the local contexts of India and other jurisdictions including emerging economies.”

Endless referencing?

FVA can often be driven by different models and estimates which officially have to be determined by the management.

Is this a responsibility or freedom? In the absence of detailed rules, how are the estimates to be determined by the management, particularly in developing countries?

That leads us to a fundamental question — how will the fair value of assets and liabilities be “negotiated” between management and auditors? We may end up with a long chain of professional referencing where professional valuers, management and auditors flourish in an environment where no one is held accountable by the system, while the increased costs are borne by investors.

All this explains why the top honchos in the ICAI are rooting for IFRS but it is indeed inexplicable why Corporate India, especially those who have no need for foreign capital, have not raised their voice on these lines. Similarly, investor forums too have been silent.

Taken for Granted

The Report questions the presumption in the world of finance that the disclosure of fair value to investors without time lag is efficient and preferable.

Crucially, it points out that beneath the armour of fair value and transparency, preparers and auditors admit to the increasing magnitude of subjectivity and risks under IFRS.

Naturally, this raises a basic doubt — where there are multiple fair values that can be chosen from under IFRS, what can be held to be transparent?

On top of this, corporates fear that they have to grapple with the consequent tax implications.

The Report points out how the US Securities Exchange Commission and Financial Accounting Standards Board are increasingly under pressure to slow the pace towards convergence. Ditto with regulators in Japan. In effect, world over there seems to be a rethink on IFRS.

The Suzuki-Jain study points out that IFRS brings significant “unexplored impacts” to many different areas of socio-economics, some of which are negative and override the positive effects in capital markets.

Managers are incentivised and often forced to play the number game based on “unrealized profits” which in turn are expected to be distributed as dividends.

No wonder IFRS is being pursued by these vested interests including international investing community. Interestingly, in such a scenario the Report points out as to how no one will take responsibility or will be held accountable simply because G-20 leaders and multilateral agencies have endorsed the same.

All these are frightening. Yet, ICAI is slated to discuss this Report in its Council Meeting at its own leisure in March.

Perhaps, by that time it might become too late as the timeline for the first set of corporates who have to begin their convergence is April 1.

Surely, vested interests would love the Suzuki-Jain Report to be buried.

Therefore, it is in the interest of trade bodies and chambers of commerce to ensure larger discussion and generate appropriate political pressure to ensure postponement of IFRS implementation till the findings of this Report are widely disseminated, discussed and debated. After all, should not the “most transparent accounting idea” be introduced transparently?

Source : The Business Line.