

UTILIZATION OF FOREIGN FUNDS IN INDIA THROUGH HARMONIZATION OF DOMESTIC ACCOUNTING STANDARDS AND INTERNATIONAL ACCOUNTING STANDARDS

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ABSTRACT

The Indian economy was traditionally a socialistic economy. So the Indian Accounting Standards were made keeping into consideration the needs of the Indian business environment, primarily. But with the introduction of "LPG" i.e. liberalisation, privatisation and globalisation in the early nineties, a time came when it was seen that it would be right to refer to the Indian economy as a mixed economy. It was since this time that the Indian economy started to adopt features of not only the socialistic economy but also the capitalistic economy. The doors and windows of the Indian economy were opened. Under the circumstances, it became extremely essential to consider the demands of the global business environment. Hence, arose the necessity of harmonising the Domestic Accounting Standards (already referred here as the Indian Accounting Standards) and the International Accounting Standards. In the absence of such harmonisation it was seen that utilisation of foreign funds was becoming very difficult and this was forcing the Indian economy to progress at a slower rate. Hence, the question of harmonising the two sets of accounting standards took birth and was being addressed in research works.

Keywords: Domestic Accounting Standards (DAS), International Accounting Standards (IAS), Foreign Direct Investment (FDI).

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INTRODUCTION:

In a study on the comparison of the Indian Accounting Standards and the International Accounting Standards, effort was made to study the characteristic features of the Indian Accounting Standards that are needed to be changed in order to match the International Accounting Standards. It was seen that with the advent of globalisation in India, the issue of Foreign Direct Investment (FDI) became a significant one. In order to make the economy proceed at a faster rate and transform India from a developing economy to a developed economy, it was necessary to increase the volume of foreign direct investment. But there were barriers to it. One such barrier was arising out of the differences in the mode and nature of the Domestic Accounting Standards and the International Accounting Standards.

The Indian organisations were maintaining their books of accounts, financial statements and other relevant financial and management data by following the Domestic Accounting Standards. There was nothing wrong in it but these books of accounts, financial statements and sets of financial and management data were at times not capable of supplying the data that was needed by a foreign organisation to invest money in this country. This was hampering the rate of economic development in India as the volume of Foreign Direct Investment was not as much as it would have been ideally. From here arose the issue of reconciling the two sets of accounting standards i.e. the Domestic Accounting Standards (DAS) and the International Accounting Standards (IAS).

LITERATURE REVIEW

A discussion on the literatures reviewed in this study is as follows:

1) Generally Accepted Accounting Principles:

This is a technical term used in accountancy. This refers to the existing rules and conventions that are followed during preparation of the books of accounts. This is at times referred as Generally Accepted Accounting Principles (GAAP).

2) Accounting Standard:

At times it is seen that there are a number of accounting rules being followed by different companies across a wide spectrum of businesses during preparation of the books of accounts making comparative analysis of financial statements nearly impossible. This led to the concept of accounting standards to maintain uniformity in such situations.

3) Indian Accounting Standards:

Indian Accounting Standards considered in this study are as follows:

1. AS - 1 Disclosure of Accounting Policies
2. AS – 2 (Revised), Valuation of Inventories
3. AS – 3 Cash Flow Statements
4. AS – 4 Contingencies and Events Occurring after the Balance Sheet Date
5. AS – 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
6. AS – 6 Depreciation Accounting
7. AS – 7 Accounting for Construction Contracts
8. AS – 8 Accounting for Research and Development
9. AS – 9 Revenue Recognition
10. AS – 10 Accounting for Fixed Assets
11. AS – 11 Accounting for the Effects of Changes in foreign Exchange Rates
12. AS – 12 Accounting for Government Grants
13. AS – 13 Accounting for Investments
14. AS – 14 Accounting for Amalgamations
15. AS – 15 Accounting for Retirement Benefits in the Financial Statements of Employers
16. AS – 16 Borrowing Costs
17. AS – 17 Segment Reporting
18. AS – 18 Related Party Disclosures
19. AS – 19 Leases

4) Comparison between Indian Accounting Standards and International Accounting Standards:

Differences between Indian and international accounting standards are considered as follows:

Sl. No	International Accounting Standards		Indian Accounting Standards	
	IAS No	Title of the Standard	AS No	Title of the Standard
1	1	Presentation of Financial Statements	1	Disclosure of Accounting Policies
2	2	Inventories	2	Valuation of Inventories
3	4	Depreciation Accounting	6	Depreciation Accounting
4	7	Cash Flow Statements	3	Cash Flow Statements
5	8	Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	5	Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies.
6	10	Events after the Balance Sheet Date	4	Contingencies and Events Occur after the Balance Sheet Date.
7	11	Construction Contracts	7	Acc. for Construction Contracts
8	14	Segment Reporting	17	Segment Reporting
9	16	Property, Plant and Equipment	10	Accounting for Fixed Assets
10	17	Leases	19	Leases
11	18	Revenue	9	Revenue Recognition.
12	19	Employee Benefits	15	Acc. for Retirement Benefits in the Financial Statements of Employers.
13	20	Acc. for Govt. Grants and Disclosure of Govt. Assistance	12	Accounting for Government Grants
14	21	The Effects of Changes in Foreign Exchange Rates	11	Accounting for the Effects of Changes in Foreign Exchange
15	22	Business Combinations	14	Accounting for Amalgamations
16	23	Borrowing Costs	16	Borrowing Costs
17	24	Related Party Disclosures	18	Related Party Disclosures
18	25	Accounting for Investments (withdrawn from 01.01.2001)	13	Accounting for Investments
19	40	Investment Property (Effective 01.01.2001)	-	Dealt with by Accounting Standard 13
20		Corresponding IAS has been withdrawn since the matter is now covered by IAS 38.	8	Accounting for Research and Development.

RESEARCH DESIGN AND APPLIED METHODOLOGY

This research is aimed at studying the differences in the Indian Accounting Standards and the International Accounting Standards. This is being done with the objective of reconciling the two sets of accounting standards so that the issue of foreign direct investment is easier to deal with.

A discussion on the research design, data collection and analysis are as follows:

1) Research Design:

The Indian companies mostly follow the Indian Generally Accepted Accounting Principles. These are better known as IGAAP. But it was decided to follow IFRS from April 1, 2012 in a phased manner. Some companies have voluntarily accepted these from 2007 only. This was done by them to be at par with the global companies and facilitate easy business opportunities for them. This research aims to study how the use of IFRS has positively impacted these Indian companies in their volume of business acquisitions over the years.

2) Sampling:

We have information on accounting differences in 62 countries. However, our sample size is constrained by data availability, depending on the regression. Countries are classified in a decreasing order of absence and divergence. Our sample captures a significant proportion of the world economy; it represents 66.2% of the total World GDP in 2001 across 30 countries. Our view is that until 2001, the differences between DAS and IAS in our sample countries reflected the natural development of accounting standards without mandated adoption of IAS.

3) Data Collection:

For sample selection for the study, the researcher looked at the list of Indian companies that issued Global Depository Receipts (GDRs) in European Union. There were a total of 172 Indian companies whose GDRs are listed on Luxembourg Stock Exchange. These companies were bound to report their financial statements in IFRS also because European Union has mandated IFRS reporting from 2007.

The researcher then looked at the websites of each of these 172 companies to locate the annual reports in Indian Generally Accepted Accounting Principles and IFRS.

ANALYSIS

The financial statements of an organisation should be able to throw light on the following areas:

1) Liquidity:

It refers to the capacity of the organisation to meet its day to day obligations.

2) Profitability:

Profitability is the capacity of the company to earn profits.

3) Leverage:

It refers to the financial stability of the company.

4) Market Based Ratios:

Some of the market based ratios are:

Variables	Equations
1. Liquidity:- Quick ratio	Quick Assets (Cash, Marketable securities and Receivables / Current liabilities
2. Profitability: - Return on equity	Net Profit / Shareholders' equity
3. Leverage: - Gearing ratio	Total debts (long and short term) / Shareholders' equity
5 Market Based Ratio:- Price earnings ratio	Market price per share / EPS

Based on each ratio, financial risk is calculated as the standard deviation of the four parameters for each company for each of four years. There are two sets of financial risks - one IFRS based and the other IGAAP based. The table presents the descriptive details for the economic activity of financial risk as under:

Economic Activity	IFRS		IGAAP		Difference (IFRS- IGAAP)	
	Mean	SD	Mean	SD	Mean	SD
Financial Risk	9.4417	3.7636	9.1400	4.0007	0.3017	0.7533

From the above table, it is observed that in absolute terms, mean of financial risk is more in IFRS as compared to IGAAP. Even though the financial risk increases in IFRS as compared to IGAAP in absolute terms, the testing of hypothesis of impact on financial risk is done using the statistics at 5% level of significance.

CONCLUSIONS

Today, India shares a very small portion of the international funds. This is hugely because when the international investors study the financial statements and the books of accounts of the Indian firms before investing money, in order to understand the prospect of the business and how quickly profits can be ploughed back, it is seen that they do not get the necessary data. This largely impacts investment. The Indian firms are used to follow the Indian Accounting Standards which were in many areas different from the International Accounting Standards. Today from the governmental sources as well as from the private sources efforts are being made to follow the International Accounting Standards. But this study also highlights on the degree and nature of adoption of the International Accounting Standards. The research proves that the method of adoption of these accounting standards should be voluntary. Only then the Indian Accounting Standards will be able to take the shape of their international counterparts and serve the purposes as their international counterparts do. This will be the ideal situation which can be brought in by a process of continuous change in the Indian Accounting Standards and bringing them as close as possible to the International Accounting Standards.

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