Convergence of Accounting Standards on Consolidated Financial Reporting Practices

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Abstract:

Convergence is the process by which standard setters across the globe to discuss accounting issues, drawing on their combined experiences in order to arrive at the most appropriate solution to resolve the issues. Accounting standards or policies made by different international organizations which come under two categories; those backed by International or Political agreements which includes the United Nations and the European Union and Voluntary organizations which includes IASB, IFAC, IOSCO, and the European Financial Reporting Advisory Group. Further it includes, Confederation of Asia Pacific Accountants, American Accounting Association, The British Accounting Association, The Indian Accounting Association etc. This paper focus on the, Early Developments in convergence, need for Convergence, Important points of Convergence with relation to consolidated financial reporting and accounting practices. The result of this paper reveals that accounting standards have substantially converged with accounting standards, at least in the area of consolidated financial reporting, but there still exist some differences between the two referential which discussed in this paper.

Keywords: Accounting, IFRS, Convergence, Consolidated Financial Reporting, IASB.

Introduction: -

The globalization is a worldwide booming phenomenon, a long process, whose complexity and irreversibility are now recognized, accepted and acknowledged by the vast majority of countries. It is obvious that the benefits of the existence of a common and uniform financial reporting framework, which is based on the globally accepted accounting standards, are more pronounced in the current conditions of globalization. We can thus speak of a process of accounting harmonization, standardization and uniformity accounting, but also of a comprehensive process of accounting convergence, convergence to a set of high quality standards accepted by the accounting profession worldwide. Accounting convergence plays an important role in the projects of prominent international and national accounting regulatory bodies who have realized and supported the need for compatible and high quality international standards. This process of convergence which has become the common goal of the two major international bodies (FASB and IASB) is the largest depth in accounting internationalization plan. At the same time, the accounting convergence is presented as a process of moving towards a single point, especially the movement toward union or uniformity.

Accounting convergence process questions the increase of comparability between two or more international accounting referential, while accounting harmonization phenomenon refers to the degree of compatibility and/or comparability between a national and international accounting standards. In the specialized literature, the concept of accounting convergence is mainly used where there is a direct reference to U.S. GAAP compared to IAS/IFRS.

The convergence between U.S. GAAPs and IFRS has its starting point in 2002, after the meeting of FASB and IASB members, when the Norwalk Agreement was signed. Following this agreement, the IASB and the U.S. Financial Accounting Standards Board (FASB) have expressed their commitment to work together in order to achieve convergence of IFRSs and U.S. Generally Accepted Accounting Principles (GAAP) and to remove the differences between these referential; there still remains a priority of both the IASB and the FASB the common set of high quality global standards. Over time, the two sets of standards are expected to improve both in quality and become increasingly similar, if not identical. Therefore, points out that the purpose of FASB-IASB convergence efforts is to approximate U.S. GAAP and IFRS standards as much as possible in different jurisdictions, improving the overall quality of these standards. To achieve compatibility between standards, these two bodies have focused their efforts on: short term convergence projects; and major joint projects.

Globalization has created an unavoidable demand for convergence of financial reporting that is being met by International Financial Reporting Standards (IFRS). These international accounting standards have brought significant changes in accounting procedures and financial reporting practices worldwide. Specifically, these regulatory changes have led to substantial modifications in the preparation of financial statements and the presentation of financial information to various stakeholders globally. It has defined them as an innovation of historical proportions. Regarding the issue of the consolidated financial statements, the topic of Joint Arrangements was taken into account, and in 2007 an exposure draft ED 9 "Joint Arrangements" was published which has resulted in issuing a standard in 2011, namely IFRS 11. Regarding long-term projects, it can be observed as Business Combinations and Consolidation projects are on the agenda of the two regulatory bodies. These two projects have been completed by issuing new standards in 2007-2008 and others in 2011. The entire process of convergence has enjoyed support of the world from the beginning, but we believe that although there were issued a number of new standards on consolidation, convergence has not yet been achieved and there are also a number of significant differences between the two sets of standards.

Under this paper first we presented some aspects regarding the process of convergence between the most important referential (IFRS and US GAAP), then we continued our study pointing out the main contributions of the researchers on the topic of convergence and harmonization and then, we tried to establish through an empirical analysis the stage of convergence between IFRS and US GAAP regarding consolidation aspects.

Convergence for Consolidated Financial Reporting Practices: -

Globalization is the root cause of the internationalization of accounting standards. Countries adopting IFRS are more exposed to the benefits of globalization of businesses. More and more national accounting regulatory bodies are in favour of adopting IFRS, however, individuals' participation in the standards-setting process is less than expected. Before finalizing any standard at any level, the perceptions and viewpoints of stakeholders in the field must be gauged to make it acceptable and implementable at all levels. Very few studies focus on the participation and perception of ultimate preparers and users of accounting information in decision-making. Considering the above-mentioned scenario, the current analyses and presents various issues about IFRS adoption at one platform in a structured manner. The key stakeholders within the accounting profession encompass auditors, investors, managers, regulators, and standard setters. Through an examination of stakeholders' reactions to the adoption or convergence of International Financial Reporting Standards (IFRS), valuable insights can be obtained into the perception of the worldwide transition to IFRS and the anticipated advantages and obstacles identified by these stakeholders. The adoption and convergence of International Financial Reporting Standards (IFRS) plays a crucial role in the process of globalization accounting standards. Understanding the reactions of stakeholders can provide valuable insights for making informed decisions about the dissemination, modification, or interpretation of these standards.

The core principle of the new standard will recognize revenue when a company transfers goods and services to a customer equal to the amount of consideration the company expects to receive from the customer. Some of the most important differences between current practices and the new standard are that revenue would be recognized only from the transfer of goods or services to a customer. That change would affect some long-term contracts, the standard setters said. The example offered is that percentage-of-completion revenue recognition would be allowed, but only if the customer owns the work-in-progress as it is built or developed. In addition, a company would be required to account for all distinct goods or services, which could require it to separate a contract into different units of accounting from those identified in current practice. Another change would be that collectability would affect how much revenue is recognized, rather than whether revenue is recognized or not. Also, a greater use of estimates would be required in determining both the amount to allocate and the basis for that allocation, which would better reflect the economics of a transaction. A company would follow five steps to apply the revenue recognition standard: identify the contracts with the customer; identify the separate performance obligations; identify the transaction price; allocate the transaction price to the performance obligations; and recognize revenue when a performance obligation is satisfied. The standard would be applied to all contracts to provide goods or services to customers, except leases, insurance contracts and financial instruments. Companies would be required under the standard to disclose qualitative and quantitative information about contracts with customers, including a maturity analysis for contracts extending beyond a year, and the significant judgments and changes in judgments made in applying the proposed standard to those contracts.

Provisions of Ind AS 110 Related to Consolidated Financial Reporting

Consequently, the requirements of Ind AS-110 apply to all investor/investee relationships. The Ind AS-110 definition of control encompasses three distinct principles (Power over the investee, Exposure, or rights, to variable returns from its involvement with the investee, The ability to use its power over the investee to affect the amount of the investor's returns), which, if present, identify the existence of control by an investor over an investment, hence forming a parent-subsidiary relationship.

Ind AS-110 has introduced specific guidance on franchise, which aims to provide more clarity on whether franchisors should consolidate their franchisees. In determining whether a franchisor controls a franchisee, judgment it required to determine whether the franchisor's rights over its franchisee are substantive or protective in nature. Ind AS-110 distinguishes decision-making rights held by the franchisor that protect the franchise brand from decision making rights that significantly affect the franchise's returns, for example, the franchisee's funding structure. The franchisor does not have power over the franchisee if other parties have the current ability to direct the franchisee's relevant activities. The lower financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee, the more likely it is that the franchisor only holds protective rights and have no control over the franchisee, hence not to be consolidated. An entity that controls one or more other entities called a parent, shall present consolidated financial statements as per this Ind AS except as exempted by this Standard.

Important points to be considered to Prepare a Consolidated Financial Statement: -

- Identify the subsidiaries: List all subsidiaries under common control and determine their percentage of ownership by the parent company.

- Gather financial statements: Collect the financial statements of all the subsidiaries, including balance sheets, income statements, and cash flow statements.

- Eliminate intercompany transactions and balances: Identify and eliminate intercompany transactions and balances to avoid double counting in consolidated financial statements.

- Adjust for minority interests: If the parent company owns less than 100% of a subsidiary, calculate and adjust for minority interests in the consolidated financial statements.

- Ensure compliance with accounting standards: Ensure that the consolidated financial statements comply with accounting standards such as the Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS).

- Check for errors and inconsistencies: Review the consolidated financial statements for any errors or inconsistencies, and ensure that they accurately reflect the financial position, performance, and cash flows of the group.

- Disclose any relevant information: Disclose any relevant information, such as significant accounting policies, contingencies, and related party transactions.

- Obtain audit or review: Engage external auditors or independent accountants to audit or review the consolidated financial statements to provide assurance of their accuracy and completeness.

- Communicate with subsidiaries: Clarify roles and responsibilities to prepare consolidated financial statements and resolve discrepancies.

Consolidated Financial Reporting under IFRS-10

IFRS 10 establishes principles for presenting and preparing consolidated financial statements when an entity controls one or more other entities. IFRS 10:- requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements; defines the principle of control, and establishes control as the basis for consolidation; sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee; sets out the accounting requirements for the preparation of consolidated financial statements; and defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

Consolidated financial statements are financial statements that present the assets, liabilities, equity, income, expenses and cash flows of a parent and its subsidiaries as those of a single economic entity. In September 2014 IFRS 10 was amended by Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28), which addressed the conflicting accounting requirements for the sale or contribution of assets to a joint venture or associate. In December 2015 the mandatory effective date of this amendment was indefinitely deferred by Effective Date of Amendments to IFRS 10 and IAS 28.

In December 2014 IFRS 10 was amended by Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28). These amendments clarified which subsidiaries of an investment entity should be consolidated instead of being measured at fair value through profit or loss. The amendments also clarified that the exemption from presenting consolidated financial statements continues to apply to subsidiaries of an investment entity that are themselves parent entities. This is so even if that subsidiary is measured at fair value through profit or loss by the higher level investment entity parent. Other Standards have made minor consequential amendments to IFRS 10, including Annual Improvements to IFRS Standards 2014–2016 Cycle (issued December 2016) and Amendments to References to the Conceptual Framework in IFRS Standards (issued March 2018).

Conclusion: -

Our paper makes a contribution in the field of studies which approach the convergence theme, by trying to calculate and analyse the extant comparability degree between the two sets of standards, the IFRSs and the USGAAPs which are included in the global framework for consolidated disclosures and consolidated financial statements. Our paper suggests that the degree of comparability, at least in this respect, is still low in the process of convergence. Constantly keeping up with the pronouncements published by the International Accounting Standard Board (IASB) will also be necessary for the sustainable economic development in India. If this is done, as we have suggested, only then will India be able to fully appreciate the importance and benefit of this convergence to IFRS regardless of its hurdles for consolidated financial statements. But the limits of our study, especially the focus on the differences between the two sets of accounting standards do not allow us to draw any general conclusions in any reporting practices.

We also remarked differences in the consolidation process, for example, regarding the need and decision to consolidate, the different assessment used in the case of indicators of control, some differences regarding specifications to related parties and de facto agents, specifications related to silos; differences regarding some accounting policies (for example the exclusion of proportional consolidation method in the case of joint arrangements by the IFRS framework, differences regarding the application of the equity method of accounting, etc.); differences regarding disclosures, or differences referring to certain industry-specific exemptions requirements.

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