

International Financial Reporting Standards (IFRS) and Its Influence on Pakistan

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Abstract

Worldwide application of IFRS (International Financial Reporting Standard) not only standardize the accounting treatments but also helpful in producing true and fair financial statements. All the counties using IFRS (International Financial Reporting Standard) can easily make comparisons of their financial statements across the industries and countries. Because of its fair results these are highly reliable standards for the allocation of resources and for keeping the accounting records. ICAP (Institute of Chartered Accountants of Pakistan) is responsible for the implementation of these standards in Pakistan. ICAP (Institute of Chartered Accountants of Pakistan) suggests theses standards to SECP (Securities and Exchange Commission of Pakistan), SECP (Securities and Exchange Commission

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of Pakistan) implement these standards but there are some contradictions between these standards and the companies' ordinance 1984. ICAP (Institute of Chartered Accountants of Pakistan) council formulates a strategy to provide a roadmap for the implementation of these standards. Despite of all its advantages IFRS (International Financial Reporting Standard) adoption gave some challenges e.g. Non-compliance with existing regulations, different views of SECP (Securities and Exchange Commission of Pakistan) etc. but these standards plays an important role in the increased economic revenues of Pakistan.

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1 Introduction

This research study elaborates the importance of IFRS (International Financial Reporting Standard) and its adoption in Pakistan. IFRS (International Financial Reporting Standard) gives helpful standards for the developing countries that can increase the economic revenues by showing the true and fair position of the economy. This paper contains the precise discussion of IFRS (International Financial Reporting Standard) and detailed discussion of IFRS (International Financial Reporting Standard) adoption in Pakistan. First part of this research outcome gives the IFRS (International Financial Reporting Standard) principles and their relative importance. Second section connotes the adoption of IFRS (International Financial Reporting Standard) in Pakistan and its execution by ICAP (Institute of Chartered Accountants of Pakistan) then implementation by SECP (Securities and Exchange Commission of Pakistan). ICAP (Institute of Chartered Accountants of Pakistan) council formulates the strategy for the compliance of these standards with those of the existing laws and regulations, it

also monitor these standards once implemented. Third section of the paper elaborates the importance of IFRS (International Financial Reporting Standard) implementation in Pakistan. There are numerous advantages of IFRS (International Financial Reporting Standard) including comparative analysis of, true and fair statements, appropriate allocation of resources, investor's confidence etc. The forth and last part of the study states the obstacles in the adoption of IFRS (International Financial Reporting Standard) in Pakistan. This research product gives the information about the followings:

RQ1: What are the principles of IFRS (International Financial Reporting Standard)?

RQ2: What is the adoption process of IFRS (International Financial Reporting Standard) implementation?

RQ3: What are the consequences of IFRS (International Financial Reporting Standard) adoption in Pakistan?

RQ4: What are the hurdles in way to implement IFRS (International Financial Reporting Standard) in Pakistan?

2 Literature review

Taking up international financial reporting standards as a part of the countries regulations is common now days. Many countries implemented IFRS (International Financial Reporting Standard) and some are on the way to take steps in the implementation of these standards (Sacho & Oberholster, 2008). Because of all the listed firms around the world are influenced directly or indirectly by the IFRS (International Financial Reporting Standard) issued by IASB (International Accounting Standard Board). Accounting standards are formed not only by the pragmatic analysis but also by the political actions due to which IFRS (International Financial Reporting Standard) is susceptible in losing its

worth(Keiso, Weygandt &Warfield, 2007). According to the Fatima Alali & Lei Cao the major undertaking of IFRS (International Financial Reporting Standard) is to enable the users of financial statements to better compare their statements across countries and within industries (Nobes, 2008). The main goals of IFRS (International Financial Reporting Standard) are to create quality and relevant standards that are also comparable, for the promotion of these standards and to apply the standards in maintaining the quality (A. Skotarczyk, 2011). IASB (International Accounting Standard Board) formulates these accounting standards under the process called 'due process', and individuals, companies and government authorities also help in this process. IFRS (International Financial Reporting Standard) are formulated for the unionization of the accounting standards across the world for better quality and fair value at international level. These standards provide substitutes for the accounting operations. As the accounting affairs vary across the country, nations and industries so as different substitutes are available for their resolution (Financial Standards Report, 2010). IFRS (International Financial Reporting Standard) are enforced by the International Accounting Standard Board in 2001; IASB (International Accounting Standard Board) replaced the IAS committee because the IFRS (International Financial Reporting Standard) is implemented by the organization. A scrutinizing board was established on February 1, 2009 the objective of this board is to hire and manage the members of the committee. IASB (International Accounting Standard Board) is based upon the IASC (International Accounting Standard Committee) foundation and it formulates the high quality, enforceable accounting standards⁶. Standards set by IASC (International Accounting Standard Committee) are International Accounting Standards (IAS) and those set by the IAB are called as IFRS (International Financial Reporting Standard). There are 30 IAS (International Accounting Standards) and 8 IFRS (International Financial Reporting Standard). The preparation of financial statements is based upon going concern principal and the accrual based accounting. And these

financial statements include; balance sheet, income statement, cash flow statement, statement of changes of equity and the accounting notes. 110 countries implemented IFRS (International Financial Reporting Standard) at the time of writing but by the end of 2011 all the countries shift towards IFRS (International Financial Reporting Standard) for the preparation of their financial statements (Theobald). A research study based upon the features of accounting earnings including the magnitude and quality of accruals concluded that the accounting earnings quality depends upon the investor's protection which is achieved as a result of IFRS (International Financial Reporting Standard) implementation for the preparation of accounting records and there is no direct relation in the quality of earnings and the IFRS (International Financial Reporting Standard) adoption (Houqe, Dunstan, Karim, & Zijl, 2010).

2.1 Principles of International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS)

In 2007 United Nations Conference on Trade and Development (UNCTAD) stated the adoption of IFRS (International Financial Reporting Standard) and Pakistan made major progress in updating its accounting standards up to international level (Financial Standards Report, 2010). Following are the principles of IFRS (International Financial Reporting Standard):

- First time adoption of IFRS (2010)
- Share-based payment (2010)
- Business combinations (2010)
- Insurance contracts (2006)
- Non-current assets held for sale and discontinued operations (2010)
- Exploration for and evaluation of mineral resources (2006)
- Disclosures of financial instruments (2009)

- Operating segments (2010)
- There are some principles of IFRS (International Financial Reporting Standard) that were specially formulated for the small and medium size enterprises that are:
 - Presentation of financial statements (2010)
 - Inventories (2005)
 - Cash flow statement (2010)
 - Accounting policies and changes in accounting estimates and errors (2005)
 - Events after the reporting period (2005)
 - Construction contracts (1995)
 - Income taxes (2001)
 - Property, plant and equipment (revised 2009)
 - Leases (2010)
 - Revenue (1995)
 - Employee benefits (revised 2009)
 - Accounting for government grants and disclosures of government assistance (2009)
 - The effects of changes in foreign exchange rates (2005)
 - Borrowing costs (revised 2009)
 - Related party disclosures (2005)
 - Accounting and reporting by retirement benefit plans (1998)
 - Consolidated and separate financial statements (2010)
 - Investment in associates (revised 2009)
 - Financial reporting in hyperinflationary economies (revised 2009)
 - Interests in joint ventures (revised 2009)
 - Presentations and disclosures of financial instruments (2010)
 - Earnings per share (2005)
 - Interim financial reporting (1999)

- Impairment of assets (revised 2009)
- Provisions, contingent liabilities and assets (1999)
- Intangible assets (2010)
- Measurement and recognition of financial instruments (2010)
- Investment property (2009)
- Agriculture (2009)

2.2 Adoption of International Financial Reporting Standards (IFRS) in Pakistan

Institute of Chartered Accountants of Pakistan (ICAP) plays a major role in the implementation of IFRS (International Financial Reporting Standard) in Pakistan it was set up under the CA Ordinance 1961, it monitors the accounting regulations. Its member has the authority to sign all the audit reports of the organizations. There are 16 council members including 12 elected and 4 government candidates. As ICAP (Institute of Chartered Accountants of Pakistan) is responsible for all the accounting regulations so at the time of IFRS (International Financial Reporting Standard) implementation after a careful review of these standards by a committee ICAP (Institute of Chartered Accountants of Pakistan) suggests the adoption of these standards to SECP (Securities and Exchange Commission of Pakistan). And SECP (Securities and Exchange Commission of Pakistan) implement IFRS (International Financial Reporting Standard) under the companies' ordinance 1984. All the companies have to comply these standards as given by the ICAP (Institute of Chartered Accountants of Pakistan) in the preparation of their accounting records. All the IFRS (International Financial Reporting Standard) principles that are enforced by the international standard board (IASB) are applicable in Pakistan except the IFRS (International Financial Reporting Standard) 1 and IFRS (International Financial Reporting Standard) 9. The execution of these standards is

under consideration of ICAP. Exceptions are there regarding the adoption of IFRS (International Financial Reporting Standard) e.g. IFRIC (International Financial Reporting Issues committee) 4 was concerned by government on or before the June 30th 2010, IAS (International Accounting Standards) 39, 40 & IFRS (International Financial Reporting Standard) 7 should be implemented in case of banks and DFIs (Development Finance Institutions) and IAS (International Accounting Standards) 39, 40 in case of insurance companies.

2.3 Road Map for compliance of International Financial Reporting Standards (IFRS)

ICAP (Institute of Chartered Accountants of Pakistan) council formulates the strategy for the implementation of IFRS (International Financial Reporting Standard) by December 31, 2007 in all the public companies. The strategy laid down that the strict enforcement of these standards and regular monitoring after the implementation enable the entities following the IFRS (International Financial Reporting Standard) to evaluate the problems in the execution of these standards and then finding solutions to overcome the problems faced in the implementation. It was also found that there is the need to update the existing laws in order to take IFRS (International Financial Reporting Standard) into practice.

IFRS (International Financial Reporting Standard) are not cost effective, if executed for all types of entities. For different kinds of entities different standards should be there as in the case of SME (Small and Medium Enterprises) standards should be according to its level and area of expansion. By the need of our ICAP (Institute of Chartered Accountants of Pakistan) formulates the standards specialized for SME's (Small and Medium Enterprises). It contributes large part in the economic earnings of Pakistan.

2.4 Significance of International Financial Reporting Standards (IFRS)

IFRS (International Financial Reporting Standard) was formulated for the standardization of accounting regulations all over the world. IFRS (International Financial Reporting Standard) are very useful for making the comparisons of the financial statements (Morais & Fialho, 2008). It directs to proficient capital allocation (McCreevy, 2005). It helps the investor to manage their portfolio in most profitable way (McCreevy, 2005; Tweedie, 2007). According to a research study IFRS (International Financial Reporting Standard) supports the cross-border investments. And it not only helps to expand the investment arena but also help the investors to make profits with diversified portfolio (Lee & Fargher, 2010). It is also reported that IFRS (International Financial Reporting Standard) fabricates better quality financial statements as compared to the existing regulations, so it reduces the cost of capital (Barth et al., 2008; Prather-Kinsey et al., 2008; Li, 2010).

IFRS (International Financial Reporting Standard) enhanced the investment of international mutual funds. Many researchers found that IFRS (International Financial Reporting Standard) influences the economic status of many firms, value relevance of the reports made under IFRS (International Financial Reporting Standard) are accurate (Barth et al., 2008; Daske et al., 2008; Prather-Kinsey et al., 2008). IFRS (International Financial Reporting Standard) entails full disclosure of all the accounting events that will help in producing true and fair value of the firm's 15 and it reduces the risk of lower returns to a large extent. Due to the increased reliability of financial statements prepared under IFRS (International Financial Reporting Standard) the investors are more secure for their diversified investment. IFRS (International Financial Reporting Standard) reduces not only the risk but also the cost of information (Ball, 2006).

2.5 Challenges in the implementation of International Financial Reporting Standards (IFRS) in Pakistan 117

- IAS (International Accounting Standards) 39 is not executed presently because of non-availability of information and quality of data and also the predictions and decisions varies across the industries. The methods of forecasting the future cash flows also vary that leads to different techniques used for the comparisons of the financial statements. Insurance regulations entail to take the investment at cost or market price whichever is less whereas the IAS39 requires taking the investment at its fair value.
- IFRIC (International Financial Reporting Issues committee) 4 & IFRIC (International Financial Reporting Issues committee) 12 implementation is delayed because of these reasons; affect the status of assets, IRR varies because of the changes in profit and dividend distribution, calculations of discount rate and lease payments, evaluating the discounting rates of future cash flows and some other legal constraints are there.
- SECP (Securities and Exchange Commission of Pakistan) is of the point of view that mutual funds are not the entities so that its financial statements can't be merged with asset management companies but IAS entails the consolidation of financial statement so IAS (International Accounting Standards) is under consideration for the execution by ICAP (Institute of Chartered Accountants of Pakistan).
- IAS (International Accounting Standards) 1 entails that the existing terminologies and the contents of the financial statements should be updated under IFRS (International Financial Reporting Standard).
- Contradictions are there in the regulations of IFRS (International Financial Reporting Standard) and Companies Ordinance 1984 e.g. in the treatment of revaluation surplus in the balance sheet, in the time period of consolidation of financial statements etc.

3 Conclusion

Summing up the whole study in only few word of a line, IFRS (International Financial Reporting Standard) the world's most acceptable standards producing true and fair financial statements is composed of such principles that are sufficient for keeping the financial statements updated and comparative for analysis across the industries and countries. It includes all the principles regarding the accounting treatment of all material objects. IFRS (International Financial Reporting Standard) also enhances the cross-border earnings and built investor's confidence. IFRS is implemented in Pakistan by ICAP (Institute of Chartered Accountants of Pakistan) under the supervision of SECP (Securities and Exchange Commission of Pakistan). Strict strategy is established by the ICAP (Institute of Chartered Accountants of Pakistan) council for the implementation of IFRS (International Financial Reporting Standard). After implementing these standards council review its effects on daily basis. SECP (Securities and Exchange Commission of Pakistan) made appropriate changes as required in the existing regulations.

IFRS (International Financial Reporting Standard) is important for the implementation because of its countless benefits e.g. comparative attribute, resource allocation, enhanced investment, diversified portfolios, and improved financial statements and cost effective as it gives regulations according to the status of entities. Despite of its familiarity there are some hurdles in its implementation like the contradictions with existing regulations, difference in the method of recoding accounting transactions, difference in dividend distribution policies, issues of the mutual funds status i.e. mutual fund is not the company so the asset management companies cant consolidate he financial statements of mutual funds etc. Limitations of the research study includes the IFRS (International Financial Reporting Standard) implementation in SME, its regulations adopted by the local industries, solutions to overcome the hurdles in IFRS (International Financial Reporting Standard) adoption and the enhanced economic revenues are not discussed in detail. The benefits of IFRS (International

Financial Reporting Standard) adoption in Pakistan are not reported in monetary terms. Future researches could elaborate the benefits of IFRS (International Financial Reporting Standard) in Pakistan in monetary terms and also elaborate the implementation of IFRIC (International Financial Reporting Issues committee) 4 & 12 and about IAS (International Accounting Standards) 39 and the strategy adopted by ICAP (Institute of Chartered Accountants of Pakistan) & SECP (Securities and Exchange Commission of Pakistan) for the execution of these standards. IFRS leads the developing nations towards their way to progress.

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