IJRTBT

INTERNATIONALIZATION OF INDIA ACCOUNTING STANDARD AND ITS IMPACT ON INDIAN COMPANIES

Surajit Das*, Tapash Ranjan Saha, Swapan Kr. Maity

Institute of Management Study, Maulana Abul Kalam Azad University of Technology, West Bengal, India.

**Corresponding Author's E-mail: surajitdas.d@rediffmail.com*

ABSTRACT

The importance of international accounting practice studies has grown over the past few years to meet economic agent demands and to facilitate international business practices. It is essential to understand that international accounting convergence is an important topic for capital market regulators, investors, markets, governments and all others who deal with financial information of public companies. Indian companies are also raising their capital globally due to diversification, cross-border mergers, investments or divestments.

The adoption of accounting standards that require high-quality, transparent, and comparable information is welcomed by investors, creditors, financial analysts, and other users of financial statements. It is difficult to compare worldwide information without a common set of accounting and financial reporting standards. The use of a single set of high quality accounting standards would facilitate investment and other economic decisions across borders, increase market efficiency, and reduce the cost of raising capital.

The motivation for this paper is to evaluate the impact on financial risk of Indian companies by disclosing their accounting information under IFRS. Financial risk of the company is associated with level of liquidity, profitability, leverage and the earnings ratio of the company. As a matter of fact, better disclosures reduce the estimation risk of future earnings, thereby reducing the cost of information asymmetry that occurs due to adverse selection and risk premium which in turn reduces the financial risks faced by the companies and increases the economic activities. For Analysis, different ratios have been used and for testing hypothesis, *t* test with *p*-value is considered.

Keywords: Financial Risk, Liquidity Ratio, Profitability Ratio, Leverage Ratio, Earnings Ratio, IFRS

INTRODUCTION

IFRS issued by the International Accounting Standards Board (IASB) are now being recognized as the premier global reporting standards of accounting information worldwide. Today, more than hundred nations demand or permit the use of IFRS in their countries. Many countries have already announced their willingness to adopt IFRS in their countries. This is becoming the most popular and commonly accepted financial reporting model around the world, such as, European Union, Australia, New Zealand and Russia. The legal frameworks currently permit the use of IFRS in their countries. The importance of IFRS grew as they provide greater comparability of financial information for investors and encourage them to invest across borders. Studies show that, IFRS adoption help in lowering the cost of capital for the companies and benefits more efficient allocation of capital (Firoz, Ansari & Akhtar, 2011).

With the growing economy and increasing integration among the global economy, Indian companies are also raising their capital globally due to diversification, cross-border mergers, investments or divestments. Under these circumstances, it is imperative for Indian corporate world to adopt IFRS for their financial reporting. The Core Group of Ministry of Corporate Affairs of India (MCA) has recommended convergence to IFRS in a phased manner from April 1, 2012. Till then, an Indian corporate having global aspirations should consider voluntary adoption of IFRS. The convergence with IFRS standards is set to change the landscape for financial reporting in India. Indian companies currently follow the local accounting standards known as Indian Generally Accepted Accounting Principles (IGAAP) issued by Institute of Chartered Accountants of India (ICAI) on behalf of MCA, Government of India. Daske *et al.*, (2008) in their study on economic consequences due to mandatory IFRS reporting around the world, argued that, from an economic perspective, there are reasons to be skeptical about the above expectations because the economic consequences of mandating IFRS reporting are not obvious. Arguing on the same basis, this research aims to study the impact on economic activities of Indian companies by adopting IFRS. Even though there are several similarities between IGAAP and IFRS, still there exist differences that can have significant economic impacts. The research aims to

understand these impacts due to IFRS adoption by Indian companies. According to Oracle White Paper (2008) the International Accounting Standards Board (IASB) since 1970, worked to develop a single set of International Standards, the IFRS. The world's capital market ebb and flow continuously, and participants in that market place must have access to financial information that factually reflects their economic performance, is consistent among companies around the globe, and is governed by a trusted and respected authority of corporate compliance. According to Ammer, Clinton & Nini, (2004), the objective of the study was to test whether U.S. GAAP reconciliation effectively enhances disclosure, to examine several measures of transparency for the cross-listed firms, relative both to pre-listing measures and to a control sample of firms that have not cross-listed. The researchers found substantial evidence that the mandatory reconciliation to U.S. GAAP accompanying a U.S. equity listing has engendered a significant improvement in the transparency of European financial firms, at least in some cases. Moreover, firms currently using IFRS appear to have a similar degree of transparency to those firms already cross-listed. Lantto & Sahlström, (2009) studied the impact of International Financial Reporting Standard adoption on key financial ratios and revealed increase profitability ratios and decrease in price to earnings ratio; decrease in liquidity ratio; increase in gearing ratio and decrease in equity ratios. The results of the study indicated that the adoption of IFRS changes the magnitudes of the key accounting ratios of Finnish companies by considerably increasing the profitability ratios and gearing ratio moderately, and considerably decreasing the PE ratio and equity and quick ratios slightly. Cotter, Tarca & Wee, (2012) studied 145 large listed Australian firms to explore the impact of IFRS adoption on the properties of analysts' forecasts and the role of firm disclosure about IFRS impact. They found that analyst forecast accuracy improves and there is no significant change in dispersion in the adoption year, suggesting that analysts coped effectively with transition to IFRS. Harris & Muller (1999), examined only reconciliations between US GAAP and IAS for 31 companies from 1992 to 1996, provide inconclusive evidence of the usefulness of their conciliations. They find US GAAP earnings reconciliation is value relevant and US GAAP is associated more highly with market measures after controlling for IAS amounts in certain models (market value and returns) but not all models (per-share). Barth, Landsman & Lang (2006) showed that companies using IAS exhibit less earnings smoothing, more timely loss recognition, and more value-relevance than those applying domestic (non-US) GAAP.

From the above, it has been observed that majority of the studies in IFRS are concentrated in the developed nations. It is because countries in European Union, Australia and New Zealand have mandated IFRS way back in 2005, there are various studies trying to understand the post-adoption scenarios. Since the USA and India are going to mandate IFRS, these studies are more futuristic in nature. Studies using emerging countries as their samples are very rarely done. From the above literature review, it is apparent that none of the research has directly been able to relate the impact on economic activities like investments, financial risks, diversifications, mergers and acquisitions and other key financial functions by the adoption of International Financial Reporting Standards by Indian companies. The intuition is that adoption of IFRS is viewed as a commitment to better disclosure, which may have various impacts on Indian companies, which is required to be researched and thus check the impact on economic activities after adoption of IFRS by Indian companies.

Objective of the Study:

1. To study the basic differences between IFRS and IGAAP.
2. To measure the impact on financial risk by adoption of IFRS.
3. To find out the impact of IFRS on quick assets, current liabilities, EPS, compared to IGAAP.

RESEARCH METHODOLOGY

1. **Sample size:** Here the researcher has considered three Indian Companies those who have adopted IFRS voluntarily from 2007-08.
2. **Data Type:** This study mainly focuses on the impact of IFRS on Financial risk Ratio, we have mainly used secondary data obtained from the banks income statement.
3. **Data Range:** Here we have considered last five years data for this analysis: 2007-08, 2008-09, 2009-10, 2010-11, 2011-12.
4. **Tool Used for Analysis:** For testing the objective we have used different financial ratio and for testing the hypothesis we adopted *t*-test.

Table 1: Hypothesis & Variables

Variables	Equations
1) Liquidity - Quick ratio	Quick assets (cash, marketable securities and receivables) / Current liabilities (Lantto & Shalstrom, 2009; Padrtova & Vochozka, 2011Hassan & Shobami, 2017).

(2) Profitability - Return on equity	Net profit / Shareholders equity (Lantto & Shalstrom, 2009; Padrtova & Vochozka, 2011).
(3) Leverage-Gearing ratio	Total debts (long and short term) / Shareholders equity (Lantto & Shalstrom, 2009; Padrtova & Vochozka, 2011).
(4) Market based ratio-price earnings ratio	Market price per share / EPS (Lantto & Shalstrom, 2009; Padrtova & Vochozka, 2011).

Hypothesis - Financial Risk and IFRS

H_0: Financial risks are being same after the adoption of IFRS voluntarily, i.e., there is no change in the mean values of μ1 financial risk under IFRS and μ2 Financial risk Under IGAAP, therefore,

H_0: μ1 = μ2.

H_1: Financial risks improved after the adoption of IFRS voluntarily, i.e., mean financial risks under IFRS (μ1) decreased as compared to mean financial risks under IGAAP (μ2), therefore,

H_1: μ1 < μ2.

Table 2: Difference between IFRS & Indian Accounting Standards

AREA	Item	IGAAP	IFRS	Impact	Ratios
Liquidity Indicator	Proposed Dividend	Recognized in the same year	When it is approved by the share holder	C.L	1. Current Ratio (CR) 2. Quick Ratio (QR)
	Current Investment	Measured at cost or market value	Fair value measurement	C.A	
	Balance of Excise and custom duty	Revenue considered as net of excise	Considered in revenue	C.A Or C.L	
	Deferred contract cost	Not recognized	Considered as current assets	C.A	
Profitability Indicator	Revenue recognition	Net of Excise & duties	Adding excise	Profit margin	1. Return on Assets (RA) 2. Return on Equity (RE) 3. Net Profit Margin (NP) 4. Return on capital Employed (ROCE)
	Extra-Ordinary Item	Considered	Recognize as a normal course of business	Profit	
	Pref. Dividend	As dividend	As interest cost	EPS & Return on Equity	
	Change in depreciation	Retrospective	Prospective	Profit margin	
	Repairing charges	As expenses under P/L A/C	Capitalized (includes in Assets)	Revenue Assets	
	ESOP Cost	Valued as intrinsic value	Fair value	Profit Margin	
Capital Structure Indicator	Non- Controlling Interest	Outside equity	With in Equity	Net worth	1. Debt-Equity ratio (DE) 2. Proprietary Ratio
	Redeemable Pref. Share	As a part of equity	As liability	Debt, Equity, Net worth, Total Liabilities	

Assets based Indicator	Merger & Acquisition Assets and liabilities	Book Value Valuation	Fair Value and Goodwill tested Annually	Goodwill Total Assets	1. Goodwill to Assets Ratio (GAR) 2. Degree of Depreciation & Amortization (DD&A) 3. Fixed Assets/Total Assets(FA -TA)
	Depreciation	Prescribed rate or useful life of the assets whichever is higher	Useful life of the assets	Depreciation	
	Intangible Assets other than goodwill	Amortize annually up to finite life (10 years). No concept of infinite life.	Amortize annually up to expected finite life. In case of infinite life, tested for impairment annually.	Amortization and Fixed assets.	
	Goodwill out of Business combination	Amortize over its useful life	Not amortize, tested for impairment annually	Goodwill and amortization	

RESULTS AND DISCUSSION

Table 3: Financial Matrix under IFRS

YEAR	COMPANY	QR	ROE	GR	PE	FINANCIAL RISK
2007-08	Infosys Ltd	5.4765	0.2954	0	17.5932	
2008-09	Infosys Ltd	5.8077	0.3096	0	12.6237	
2009-10	Infosys Ltd	6.5543	0.2617	0	23.9873	
2010-11	Infosys Ltd	6.5062	0.2513	0	27.0971	
2011-12	Infosys Ltd	6.3849	0.2432	0	25.8945	
2007-08	NTBL	3.3347	0.0728	0.6014	26.5	
2008-09	NTBL	0.9031	0.0667	0.5493	13.2222	
2009-10	NTBL	1.1954	0.0342	0.4742	22.2109	
2010-11	NTBL	0.5874	0.0492	0.398	13.1841	
2011-12	NTBL	0.4832	0.5631	0.3854	18.2361	
2007-08	Rolta India	5.6139	0.1347	0.4965	22.4248	
2008-09	Rolta India	4.5843	0.1338	0.6928	10.6822	
2009-10	Rolta India	3.2116	0.1448	0.784	11.6841	
2010-11	Rolta India	1.1493	0.1796	0.4311	5.9028	
2011-12	Rolta India	2.2754	0.1563	0.6389	9.9872	
MEAN		3.604527	0.193093	0.36344	17.41535	21.57640667
STANDARD DEVIATION		2.363055	0.135947	0.286489	6.889409	9.674900545

Table 4: Financial Matrix under IGAAP

YEAR	COMPANY	QR	ROE	GR	PE	FINANCIAL RISK
2007-08	Infosys Ltd	3.1062	0.3377	0	17.5414	
2008-09	Infosys Ltd	4.2991	0.328	0	12.6587	
2009-10	Infosys Ltd	4.0923	0.2719	0	23.8083	
2010-11	Infosys Ltd	4.7147	0.2631	0	27.0496	
2011-12	Infosys Ltd	4.9132	0.2842	0	28.0924	
2007-08	NTBL	0.3575	0.0561	0.437	26.5	
2008-09	NTBL	0.4388	0.0859	0.5076	13.2222	
2009-10	NTBL	0.688	0.0657	0.4046	22.2109	
2010-11	NTBL	0.6767	0.0843	0.3121	13.1841	
2011-12	NTBL	0.7209	0.0765	0.3587	15.8765	
2007-08	Rolta India	3.0908	0.1945	0.5851	17.119	
2008-09	Rolta India	3.15	0.2037	0.691	6.9068	
2009-10	Rolta India	3.7359	0.1585	0.7821	10.6029	
2010-11	Rolta India	3.7861	0.2115	0.7707	5.1727	
2011-12	Rolta India	3.7654	0.2276	0.7609	9.6324	
MEAN		2.76904	0.189947	0.373987	16.63853	19.9715
STANDARD DEVIATION		1.689219	0.097516	0.309938	7.426034	9.52270672

Interpretation:

This means that the absolute values of quick assets, current liabilities, EPS under IFRS are better compared to IGAAP. Based on each ratio, financial risk is calculated. There are two sets of financial risks-one IFRS based and the other IGAAP based.

Testing of Hypothesis:

The hypotheses are as under:

H_0: $\mu 1 = \mu 2$ (1 = IFRS, 2 = IGAAP)

H_1: $\mu 1 < \mu 2$ (left one-tailed)

Significance level = 0.05

Degrees of freedom, v = 15+15-2 = 28

Critical region is t < -1.7011

So, the test statistic is:

$$t = \frac{(\ddot{x}1 - \ddot{x}2) - (\mu 1 - \mu 2)}{\sigma p \sqrt{1/n1 + 1/n2}}$$

Where $\ddot{x}_1$= sample mean value of financial risk under IFRS = 21.57640667

Where $\ddot{x}_2$= sample mean value of financial risk under IGAAP = 19.9715

Under H_0: $\mu 1 - \mu 2 = 0$ as $\mu 1 = \mu 2$

n1 = sample size under IFRS = 15

n2= sample size under IGAAP = 15

σp = pooled standard deviation of the sample

$$\sigma p = \frac{(n_1 - 1)(\sigma 1)^2 + (n_2 - 1)(\sigma 2)^2}{n1 + n2 - 2}$$

σ1 = sample standard deviation of financial risk under IFRS = 9.6749

σ2 = sample standard deviation of financial risk under IGAAP = 9.5227

$\sigma_p = 92.14$

$$t = \frac{(\ddot{x}_1 - \ddot{x}_2) - (\mu_1 - \mu_2)}{\sigma_p \sqrt{1/n1 + 1/n2}}$$

$t = 0.0476$

Interpretation:

This value does not lie in the critical region but lies in the acceptance region and so H_0 gets accepted. Thus, there is no statistical evidence at 5% level of significance, to prove that financial risk decreases under IFRS voluntary adoption as compared to IGAAP. Therefore, even though differences can be observed in financial risk in absolute terms, there is not enough evidence to prove the same statistically.

CONCLUSION

Data analysis and interpretation bring out interesting results related to the impact on financial risk of Indian companies due to voluntary IFRS adoption. This suggests that the adoption of stricter accounting rules under IFRS could be the reasons for the changes observed in accounting figures and financial ratios. There is no statistical evidence at 5% level of significance to prove that Financial Risk factors improved/increased under IFRS voluntary adoption by Indian companies. The research is important as it studies the impact of IFRS adoption on financial risk ratio of Indian companies, especially when the adoption of IFRS is still voluntary in India. Till date, there is only one study in India as sample country in relation to banking industry but being descriptive in nature, the study does not empirically test IFRS implications on the banking industry. This paper, therefore, has great relevance to the Indian scenario.

REFERENCES

Ammer, J., Clinton, N. & Nini, G. (2005). Accounting Standards and Information: Inferences from Cross-Listed Financial Firms. *International Finance Discussion Papers Number 843, Board of Governors of the Federal Reserve System (U.S.)*. Retrieved From: https://ideas.repec.org/p/fip/fedgif/843.html

Barth, M.E., Landsman, W.R. & Lang, M.H. (2008). International Accounting Standards and Accounting Quality. *Journal of Accounting Research*, 46(3), pp 467-498.

Cotter, J., Tarca, A. & Wee, M. (2012). IFRS Adoption and Analysts' Earnings Forecasts: Australian Evidence. *Accounting & Finance*, 52(2), pp 395–419.

Daske, H., Hail, L., Leuz, C. & Verdi, R.S. (2008). Mandatory IFRS Reporting Around the World: Early Evidence on the Economic Consequences. *Journal of Accounting Research*, 46(5), pp 1085–1142.

Firoz. M., Ansari, A.A. & Akhtar, K. (2011). IFRS Impact on Indian Banking Industry. *International Journal of Business and Management*, 6(3), pp 277-283.

Hassan, A.B.M.R. & Shobami, A.A (2017). Cash Management in Publicly Traded Cement Companies in Bangladesh: An Appraisal. *International Journal on Recent Trends in Business and Tourism*, 1(4), pp 63-71.

Harris, M.S. & Muller, K.A. (1999). The Market Valuation of IAS Versus US-GAAP Accounting Measures using Form 20-F Reconciliations. *Journal of Accounting and Economics*, 26(1–3), pp 285–312.

Lantto, A.M. & Sahlström, P. (2009). Impact of International Financial Reporting Standard Adoption on Key Financial Ratios. *Accounting and Finance*, 49(2), pp 341-361.

Oracle White Paper. (2008). Oracle SQL Developer for Database Developers. Retrieved From: http://www.oracle.com/technetwork/developer-tools/sql-developer/sqldeveloperwhitepaper-v151-130908.pdf

Padrtova, M. & Vochozka, M. (2011). The Value Statements According to IFRS in Comparison with the Financial Statements in Accordance with Czech Accounting Standards. *Economics and Management*, 16, pp 80-85.