Adaption of IFRS and its Impact on Qualitative Factors of Financial Statement: Evidence from India

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Abstract

Aspirations of Indian Companies to turn into global players in this era necessitated introduction of International Financial Reporting standard (IFRS) for transparency, accuracy, comparability of financial reporting all over the world. Adaption of IFRS improves understanding of the financial reporting of the company which encourages international capital inflows, introduces similar accounting standard for all subsidiaries across the globe, reduces fraud , risks for the investors and this harmonizes language of reporting both in the external and internal context. Indian companies are also raising their capital globally for diversification. Cross-border mergers, investments or divestments have been occurring among the corporate.

In view of these advantages, GOI has been introducing International Financial Reporting standard in a phased manner. Yet, it beneficial for Indian companies to introduce this standard voluntarily.

This paper aims to make a comparison between IFRS and IGAAP and evaluate the impact of IFRS on the qualitative factors of the financial report. For the purpose of Analysis, a close ended questionnaire has been used and for testing hypotheses, one sample t test with p values are considered.

Keyword: *IFRS, IGAAP. Qualitative factors, One sample t test, p value.*

Introduction

In era of globalization, one of the foremost requirements to operate a business both at domestic and global level successfully is to have a sound financial reporting system. As the old saying goes, "Accounting is the language of business," the business enterprises should speak the same language for exchanging and sharing financial statements on their International Business activities (Ramkesh Gupta, 2012) to create better understanding at the global level. International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that the company accounts are understandable and comparable across international boundaries.

Indian companies with globalization have been integrating with Global business for the purpose of

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raising capital, cross-border mergers, investments or divestments. Now, it is imperative to have global standards in all domains of business especially in financial reporting to avoid discrepancies and cross border conflicts and have a well defined, structured policy framework for financial reporting. Ministry of Corporate Affairs of India (MCA) has been taking steps to converge Indian Accounting standards(AS) with that of IFRS in a phased manner from April 1, 2012. Subsequently, announcements have been made in areas where Indian companies are directed to use new standards of financial reporting as per IFRS. Until Indian Accounting Standard are fully integrated with IFRS, Indian corporates having global aspirations should consider voluntary adaption of IFRS in their own interests of business growth.

In this study, the researcher wants to make a comparison between these two accounting standards and try to find out the impact area of IFRS on financial statement inclusive of both quantitative and qualitative areas.

Literature Review

Impact of IFRS on Financial Components

Beke (2011) has conducted a study on 65 IFRS adapted firms and 260 firms following local rules in Hungary to measure the difference between local rule and international standard. For that, he has applied logistic regression model on different ratios. The results show that companies having IFRS adaption had a significant impact on earnings ratio, solvency ratios and profitability ratios while the new standard make the financial statement more transparent and user friendly.

The objective of a research by **Ahmed & Alam (2012)** on the effect of IFRS adaption in financial statement in Australia is to analyse changes in accounting surplus, equity, assets and liabilities. They found some difference between two sets of accounting standards with respect to average surplus or loss having decreased, and equity assets and liabilities having increased. But no major changes on overall financial position have been found.

Da Silva Macedo et.al (2013) in their investigation, find the impact of convergence to IFRS on the informational content of accounting in Brazil. They have calculated different ratios and employed K-S test for testing normality and also wilcoxon sign test for the hypothesis testing. Results indicate that Assets turnover, Gross margin, Operating Cash Flow over total assets and Operating Cash Flow over stock holder equity are lower in the IFRS based financial statement. On the other hand, Book value per share and EPS and the explanatory power of these ratios have been increased after adaption of IFRS.

Sovbetov (2013) in his study on the impact of IFRS on key financial ratios in UK market, has selected some areas like profitability, efficiency & liquidity, capital structure and inventory. He applied regression equation on this nine ratios on total assets, market capitalization, stock and trade value and a dummy variable. He observed that IFRS has significant impact only on ROA, PM ratio and no evidence of any impact on other seven.

Ibiamke et.al (2014) in their research on the effect of IFRS on financial ratios in Nigeria, have used pair t test for testing hypothesis and regression analysis to define the relationship between IFRS and local GAAP. Their conclusion was that IFRS adaptation did not have any impact on profitability, liquidity and market ratios.

Jindrichovska & Kubickova (2014) analyzed the impact of IFRS on key financial ratios on Czech Republic. Using t test on mean differences , they found that IFRS brought in changes on all the indicators of the financial situation of Companies. Indicators examined this way were both in positive and negative directions.

Impact of IFRS on the earning quality of the organization

Ton (2011) conducted a study on the effect of IFRS on earning management of 75 listed Dutch Companies. Using Modified Jones Model, he did not get enough evidence to support that IFRS was associated with a lower level of earning management while there was difference between small and large companies in this regard.

Cains et.al (2011) unveil the effect of fair value measurement on accounting comparability in U.K and

Australia through IFRS. They have employed T index and found that comparability increase only for accounting area where IFRS requires fair value measurement.

Manzano & Conesa (2014) have conducted a research on the impact of IFRS adaption on earning management at Mexican companies. Applying the upper version of comparability index, called convergence index, formulated an equation where firm size, growth, CFO, Assets, debt are considered as a control variables of accounting conservativeness. They also used Modified Jones Model (1991) to estimate the non-discretionary component of total accrual. The results of this study suggested that convergence of accounting standard increased comparability of accounting earnings here.

Challenges and benefits of IFRS adaptation.

Irvine &Lucas (2006) critically looked at the impact of IFRS adaptation on United Arab Emirates. Through this descriptive study, they identified some points which are affected by IFRS adaptation. These were international trade, capital market of big 4 international accounting firms. In this research they have outlined some challenges for implementing IFRS in developing countries like U.A.E.

Gyasi (2009) conducted a study on the topic of adaptation of IFRS in developing countries such as Ghana. He identified several factors which are affecting the process of IFRS adaptation. These are Economic growth, Legal system, External environment, capital market, ineffectiveness of previous accounting standard etc. He conducted a survey on different companies in Ghana and then quantified the opinion which helps to find out these factors.

Conservativeness of IFRS and local standard for defining the profit and equity position of the companies

As per Research by **Punda (2011)** on impact of IFRS in U.K market by using Gray Conservative Index as a measure of profit reporting and equity discloser, if the index value is less than 1, it indicates IFRS is less conservative and vice-versa. The result1 shows that, for reporting profit and disclosing equity, IFRS is less conservative compare to U.K GAAP.

Danifoo et.al (2012) conducted a study on the effect of convergence of IFRS in China on the basis of Gray conservative index to calculate Index of net earnings and equity for each company each year. They suggested that if the value of index varies in between .90 to 1.10,the local standard and IFRS were relatively equivalent for defining net income and net equity. They found net earning did not exceed 10% from 2002 to 2009 and this is true for net equity also.

Baruan (2014) in his research on the difference between local standard and IFRS on 42 countries around the world through Gray Index finds that IFRS is more transparent and less conservative compare to local GAAP.

Ibiamke et.al (2014) used pair t test and Gray index to define the conservativeness between IFRS and local GAAP on financial ratios in Nigeria. They concluded through Gray Index that IFRS adaptation led to decrease in profitability, liquidity and market ratio.

Objectives:

The review of literature undertaken in this paper above, clearly reflects that whenever a country shifts the accounting standard to IFRS, the financial figures as well as qualitative factors also change. As India is gradually is adopting IFRS, it is essential to determine the impact of IFRS on financial indicators of the Indian company. This paper has set the objective to analyze the impact of IFRS on key qualitative factors of Indian Companies.

Methodology and Data Source:

A survey was conducted on Professional Chartered Accountants by the researcher to identify the effect of IFRS on the qualitative factors by applying purposive sampling technique. Out of one hundred and fifty (150) questionnaires, one hundred and eighteen (118) were returned; the response rate was 79%. The survey instrument in the form of close-ended questionnaire was developed for the purpose of collecting main data

Reliability test result for primary survey:

The internal consistency of the survey instrument should be tested by reliability analysis **(Ndubisi, 2006)**. The cronbach's alpha in this study was **0.649** (higher than 0.6), the constructs were therefore deemed to have adequate reliability.

Operational Definitions:

When a company adopts new rules for preparing financial statement that can directly affect the company's financial parameters (profitability position, liquidity position, leverage position and assets position). On the other hand, new standard indirectly influences the company's qualitative characteristic like Comparability, Transparency, Accuracy and Reliability and Understandability.

In this research, attempt has been made to identify the impact of IFRS on the qualitative Characteristics of financial statement as compared to Indian GAAP.

Table : 1 - Basic Difference Between IFRS & IGAAP and Impact Area

Factors	IFRS Rules	Indian GAAP	Impact Area
Component Of Financial Statements	As per IFRS, financial statement consist of : 1) Statement of financial position 2) Statement of comprehensive Income including revaluation of gains, foreign exchange fluctuation. 3) statement of changes in equity 4) Cash flow statement 5) Notes to accounts, Annexure and explanation. For the public Ltd company with subsidiaries, it has to prepare consolidated statements along with stand alone	As per IGAAP, financial statement consist of : 1)Balance Sheet 2)Profit & loss Account 3)Cash flow statement 4) Notes to accounts, Annexure and explanation. For the public Ltd company with subsidiaries, it has to prepare consolidated statements along with stand alone	Compatibility of Financial Statement
Format Of Balance Sheet	IFRS does not provide any particular format. But a liquidity presentation is used on the basis of current and non-current assets & Liabilities. It provides more reliable and relevant information	Accounting standard does not provide any format But Company Act 1956 schedule VI, Banking Act, Insurance Act prescribe certain format for banking industry, Insurance Industry and other public ltd Company	Reliability & Accuracy

Factors	IFRS Rules	Indian GAAP	Impact Area
Format Of Income Statement	IFRS does not provide any particular format. But as per International Accounting Standard (IAS) 1, expenditure is presented and classified as per function or nature	Accounting standard does not provide any format. But Company Act 1956 schedule VI, Banking Act, Insurance Act prescribe certain format for banking industry, Insurance Industry and other Public Ltd Companies	Reliability & Accuracy
Cash Flow Statement	As per IFRS, cash flow from operating activities, Investment activities and financial activities recorded separately and it is mandatory for all who ever adopted IFRS.	As per IGAAP, cash flow from operating activities, investment activities and financial activities are recorded separately. But Level III entities (Non corporate Entities) are exempted	Compatibility of Financial Statement
Statement of Changes in Equity	It shows all the transaction with owners like accounting profit and all other relevant capital transactions	No separate statement require as per IGAAP. In balance sheet separate schedule disclosed such as 'Share Capital' and 'Reserve & Surplus'	Understandability by Investors & Other related parties
Statement of Recognized Income and Expenses	A Statement of recognized income and expenses can be presented if the Statement Of Changes in Equity is absent.	Not required	Understandability by Investors & Other related parties
Rule for Preparing Consolidated Financial Statement	Consolidated financial statement are prepared as per uniform accounting policies for all the entities in a group.	Consolidated financial statement are prepared as per uniform accounting policies for all the entities in a group. If uniform accounting policies is not applicable, that should be disclosed with the proportion of item to which different accounting policies have been applied	Consistency & Uniformity of Policies

Factors	IFRS Rules	Indian GAAP	Impact Area
Presentation of Extra Ordinary Items	IFRS does not recognized any extraordinary or exceptional item adjusted into income statement or in notes.	IGAAP permitted to present extra ordinary item in income statement as profit before tax and exceptional items	Income statement Transparency
Type of Business Combination	IFRS 3 deals with business combination which is defined as "a transaction or other event in which an acquirer obtains control of one or more businesses". As per the standard all business combination considered as Acquisition.	No Comprehensive accounting standard described such deals. However AS14 deals with Amalgamation, merger, demerger etc. carried out pursuant to Indian Companies Act. This does not deal with acquisitions.	Understandability by Investor & Other related parties Assets & liabilities position
Dividend Proposed After The End of Reporting Period	Dividend proposed after the end of reporting period but before preparing financial statement is prohibited to consider as liabilities	Dividend proposed after the end of reporting period but before preparing financial statement is approved to be recorded as current liabilities in the financial statements	Liquidity position
Change in depreciation Method	Treated as a change and consider prospectively	Treated as a change in accounting policy and accounted by retrospective effect	Profitability position
Accounting for Business Combination	In case of Business Combination, Purchase Method is recognized only as per IFRS.	In case of Business Combination, purchase method and uniting interest method is recognized as per IGAAP. Uniting Interest Method is a method in which combined companies were portrayed as if they had always operated as a single entity.	Transparency & Understandability by Investors & Other related parties

Factors	IFRS Rules	Indian GAAP	Impact AREA
Valuation of Goodwill	IFRS 3 prescribes that , in case the difference of net identifiable assets acquired based on fair value exceeds purchase consideration then such gain is accounted as profit or loss to acquirer; otherwise it is recorded as goodwill and is tested for impairment annually	AS14 provides that if there is any difference between purchase consideration and net assets acquired is accounted as capital reserve (negative goodwill) or goodwill. Goodwill is amortized over a period of 5 years unless longer period is justified.	Profitability & Goodwill valuation
Measurement of Intangible Assets	Intangible Assets can be measured at cost or revalued as per active market price	Intangible Assets can be measured at cost only	Assets Position Accuracy & Accuracy
Assets Revaluation	If revaluation is required on property, plant and equipment, the entire class of assets to which that assets belong, should be revalued	If revaluation is required on property plant and equipment, the entire class or selective class of assets are considered for revaluation	Valuation of fixed assets: Consistency & Uniformity of policies
Contingent Assets Disclosure	If the economic value is probable from those contingent assets, that should be disclosed in financial statement	Contingent assets are disclosed as a part of Director's Report, not in financial statement	Valuation of assets & Transparency

Qualitative Factors and Hypotheses formulation:

Understandability in financial reports requires the information to be concise, complete and clear in presentation so as to facilitate the use of the information while the quality of information enables users to comprehend their meaning (IASB, 2008). This also requires disclosure notes to the balance sheet and income statement which may be valuable in terms of explaining and providing more insight into earnings figures (Beretta & Bozzolan, 2004).

Measuring comparability of annual reports of a company, the structure of the annual report, the accounting policies used and the explanation of transactions are of special importance (Jonas & Blanchet, 2000) for any accounting standards. Comparability is one of the important qualitative factors which all accounting information must possess so that financial statements of companies can be compared across companies, regions and over time periods.

Hypotheses derived from the above discussions and table-1, are presented subsequently.

H1 **:** Understandability of financial information remains the same after adoption of IFRS voluntarily

H2 : Accuracy and reliability of financial information remain the same after adoption of IFRS voluntarily.

H3: Transparency of financial information remains the same after adoption of IFRS voluntarily.

H4: Comparability of financial information remain same after adoption of IFRS voluntarily

Reliability of information requires that the information should be accurate and true and fair. Financial reporting in general is useless, if decision makers cannot trust contents of the financial statements.

H 5 :IFRS adaption improves Accuracy & reliability of reported earning

"IAS incorporates specific guidance as regards the consistency of presentation of IFRS financial statements from one period to the next" (IASB 2008). The concept of consistency and Uniformity in methods once adapted must be applied in future. It also refers that if for any valid reasons the accounting policy is changed, a business must disclose the nature of change, reasons for the change and its effects on the items of financial statements.

From the above, two more hypotheses are framed.

H6: IFRS adaption Harmonizes internal and external reporting by creating a single accounting language

H7: IFRS adaption uniform reporting standard improves consistency in subsidiaries from different countries

Transparency defined as "the absence of bias intended to attain a predetermined result or to induce a particular behavior". Transparent information facilitates better risk management by providing unbiased information to the market. Assumptions and argumentation for the different estimates made in the annual report are needed to be known (Jonas & Blanchet, 2000). The transparency of information improves probability of better Corporate Governance (Sloan, 2001; Holland, 1999).

H8; IFRS help the accountant and auditor to prevent frauds done by companies' accountant

H9: IFRS adaption brings better corporate governance
H10: IFRS adaption facilitate better business risk management

On the other hand, several studies find that adapting IFRS leads to a higher accounting quality (e.g., Barth et al. 2008; Armstrong et al. 2010) and it increases investment opportunity while financial accounting information acts as a control mechanism for external capital suppliers. Investors can evaluate their future cash by monitoring the firm through their financial disclosure thus assessing riskiness of their investment (Biddle et al. 2009).

Hl1l: IFRS adaption improves accessibility to National and International capital market?

H12: IFRS adaption make Merger/Acquisition became easy

H13: IFRS reduces of the cost of international auditing.

H14: IFRS adaption reduce cost of capital

H15: IFRS adaption improves Qualitative reporting

H16 : IFRS adaption Reduces inform asymmetry

Statistical Results :

Table 2

Descriptive Statistics on the Basis of Primary Data

Variables	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Simplify process-	1	5	3.47	1.091	-.494	.223	-.597	.442
Improve analysis of information	1	5	3.44	1.202	-.459	.223	-.924	.442
Enhanced accuracy & reliability of information	1	5	3.66	1.156	-.755	.223	-.369	.442
Better inter company comparison	1	5	3.57	1.098	-.570	.223	-.432	.442
Improved accuracy & reliability of reported earning	1	5	3.44	.873	-.679	.223	.261	.442
Helps merger and acquisition	1	5	3.43	1.058	-.414	.223	-.641	.442
Better corporate governance	1	5	3.28	1.053	-.003	.223	-1.017	.442
Better access to capital mrkt including foreign investor	1	5	3.50	1.076	-.188	.223	-.929	.442
Reduce cost of capital	1	5	3.31	1.196	-.234	.223	-.842	.442
Uniform reporting stdrd	1	5	3.42	1.112	-.390	.223	-.640	.442
Less costly internal audit	1	5	3.29	1.087	-.110	.223	-1.060	.442
Single accounting language for external and internal reporting	1	5	3.17	1.088	-.102	.223	-.872	.442
Better risk mgmt	1	5	3.25	1.132	-.139	.223	-.945	.442
Overall benefited	1	5	3.55	.984	-.802	.223	.550	.442
Reduce inform asymmetry	1	5	3.58	.909	-.465	.223	.334	.442
Prevent fraud	2	5	3.46	.975	-.020	.223	-.982	.442
Qualitative and quantitative Valid N (list wise)	1	5	3.42	1.033	-.313	.223	-.684	.442

The above descriptive statistics shows the values of mean, standard deviation; skewness and Kurtosis of all the factors. The questions required the respondents to answer on a five-point Likert-scale anchored by (5) indicating very strongly Agree and (1) strongly Disagree. On this scale, a score of 5 or 4 indicates that the respondent is Agree on that statement while a score of 2 or 1 indicates that the respondent is Disagree. Where 3 indicates Neutrality on the statement .Skewness for all the seventeen variables varies in between -.08 to +.08 on the other hand Kurtosis values varies between -3 to +3.It indicates the normality of the sample. Data normality was checked using a rule of thumb proposed by Kline (1998) which submits that any univariate skew values greater than 3.0 and kurtosis greater than 10.0 may suggest problem of normality of data (Hardigan et al., 2001). None of the results of normality from the present research approached these abnormality values. The Mean value for all the variables are more than 3 except two, Reduction of cost of capital (2.93) and less costly audit fees (2.99). Now testing hypotheses from 1 to 15, one sample t test have been applied and tested against value is 3.In this survey Likert scale point 3 indicates Neutrality, means IFRS based financial statement and IGAAP based financial statement remain same for defining qualitative characteristic.

Table -3 : Hypotheses Testing Results

One - Sample Test

	T	Df	Sig. (2) tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
H1:Simplify process	3.613	73	.001	.446	.20	.69
H2: Enhanced accuracy & reliability of information	5.777	73	.000	.716	.47	.96
H3: Improve Analysis of information	3.621	73	.001	.541	.24	.84
H4: Better inter company comparison	3.550	73	.001	.432	.19	.68
H5: Improved accuracy & reliability of reported earning	4.241	73	.000	.432	.23	.64
H6: Single accounting language for external and internal reporting	2.082	73	.041	.257	.01	.50
H7 : Uniform reporting stdrd	5.139	73	.000	.608	.37	.84

H8: Prevent fraud H8	2.082	73	.041	.257	.01	.50
H9: Better corporate governance	2.056	73	.043	.243	.01	.48
H10: Better risk mgmt	3.109	73	.003	.405	.15	.67
H11: Better access to capital mrkt including foreign investor	5.172	73	.000	.662	.41	.92
H12: Helps merger and acquisition	3.801	73	.000	.486	.23	.74
H13: Less costly internal audit	.832	73	.408	.108	-.15	.37
H14 : Reduction of Cost of Capital	-.108	73	.914	-.014	-.26	.24
H15: Qualitative reporting	3.613	73	.001	.446	.20	.69
H16: Reduce inform asymmetry	6.509	73	.000	.676	.47	.88
H17: Overall benefited	6.039	73	.000	.581	.39	.77

Above one sample t test shows that all the factors are significant, against 95% confident level except two 1) Reduction of cost of capital (p-408.) 2) Less costly internal audit fees (p-.914). **Siqi Li (2010)** conducted a study to explore the cost of equity effects of mandatory IFRS adoption in the EU. He found that, on average, mandatory adopters experience a significant reduction in the cost of equity of 47 basis points after the mandatory introduction of IFRS in 2005. Voluntary adopters, in contrast, do not experience any significant change in the cost of equity after the voluntary introduction of IFRS in 2005.

As per the results of the above analysis, I visited some experts and enlisted their opinion. According to C.A. B. Joshi and CMA Rakesh Mishra, cost of capital is keener on managerial aspects rather than accounting and it is heavily linked with the market. So rule of accounting standard might be a less influencing factor for determining cost of capital. On the other hand for audit fees they expressed opposite opinion than the above mentioned statement. They opined that introduction of IFRS will increase audit fees, as it will be essential then to prepare financial statement as per two accounting standards. Moreover, audit cost is expected to increase owing to huge transition cost.

Conclusion:

These findings led the conclusion that IFRS adoption does have a significant effect on most of the qualitative indicators financial statement. In case of qualitative factors, experts' opinions say that, IFRS mainly effect on qualitative areas of the financial statement. Comparing IFRS with IGAAP is not fully covered so it is the suggestion to the future analyst's for the further research is to adopt a cautious approach when examine ..

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