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A Study on the Impact and Perception towards the Implementation of International Financial Reporting Standards (IFRS) on Indian Corporate Sector – A Case Study

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Abstract

Globalization has laid down a way for all the countries to adopt a single set of accounting standards. Recent years have seen major changes in financial reporting worldwide under which the most obvious is the continuing adoption of IFRS worldwide. More than 130 countries have converged or recognized the policy of convergence with the IFRS. An upcoming economy on world economic map, India, too, decided to converge to International Financial Reporting Standards (IFRS). In India, ICAI has decided to adopt the IFRS by April 2011 but still there is no growth in the implementation of IFRS. The purpose of the present paper is to measure the impact of IFRS convergence on key financial ratios in India and to know the perception of stakeholders towards the implementation of IFRS. For the First objective, IGAAP consolidated financial statements and IFRS financial statements of Wipro Limited from 2011-12 to 2013-14 has been analyzed by applying several ratios. And the second objective, questionnaire was framed to take views of 109 chartered accountants on the perception towards the implementation of IFRS in India. The researcher found the various reasons for the differences for the changes in the key ratios between IGAAP and IFRS and lot of positive response from the chartered accountants towards the implementation process. Finally, conclusion has been drawn in favour of IFRS convergence.

Keywords:

IFRS, Standard Setting, Uniform Accounting Standards, Financial Reporting

JEL code: M41

Introduction

The International Accounting Standards Committee (IASC) (the predecessor body to the IASB) was established in June 1973 in London. The IASC was established as a results of an agreement between accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, European nation, UK and USA. Its mission was to formulate and publish, within the public interest, basic standards to be discovered within the presentation of audited accounts and financial statements and to promote their worldwide acceptance. Until 2002, some countries set to use IASC standards. Several of these were countries that lacked their own standard-setting infrastructure.

From 1973 to 2000, IASC issued accounting standards called as International Accounting Standards. Some of the standards are still in usage today. In April 2001, based on the recommendations of the report "Recommendations on shaping IASC for the future", International Accounting Standards Board (IASB) was formed to replace IASC and assumed the standard setting responsibilities. The IASB is the independent standard setting body of the IFRS foundation. The IFRS foundation is an independent, not-for-profit private sector organization working in the public interest.

Its principal objectives is to develop one set of top quality, comprehensible, enforceable and globally accepted international financial reporting standards (IFRSs) through its standard-setting body, the IASB, to promote the utilization and rigorous application of these standards, to require account of the financial reporting needs of rising economies and small and medium-sized entities (SMEs) and to promote and facilitate adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

The IASB stated that all Standards issued under by IASC continue to be applicable unless and until they are amended or withdrawn ***(Annexure 1)***. The IASB is better-founded, better-staffed and more independent than its predecessor, the IASC. Nevertheless, there has been substantial continuity across time in its viewpoint and in its accounting standards. International Financial Reporting Standards (IFRS) is become a global accounting language. Over 125 countries have now adopted IFRS (**Prof. Jyoti H. Pohane)** and many more have committed to make the transition in the next few years.

Need for convergence with IFRS:

1. To prevent material manipulation or errors in financial statements
2. To ensure reliable and high quality financial reporting, in certain cases, it can prove to be crucial to the economic and financial development of a country.
3. To enable a systematic review and evaluation of the performance of a MNC's having subsidiaries and associates in various countries.
4. To make the comparison of the performance of a company against its domestic and international peers easier and more meaningful.
5. To provide a level playing field where no country is advantaged or disadvantaged by its GAAP and disclosures.
6. To help in global harmonization.

IFRS in India

Convergence with IFRS: In general terms, 'convergence means to achieve harmony with IFRS. In precise terms convergence can be considered "to design and maintain national accounting standards in a way that financial statements prepared in accordance with national accounting standards draw unreserved statement of compliance with IFRSs". In this context, attention is drawn to paragraph 14 of International Accounting Standard (IAS) 1, Presentation of Financial Statements, which states that financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs. 'Convergence with IFRSs' means adoption of IFRSs with the aforesaid exceptions, where necessary.

In 2007 the Concept Paper was released which proposed Convergence of Accounting Standards in India with IFRS from April 2011. After going through various legal procedures and consultation, the Ministry of Corporate Affairs which regulates companies in India has issued a Roadmap for Convergence with IFRS in India in January 2010 and has notified 35 accounting standards called as IND AS in February 2011 for the purpose of convergence.

Present Position of Convergence

The present position is that standards that would be applicable are notified. But the date of applicability is postponed indefinitely.ICAI has notified 35 accounting standards converged with IFRS. As India converges with international financial reporting standards, there are certain basic things that the users should be aware of. First and foremost, India is converging with IFRS and not adopting IFRS. The Indian IFRS will be called Ind-AS, which would diverge from IFRS on some matters ***(Annexure 2)***. The level of acceptability of Ind-AS financial statements outside India will be somewhat discounted as those will not be in compliance with IFRS as issued by the International accounting standard board (IASB). This aspect could be somewhat mitigated by a reconciliation statement between IFRS and Ind-AS in the Ind-AS financial statements.

A lot of remarkable developments have been witnessed by Indian economy in the post-globalization era like increasing participation of the FIIs in capital market, launching of derivative instruments, spiraling growth in FDI, introduction of GDR and ADR enabling the Indian companies to raise capital from international markets**(Nikhil Chandra Shil,2009)**, overseas acquisition by the Indian companies as soon. In order to reap the benefits of convergence; ICAI has already taken a great stride to revise the existing AS to make them compatible with the IFRS. The institute has already declared a road-map for applicability of the converged accounting standards in different phases ***(Annexure 3)***.

Review of Literature

Review related the issues of convergence between US Generally Accepted Accounting Principles (GAAP) and IFRS **(Elena et al 2009)** were of the opinion that the adoption of IFRS in the USA undoubtedly would mark a significant change for many US companies. It would require a shift to a more principles-based approach, place for greater reliance on management (and auditor) judgment, and spur major changes in company processes and systems.

There are so many aspects relating to IFRS convergence which still need to be clarified, **(Dr. Kishore J. Bhagat. 2012)** such as IFRS first time adoption standard, compliance of comparative previous period figures with IFRS, changes required to the Companies Act to comply with IFRS, changes to the Income-Tax Act, the Reserve Bank of India's requirements for banks, etc.

The study conducted (**Armstrong et al 2010)** on 1084 European Union firms during the period of 1995-2006 and result showed a positive reaction to IFRS adoption events for firms with high quality pre adoption information, consistent with investors expecting net convergence benefits from IFRS adoption. It is increasingly felt that IFRSs would be the right choice for a single global standard, since it has been prepared with much considerations and consultations (**Pinky Dholakia)**.

From the study of ***shobana swamynathan, Dr. Sindhu*** in her article titled financial statement effects on convergence to IFRS – a case study in India says that Environment requires uniform accounting standards for global business. To emanate such issues, one global accounting standard for reporting financial statement i.e. IFRS was developed. During the switch over phase from local GAAP to IFRS companies will have to modify their accounting system and processes as well as provide comparative financial information between their previous GAAP and their new IFRS compliant report. This article examines the financial statement effects on convergence to IFRS from Indian GAAP. The result concluded that the IFRS is fair valuation approach and are more transparent disclosures and Indian GAAP is conservative approach.

Financial statements of an organization provides information such as the value added, changes in equity if any and cash flows of the enterprise within a defined period time to which it relates (***Iyoha and Faboyede, 2011***). This information is useful to a wide range of users making informed economic decisions. The implementation of IFRS would reduce information irregularity and strengthens the communication link between all stakeholders (***Bushman and Smith, 2001***).

An important question arising from this development is whether these changes in accounting systems really have improved the quality of financial reporting. Earlier studies report that the adoption of capital market user-orientated standards, such as IFRS, lead to improved accounting quality in continental European countries (***e.g. Bartov et al., 2005; Daske and Gebhardt, 2006; Barth et al., 2008***). Although the literature finds that the differences in accounting standards affect financial reporting quality, it does not describe what kind of impact these differences have on the accounting numbers and key financial ratios used by financial analysts, investors and other financial institutions as key performance indicators.

The purpose of the present paper is to fill this gap by measuring the impact of IFRS adoption on key financial ratios in Indian corporate sector.

Objectvies

1. To study the impact of IFRS on key financial ratios of Wipro.
2. To study the perception of chartered accountants towards the implementation of IFRS

Methodology and Design

The purpose of the present paper is to investigate whether there are changes in accounting numbers and key accounting ratios from the conversion IGAAP to IFRS. Therefore, for the first objective, secondary data has been used, this analyses the differences between financial ratios calculated from IGAAP to IFRS by taking 3 years Wipro's annual report from 2011-12 to 2013-14. The ratio's used for the analysis are- Current ratio (CR); Equity ratio (ER); Gearing ratio (GR); Operating profit margin (OPM,); Earning per share (EPS); Quick ratio QR); Return on equity (ROE); Return on invested capital (ROIC). For the second objective, primary data has been used. For this data collection questionnaire was sent to 122 chartered accountants, out of which 109 CA's responded. The primary data was collected from chartered accountants from Bangalore and for the secondary data, the only the annual reports of Wipro has been analyzed. The additional required secondary data was collected from the authorized Annual Reports and Official Website of ICAI and IFRS, various Journals and Research Papers, diagnostic study reports and newspaper articles have been surveyed in making this study.

Limitations of The Study

The data collected for the secondary data is restricted to only one company. Therefore, impact position cannot be decided from the analysis of one particular company.The data collected for the primary data is from the CA's from Bangalore only. The analysis of perception on the impact of IFRS on Financial Statements is Difficult from the selected sample.

Analysis and Interpretations

Impact of IFRS on Indian Corporate Sector – Wipro Limited:

Mainly the study is to discuss the IFRS impact on some significant ratios with the help of a case study on Wipro. Wipro Company Limited offers products and services in IT business, consumer care and lighting and also infrastructure engineering sectors. The IT business includes IT services and products. It comprises of software services, out sourcing services. The company has its geographical presence in the countries like America, Europe, India, Japan, Middle East, South East Asia and Asia Pacific.

Some selected ratios are Current ratio (CR); Equity ratio (ER); Gearing ratio (GR); Operating profit margin (OPM,); Earning per share (EPS); Quick ratio QR); Return on equity (ROE); Return on invested capital (ROIC) have been analyzed to indicate the differences between two sets of statements. The below calculated figures in the Balance Sheet and the Profit and Loss statements have been completely drawn from the annual report of the company. All figures are related to the period 2011-2012 to 2013-2014.

TABLE 1: LEVERAGE RATIO

YEAR	2011-12			2012-13			2013-14		
Particulars	**IGAAP**	**IFRS**	**DIFF.**	**IGAAP**	**IFRS**	**DIF**	**IGAAP**	**IFRS**	**DIF**
Equity ratio	0.62	0.66	0.04	0.61	0.65	0.04	0.64	0.68	0.04
Gearing ratio	0.21	0.23	0.02	0.16	0.24	0.08	0.16	0.15	-0.01

Source: Wipro Annual Report 2011-12 to 2013-14

Equity Ratio: The equity ratio is an investment leverage or solvency ratio that measures the assets value that are financed by owners' investments by comparing the total equity in the company to the total assets. The equity ratio measures two important financial concepts of a solvent and sustainable business. This shows how much of the total company assets are owned outright by the investors and it also shows how leveraged the company is with debt.

Gearing Ratio: The Gearing Ratio is one of the fundamental ratios that are used every day by financial analysts, banks and investors to understand the capital structure of a company. The financial gearing shows how much debt a company has compared to the funds that the shareholders have injected.

Analysis: the above table shows that there is an increasing trend in the equity ratio. Means higher equity ratios are more favorable for companies. From the above table the equity ratio is 6.7%, 6.15% and 5.88% more in case of IFRS in 2011-12, 2012-13 and 2013-14 respectively which shows AS are more conservative. From the above table the gearing ratio is 8.7%, 33.33% and (6.67%) more in case of IFRS 2011-12, 2012-13 and 2013-14 in gradually is in decreasing trend.

Under IFRS Special Purpose Entities1 (SPE) may have to be consolidated as they are in substance controlled through legal provisions determined at inception. In case of Indian GAAP SPE's do not need the definition of subsidiary under companies act. The consolidation of SPE's under IFRS has a substantial impact on P&L Account, Net Asset and gearing position, and also on debt equity.

TABLE 2: LIQUIDITY RATIO

YEAR	2011-12			2012-13			2013-14		
Particulars	**IGAAP**	**IFRS**	**DIFF.**	**IGAAP**	**IFRS**	**DIFF.**	**IGAAP**	**IFRS**	**DIF**
Current ratio	2.0	2.3	0.3	1.8	2.1	0.3	2.2	2.6	0.4
Quick ratio	1.9	2.2	0.3	1.8	2.1	0.3	2.2	2.6	0.4

Source: Wipro Annual Report 2011 -12 to 2013-14

The amounts of short term loans and advances and that other current assets vary. It is due to the differences in the recognition loans and trade receivables. In the case of IFRS, loans and trade receivables are treated differently. (IAS 18) The current ratio is 13.04% is more in case of IFRS which shows that Accounting Standards are more conservative. The reason under IFRS is the fair value measurement of certain assets like deferred contract costs, the excise and customs and non-convertible debentures are not included in current assets in AS.

Short term loans and advances, prepaid expenses, advance to suppliers are accounted for differently in both Indian GAAP and IFRS. The total of current liability varies which is relatively substantial. Other current liabilities contains employee benefits, statutory liabilities, advances from customers, derivative liabilities and accrued interest, also varies. The reason being that, the cost of leases and interest expenses are treated on fair values in IFRS (IFRS3) which is not the case in AS. Similarly short term provisions differs by 96 % in the year 2011-12. Under IFRS the total current liabilities are quite less as compared to AS. The liquidity of the firm is well depicted in IFRS statements.

TABLE 3: PROFITABILITY RATIO:

YEAR	2011-12			2012-13			2013-14		
Particulars	**IGAAP**	**IFRS**	**DIFF.**	**IGAAP**	**IFRS**	**DIFF**	**IGAAP**	**IFRS**	**DIFF**
Operating margin ratio	24.10%	20.56%	-3.54%	23.23%	21.00%	-2.23%	23.32%	23.26%	-0.06%
Return on equity	20.74%	22.68%	1.94%	23.15%	25.25%	2.10%	24.74%	24.51%	-0.23%
Return on invested capital	27.31%	21.53%	-5.78%	28.16%	24.07%	-4.09%	27.36%	27.42%	0.06%

Source: Wipro Annual Report 2011 -12 to 2013-14

TABLE 4: EARNING PER SHARE

YEAR	2011-12			2012-13			2013-14		
Particulars	**IGAAP**	**IFRS**	**DIFF.**	**IGAAP**	**IFRS**	**DIFF.**	**IGAAP**	**IFRS**	**DIFFE.**
Earnings Per Share	21.46	22.76	1.3	25.07	27.05	1.98	32.37	31.76	-0.61

Source: Wipro Annual Report 2011 -12 to 2013-14

In the company the Return on Capital Employed, Return on Shareholders Fund and Earning per Share are good indicators of success. The return on capital employed and return on shareholders fund depends upon share capital and profits. The share capital under IFRS is higher due to the shares issued to controlled trust do not form a part of share capital in AS. Employee Stock Options (ESOPs) outstanding and hedging reserves are the portion of shareholder funds in AS but not in IFRS (IAS19, IAS39, and IAS 32). In AS the surplus from P&L is a part of reserves and surplus which is not included under IFRS (IAS 19). The difference in non-controlling interest is due to IFRS permits its measurement as a proportionate share of identifiable net assets at fair value. (IFRS3). This explains the variation of 5.78% in the ratio of return on capital employed and a variation of 1.94% in return on shareholder's equity.

The EPS variation due to the inclusion of outstanding shares for the purpose of calculation under AS and IFRS.Using fair value method under IFRS and valuation on intrinsic value method under AS are the main reasons of differences. (IAS19)

Perception Towards The Implementation of IFRS

For primary data collection questionnaire was sent to 122 chartered accountants, out of which 109 Chartered Accountants were responded. On an analysis of questionnaire the researcher reached the following conclusions:

All the respondents are taken from chartered accountants profession because the first person who will get affected by IFRS is chartered accountants because they have to play an important role in implementation of IFRS.

1. It was found that 89% of the respondents believe that reporting under IFRS will provide true financial performance and comparability disclosures.
2. 96% respondents believe that adoption of IFRS will

facilitate investment decisions for investors.

3. 32% respondents think that there is a positive impact on shares market price.
4. 83% respondents say that lack of trained and experience resources are major challenge and 17% says that regulatory environment and clarity are another major challenge for transition.
5. 66% respondents says that they have started training and awareness programme. 21% have not yet started any programme and 13% says that implementation is in process.
6. 56% respondents says that profits will increase while only 17% respondents says that profits will decrease and rest couldn't answer.
7. Half of the population of accounting professional are quite familiar and rest of respondents are properly familiar with IFRS.

Above analysis shows that we have a big need of IFRS trained professionals as soon as possible for successful implementation.

Summary and Conclusions

From the above study shows proof of the impact of IFRS adoption on accounting numbers and on the key monetary ratios utilized by monetary analysts, investors and alternative monetary establishments as key performance indicators. By examining the modifications in budget things and distinctive the IFRS/ IAS standards that change the ratios, we tend to make a case for the explanations for the changes within the ratios. The results of this study indicate that the adoption of IFRS changes the magnitudes of the key accounting magnitude relations of Wipro Company by significantly increasing the profitability ratios and gearing ratio moderately, and equity and quick ratios slightly. Our results indicate that the will increase within the gain ratios may be explained by will increase within the financial statement profits. Moreover, our results are in line with those of Jones and Higgins (2006) suggesting that the removal of the amortization of purchased goodwill under IFRS 3 is that the most vital reason for a substantial increase in profitability ratios. Our results additionally indicate that the rise in debt things and reduce in equity explain the changes within the monetary leverage ratios. Moreover, the will increase in liquidity ratios will primarily be explained by the decrease in current liabilities. Overall, our results indicate that the adoption of rules regarding truthful worth accounting, lease accounting and tax accounting, as well as rules regarding the accounting of economic instruments, explain the changes within the key accounting ratios. In summary, the adoption of fair value accounting rules and stricter requirements concerning certain accounting issues are the reasons for the changes observed in accounting figures and financial ratios.

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ANNEXURE 1: I**nternational Financial Reporting Standards:**

IFRS1 (2008): First -time Adoption of International Financial Reporting Standards IFRS 2: Share-based Payment IFRS 3 (2008): Business Combinations IFRS 4: Insurance Contracts IFRS 5: Non -current Assets Held for Sale and Discontinued Operations IFRS 6: Explorations for and Evaluation of Mineral Resources IFRS 7: Financial Instruments: Disclosures	IFRS 8: Operating Segments IFRS 9 (2010): Financial Instruments (as of now only partially completed) IFRS 10: Consolidated Finan cial Statements IFRS 11: Joint Arrangements IFRS 12: Disclosure of Interests in Other Entities IFRS 13: Fair Value Measurement IFRS 14: Regulatory Deferral Accounts IFRS 15: Revenue from contracts.

ANNEXURE 2: **The Indian Accounting Standards (INDAS) Converged With IFRS:**

Ind-AS1 Presentation of Financial Statements Ind-AS2 Inventories Ind-AS7 Statement of Cash Flows Ind-AS8 Accounting Policies Ind-AS10 Events after the reporting period Ind-AS11 Construction Contracts Ind-AS12 Income taxes Ind-AS16 Property, plant and equipment Ind-AS17 Leases Ind-AS18 Revenues Ind-AS19 Employee Benefits Ind-AS20 Government Grants. Ind-AS21 Effects of Changes in Foreign Exchanges Ind-AS23 Borrowing Costs Ind-AS24 Related Party Disclosures Ind-AS27 Consolidated Financial Statements Ind-AS28 Investment in Associates. Ind-AS29 Financial reporting on Hyperinflationary Economies.	Ind-AS31 Interest in Joint Ventures Ind-AS32 Financial instruments – presentation Ind-AS33 Earning Per Share Ind-AS34 Interim Financial Reporting Ind-AS36 Impairments of Assets Ind-AS37 Provisions, contingent liabilities Ind-AS38 Intangible Assets. Ind-AS39 Financial Instruments - recognition and measurements. Ind-AS40 Investment Property Ind-AS101 First time adoption of Indian AS. Ind-AS102 Share Based Payment Ind-AS103 Business Combinations. Ind-AS104 Insurance Contracts Ind-AS105 Non-current assets held for sale and discontinued operations Ind-AS106 Exploration and evaluation of mineral Ind-AS107 Financial Instruments – Disclosures

ANNEXURE 3: **Roadmap for companies other than banking, insurance companies:**

Phase	**Companies covered**	**Opening balance sheet**
Phase I	Companies that are part of NSE - Nifty 50 Index Companies that are part of BSE Sensex 30 Index Companies that have shares or other securities listed in overseas stock exchanges ; and Listed and Unlisted Companies with net worth in excess of Rs 1000 Crores	1 April; 2011, (First financial statements on 31st march 2012)
Phase II	Listed & Unlisted Companies with net worth in excess of Rs 500 Crores but not exceeding Rs. 1000 Crores.	1 April; 2013 (First financial statements on 31st mar 2014)
Phase III	Listed entities with net worth of Rs 500 Crores or less	1 April; 2014, (First financial stateme nts on 31st March 2015)