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PHASE I TRANSITION TO IND AS: A STUDY OF EFFECTS ON SELECTED PSU's

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Abstract

India's road towards IFRS was undertaken through convergence. In the first phase, around 350 companies adopted the newly introduced IFRS-based Ind AS for preparing financial statements. Ind AS theoretically differs from the old Indian GAAP in many aspects including valuation and classification. We take an empirical-analytic approach to evaluate whether adoption of Ind AS at all made a difference to the financial reporting of the first phase adopters among the PSUs. Our early-bird approach brings out that unlike private sector, financial statements of PSUs did not have a significant impact of the transition.

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After the revolutionary decision of liberalisation, privatisation and globalisation in India, the Indian companies placed more importance on developing global acceptability and marketability. With the potentials of foreign investments, both the companies and the regulatory authorities focused on issues of transparency and disclosures. Companies registered under the Companies Act, 1956 had to comply with the requirements of preparing Financial Statements in accordance with the Generally Accepted Accounting Principles (GAAP) existing in India.

The GAAP consisted of Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) and duly notified by the Ministry of Corporate Affairs (MCA). These standards were the guidelines of accounting treatments to be followed while preparing the financial statements.

A major barrier to global acceptability of companies was the readability of Financial Statements. The Financial Reporting Framework in countries differed from one another. With a goal to open up the investment market, a major headache of lawmakers was the difference in domestic accounting principles and reporting guidelines (Narayanswamy, 2007, Lakmal, 2014). On the other hand, foreign companies operating in India faced di#iculty in re-stating their financials as per the existing Indian financial reporting framework which was not in line the framework of their respective countries of establishment. These differences in reporting frameworks were not just a problem for India, but it was actually a major setback to globalisation and felt worldwide.

This led the establishment of the International Accounting Standard Board and drafting of the International Financial Reporting Standards (IFRS). The primary objectives behind issuing the IFRS were to increase the reliability, readability and comparability of the financial statements worldwide and thereby facilitate cross-border trade and shareholding.

Since long, the ICAI, the NACAS and the MCA were considering revision of the existing GAAP in India due to the changing financial and investing patterns. However, the ministry and institute observed that the international standards may result in unwanted complexities and conflicts with existing laws and that may lead to inappropriate application and further, misinterpretation of financial information. Therefore, considering the social, legal and economic aspects of India, they opined for convergence with the IFRS rather than mere adoption. The Accounting Standards Board of the ICAI prepared the new Indian Accounting Standards (abbreviated as Ind AS) and till date, the ministry has notified forty-one Ind-AS. MCA decided to implement Ind-AS in India in a phased manner. Accordingly, adoption of Ind-AS for preparation of financial statement was made mandatory by the ministry from the Financial Year 2016-17 for all companies having a Net Worth exceeding Rs. 500 Crores (alternatively called the Phase I companies) for the immediately three preceding financial years and its holding, subsidiary, joint venture and associate companies. As a result, around 350 companies, falling within the definition of Phase I companies, reported their financial statements for the financial year 2016-17 as per the Ind AS. Moreover, these companies also re-stated the financial statements as on the date of transition (01.04.2015) and for the comparative period (2015-16) in accordance with Ind AS.

Table 1: Phase-wise implementation plan of Ind AS

Phase	Year of Transition	Applicability
I	Accounting Period beginning on/after 01.04.2016	• Companies (listed or unlisted) having a Net Worth of 500 Crore of more; • Holding/Subsidiary/Joint Venture/Associate thereof.
II	Accounting Period beginning on/after 01.04.2017	• Listed Companies and Companies under listing process. • Unlisted Companies having a Net Worth of 250 Crore or more. • Holding/Subsidiary/Joint Venture/Associate thereof.
III	Accounting Period beginning on/after 01.04.2018	• Scheduled Banks • Insurance Companies • NBFCs having a Net Worth of 500 Crore or more. • Holding/Subsidiary/Joint Venture/Associate thereof.
IV	Accounting Period beginning on/after 01.04.2019	• Listed NBFCs having a Net Worth of less than 500 Crore. • Unlisted NBFCs having a Net Worth of 250 Crore or more. • Holding/Subsidiary/Joint Venture/Associate thereof.

Source: Ministry of Corporate Affairs, Government of India

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However, the Reserve Bank of India recently deferred adoption of Ind AS by scheduled banks by one year (i.e. from accounting period beginning on or a!er 01.04.2019.

Literature Review:

Most of the works in the area of transition of accounting principles compared the IFRS with the local GAAP. Trewavas et al. (2012) studied the effect of IFRS adoptionin New Zeeland on public sector entities. They observed that the adoption had a great impact on the reporting of liabilities since IFRS required additional disclosures and a stricter approach to report liabilities in the financial statements. Tawiah and Benjamin (2015) used Grey's Index Conservatism and used Existing AS and IFRS (as a substitute of Ind AS) and concluded that Ind AS will provide more quality information. However, they assumed that reporting under IFRS and Ind AS will be absolutely similar. Black and Maggina (2016) examined the effectsof IFRS adoption on financial statement data in Greece. They found that, unlike most cases, the adoption did not result in any improvement of the statistical behaviour of thefinancial ratios and the usefulness of financial statement did not improve. Silva and Nardi (2017) examined whether full adoption of IFRS increase conservatism, relevance, timeliness and reduce earning management and cost of capital for public companies in Brazil. They used variousmathematical models, developed in prior researches, to show that earning quality and value relevance has increased due to full adoption of IFRS in Brazil. They furthershowed that the cost of capital has decreased in companies reporting under new principals.

Research Objective:

A rigorous review of the literatures reveals that effects of IFRS adoption is not uniform and differed from one nation to another. India moved for a convergence with IFRS through the introduction of Ind-AS and not by a straightway adoption. We wish to understand the impact of the transition to Ind-AS on three separate dimensions, namely
– return, risk and liquidity of public sector undertakings. In line with the above objective, we attempt to address the following questions–

1. Whether the transition to Ind-AS has any impact on Return Ratios?
2. Whether the transition to Ind-AS affected the Debt-Equity Ratio?
3. Whether the transition to Ind-AS affected the Currentratio?

Since companies prepared their financial statement as on 31st March 2016 as per the existing Indian GAAP and in the very next year, included restated financial statement as on the same date in accordance with Ind-AS in the comparative information for the first Ind-AS adoption year (2016-17), we use this financial information to check the impact of Ind-AS.

Sample and Methodology:

We used purposive sampling and selected Public Sector Undertakings included in NIFTY 50 and NIFTY NEXT 50 index who were Phase I adopters of Ind AS. Since banks were not required no adopt IFRS in the first phase, the scheduled banks have been excluded from the sample. Financial data is manually collected from their annual reports of the Financial Year 2015-16 and 2016-17. The industrial classification of the sample is hereunder –

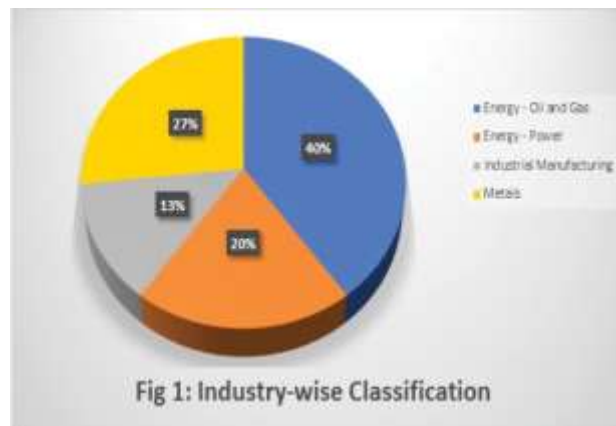

Fig 1: Industry-wise Classification

On testing the normality, we find that except debt-equity ratio, no other data follows normal distribution. So, we take Student's pair t-test for debt-equity ratio and non-parametric Wilcoxon Signed Rank Test for the return on equity (ROE), return on assets (ROA) and current ratio.

Accordingly, we form the following hypothesis:

H_{o1} = ROE ratio of the adopting entities is not affected bytransition to Ind-AS.

H_{o2} = ROA ratio of the adopting entities is not affected bytransition to Ind-AS.

H_{o3} = Debt-Equity ratio of the adopting entities is not affected by transition to Ind-AS.

H_{o4} = Current ratio of the adopting entities is not affected by transition to Ind-AS.

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5. Results:

Our evaluation show that ROE decreased in 66.67% cases whereas the Debt-Equity ratio decreased in 73.33% cases. On the other hand, the current ratio increased in 80% of the sample PSUs. Unlike the ROE, interestingly there was no specific trend in case of ROA ratio.

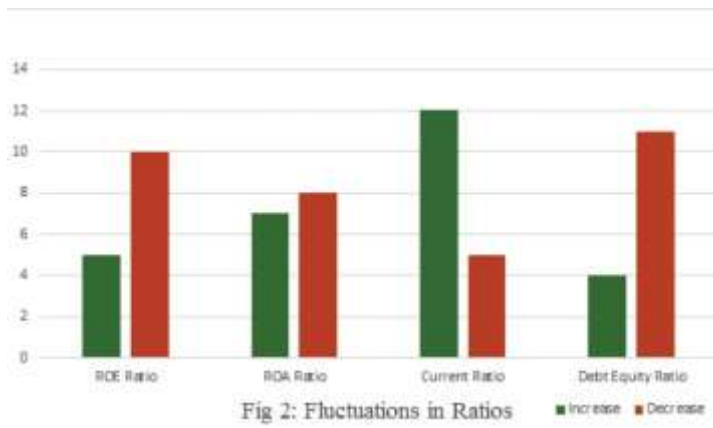

Fig 2: Fluctuations in Ratios

Studying it together, it appears that ROE ratio did not decrease because of a change in reported income, but due to increase in equity. The decreasing D/E Ratios trend further validate this observation.

Table 2: Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
ROEGAAP	15	-0.10532	1.05216	0.16822	0.25983
ROEINDAS	15	-0.10260	1.03410	0.16374	0.25498
ROAGAAP	15	-0.04210	0.78342	0.09882	0.19302
ROAINDAS	15	-0.04008	0.77614	0.09898	0.19090
CRGAAP	15	0.39526	6.33900	1.92621	1.70599
CRINDAS	15	0.02177	6.32023	1.88892	1.78959
DEGAAP	15	0.10742	3.17534	1.21541	0.92921
DEINDAS	15	0.12205	3.07223	1.14054	0.90842

Source: Researcher's calculations on IBM SPSS Statistic v25

Table 3: Wilcoxon Signed Ranks Test

Ranks				
		N	Mean Rank	Sum of Ranks
ROEINDAS - ROEGAAP	Negative Ranks	10[a]	9.00	90.00
	Positive Ranks	5[b]	6.00	30.00
	Ties	0[c]		
	Total	15		

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Ranks				
		N	Mean Rank	Sum of Ranks
ROAINDAS - ROAGAAP	Negative Ranks	8[d]	8.25	66.00
	Positive Ranks	7[e]	7.71	54.00
	Ties	0[f]		
	Total	15		
CRINDAS - CRGAAP	Negative Ranks	3[g]	10.67	32.00
	Positive Ranks	12[h]	7.33	88.00
	Ties	0[i]		
	Total	15		
a. ROEINDAS < ROEGAAP, b. ROEINDAS > ROEGAAP, c. ROEINDAS = ROEGAAP				
d. ROAINDAS < ROAGAAP, e. ROAINDAS > ROAGAAP, f. ROAINDAS = ROAGAAP				
g. CRINDAS < CRGAAP, h. CRINDAS > CRGAAP, i. CRINDAS = CRGAAP				

Source: Researcher's calculations on IBM SPSS Statistic v25

H1. At 5% Level of Significance, T* = 25. In our test, T = Min {90,30} = 30. As T = 30>25, we accept the null hypothesis thatthe population median of differences is not significantly different under the two different financial reporting frameworks.

H2. At 5% Level of Significance, T* = 25. In our test, T = Min {66,54} = 32. As T = 54>25, we accept the null hypothesis that the population median of differences is not significantly different under the two different financial reporting frameworks.

H3. At 5% Level of Significance, T* = 25. In our test, T = Min {32,88} = 32. As T = 32>25, we accept the null hypothesis that the population median of differences is not significantly different under the two different financial reporting frameworks.

Table 4: Paired Samples Statistics

	Mean	N	Std. Deviation	Std. Error Mean
DEGAAP	1.21541	15	0.92921	0.23992
DEINDAS	1.14054	15	0.90842	0.23455

Table 5:Paired Samples Test

	Paired Differences					t	df	Sig. (2-tailed)
	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference					
			Lower	Upper				
DEGAAP - DEINDAS	0.07487	0.14659	0.03785	-0.00631	0.15605	1.978	14	0.068

Source: Researcher's calculations on IBM SPSS Statistic v25

H4: Since the p value (0.068) is more than the alpha (0.05), there is not enough statistical evidence that indicates the

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population mean of differences under the two alternatives differ substantially.

Analysis and Conclusion:

IFRS has numerous differences from the existing or old Indian GAAP. Ind AS, which is nothing but India's convergence with IFRS, also consist of some major variations from the old way of preparing financial statements in India. However, our results indicate that this transition did not make a rampant impact on the financials of public sector undertakings in India. In other word, our sample did not provide sufficient statistical evidence in this respect. The return, risk and liquidity aspect in case of public sector undertakings were not that affected by the transition to Ind AS so as to be statistically significant. Our results in respect of the Indian scenario appears to be different from that of Trewavas et al. (2012) in New Zeeland. However, it should be noted that Ind AS was gracefully drafted to be appropriate in the Indian financial and legal frameworks and it rather purposefully avoids guidelines of IFRS that maycause major disturbance and Ructuation in the financial statements of Indian companies. Nevertheless, our own research with private sector entities provide a somewhat differentoutcome. Combining the two, it seems that Ind AS has a higher impact on private companies as compared toPSUs. On the other hand, we may substantiate our results from a different point of view (Daske et al.,2008) which contends that the first mandatory IFRS-based financial statements make negligible effect for firms that do not have much reporting incentives to apply IFRS. Observations from the Fig-2 above indicate that the changes in the ratios are mostly because of classification disparities and not for valuation differences.

Limitations and Further Scope:

Our research took an early-bird empirical approach to provide an insight into the initial impact of transition to Ind AS on the public sector undertakings. Since a limited number of companies fell within the scope in phase I, our observations were based on a small sample. As more and more companies start adopting Ind AS, the conclusive picture will appear vivid. Future research, taking reference from the initial evaluations, may be undertaken to further evaluate the impact on stock market movements, earning management and most of all, comparability of financial statements.

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