ELK ASIA PACIFIC JOURNAL OF MARKETING AND RETAIL MANAGEMENT
ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

ELK
Asia Pacific Journals

IFRS – A VOLUNTARY ADOPTION AND IMPLEMENTATION IN AN INDIAN IT FIRM

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ABSTRACT

Globalisation has changed the traditional way of borrowing in the financial setup from bank based to market based. To meet the needs of the global stakeholders dispersed in different countries multiple reporting has become an important regulatory requirement. Thus, there arose need for a unified reporting system.This has led to the establishment of International Accounting Standard Board (IASB) which issues International Financial Reporting Standards (IFRS), a unified mean of reporting the financial statements.

The main objective of this paper is to analyse the implication of IFRS on the financial decisions by carrying out a study on an IT company -Wipro Ltd. Overall the results show strict adherence to standard accounting standard impacts the financial indicators and helps investors in prudent decision making.

Keywords : Accounting standard, Financial reporting,Globalization, IFRS, Indian GAAP

Introduction

Globalisation has induced socio-economic changes in the domestic financial system and led to the integration of capital market worldwide.The socio-economic changes have paved way for thebusiness entities to look beyond the conventional bank-based system of borrowing to market-based system of borrowing. The firms are now raising funds from abroad and addressing the needs of world-wide dispersed investors. As a result, the companies are required to adhere to multiple reporting and thereby abide by the regulatory requirements of both the domestic and global standards. Studies conducted by Roussey, (1992), Wyatt & Yospe (1993), and Nobes et al.,(2008)suggest the desire for a uniform financial reporting standards that cater to the needs of global investors.

The international accounting community felt the need for a unified global accounting language of financial reporting. Hence entities worldwide are moving towards a single “globally accepted financial reporting standard”. IFRS as on March 2008, is practiced in at least 120 countries worldwide. IFRS are issued by the International Accounting Standards Board (IASB) with the purposeof bringing uniformity in accounting language, statements and practices and thereby helping the market participants worldwide to make prudent investment decisions.Hope et al.,(2006)suggests that nations which have implemented IFRS have more comprehensive and comparative financial information disclosure. They indicatebetteraccessibility

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

of capital andprovide more investors protection.

There has been a paradigm shift from traditional stewardship to a broader stakeholder focussed fair valuation. All the stakeholders have high level of expectation from the business in terms of business expansion, return on investment, compliance, standard etc. Thus, business communicates with its various stakeholders by means of its financial statements. Barth et al.,(2008) observes that the followers of IFRS believe that financial statements prepared is to meet common needs of most potential users.

Literature Review

Several studies have been conducted to find the difference in compliance level between varied accounting practices and the impact of adopting international standards on accounting harmonization. Daske et al.,(2007)studies the economic impact of voluntary adoption of IFRS worldwide. The effect of mandatory adaptation of IFRS on earnings quality has been focus of the study conducted by Jeanjean and Stolowy (2008). While,Das et al., (2009)emphasised upon the importance of standard accounting practice. Dumitrescu and Bobitan, (2012)) states that there is an increasing consensus building upin favour of a single,high quality, globally accepted accounting standards. Study by Indapurkar et al.,(2009)focuses on the challenges and risk involved in adopting IFRS. Bhattacharjee and Islam (2009)conducts a study on the financial reporting environment in Bangladesh and the prospect of adoption of IFRS.Dunneet al.,(2008)suggests that the benefits associated with IFRS such as enhanced investors protection, better accessibility of capital market to foreign investors etc led to its adoption in the European countries.Ray, (2012)finds that financial reports provide substantial information to the shareholders and other stakeholders about the financial health of a company. He further states, that the reported information must be reliable, bias free and should allow evaluation on the basis of a common standard. Global entities can overcome the complications of varied financial reporting by adopting IFRS.Chen et al.,(2010)conducted a study on publicly listed companies in 15 member states of European Union (EU) and finds that Accounting Quality indicators of improved after the IFRS adoption in the EU.

A good number of papers highlight the benefits of IFRS (Armstrong et al., (2010). However, previous studies have mainly focus on the value addition done by harmonized accounting standardbut we find very few studies in the context of emerging economies. Rudra and Bhattacharjee, (2012) raises concern about the presence of earnings management in the published financial reports. Shen and Chih, (2005)by studying a sample of 48 countries reports a high level of earnings management in Indian banks which can be reduced by employing greater transparency in accounting disclosure and stronger protection of investors.

Methodology

This study follows descriptive and exploratory approach. This method helps us to derive a comparative detail about

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IFRS and GAAP for the purpose of better understanding. A structured questionnaire is prepared by including various IFRS concepts and highlighting the differences with regards to Indian GAAP. Hence, the study uses questionnaire as the means of primary data. Selected variables taken from the published annual reports of WIPRO Ltd. for the year ended March 31, 2010 is the source of our secondary data. A sample size of 30 individuals is considered for pour study. Equal number of respondents are selected for each of the three type of categories which includes individual holding a degree of MBA (Finance) along with CA, individual holding M.Com degree along with MBA (finance)and others who are just holding MBA (Finance) degree with prior work experience.

Results and Discussion

The study attempts to identify the major issues confronted during the adoption of IFRS by focusing on a corporate that has voluntarily adopted the standardized accounting practice. We also provide a comparative analysis between IFRS and Indian GAAP by using the data reported by Wipro in accordance to both the methods.

Primary Data Analysis

The study uses questionnaire for primary data analysis. Questionnaire helps to gauge the finance professional's opinion on IFRS implementation. The study uses response

Table 1 give an insight on the diversified sample respondents opinion of the IFRS adoption. Issues, challenges and opportunities faced during the adoption and implementation of IFRS were discussed. As per the table, most Chartered Accountants with MBA degree are aware of IFRS. It is observed from the overall response of Chartered Accountants (pursuing MBA (Finance) degree that they are in favour of IFRS adoption. Following them, the respondents holding M.Com with MBA (Finance) degree also display fair knowledge of IFRS.

Under, IFRS fair value is considered in calculating assets and liabilities. This is in tandem with IGAAP except for in certain cases no specific guideline is available. However, component accounting of fixed asset is followed in IFRS whereas for property, plant and equipment the method calls requires depreciation to be calculated separately. Further, IGAAP calculates interest in joint venture using proportionate consolidated methodbut under IFRS it is calculated either by equity method or by proportionate consolidated method.In defining related party, IFRS considers close family members of an individual as a party who exercise considerable influence and control. GAAP covers only relatives of key management personnel. IFRS requires firms to identify both the functional and presentation currency. GAAP has no concept of functional and presentation currency. If an entity buyback its own shares, such shares are deducted from shareholder's equity and are treated as treasury shares. Under GAAP repurchased shares cannot be treated as a treasury stock.

Secondary Data Analysis:

Our study focuses on the annual report of Wipro. The company adopted IFRS

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

reporting from 2009-10. They use both Indian GAAP and IFRS to report its financials.Thus, we considered Wipro for our study as data from both IFRS and Indian GAAP can be extracted to provide a comprehensive comparison.

Wipro Ltd. is one of the largest IT companies of India. Wipro was established in 1945 as an edible oil company which later moved into IT domain. The conglomerate at present has presence in 6 continents with approximately 1,60,000 employees worldwide. Its other business includes infrastructure engineering, lighting and consumer care. The companies' stocks are listed in Bombay stock Exchange, National Stock Exchange and New York Stock Exchange.

The study analyses the income statement and balance sheet for 2 years(2010-2011 and 2011-2012) for understanding the difference in financial ratio under the two standards. These ratios act as a benchmark for firms to review their growth in relation to prior years or with competing firms or against industry. It helps the financial decision makers to arrive at prudent investment decision. Hence, we use comparative ratio analysis is undertaken to interpret the differences in financial ratios.The reconciliation of equity and Profit and Loss Account under IFRS and IGAAP helps in understanding the reason for difference in figures.

Ratio Analysis:

A ratio analysis on important parameters by studying the financial statement is provided. The formula of the same is provided in Appendix 1.

Interest Coverage Ratio reflects company's ability to pay interest on its outstanding debt. It measures company's earning relative to the amount of interest it pays.The ratio indicates the number of timesinterest could be paid out of the company's earning.

Table 1 shows that the difference in the ratio between the two standards. It has reduced drastically from -58.68 % in 2011 to -1.51% in 2012. This was due to the impact of foreign currency fluctuation on foreign borrowings. IFRS has treated this transaction as interest expense whereas in Indian GAAP it is deducted same from other income in the profit and loss account.

IFRS includes the exchange risk on foreign currency borrowings along with fixed obligations which strengthens the internal control system of a company. A higher ratio indicates better margin of safety to the shareholders and assure lender of company's solvency.

Debt Equity Ratio indicates relation between assets financed by creditors and the portion of asset financed by stockholders. It is also referred to as long term solvency ratio as it indicates the soundness of financial policies of a company. A firm with high debt equity ratio is considered to be at risk.

Table 1 shows that the variation or difference in ratio has decreased from -13.76 % to -12.16% from 2011 to 2012. This symbolises low debt which in turn boosts the lenders confidence as their loan would be repaid in timely manner and in turn the stockholders would be assured of a fair return. The average debt equity ratio under IFRS is 0.54 and under Indian

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

GAAP is 0.62 reflects the managerial effectiveness and financial wellbeing of the company to its current and potential stakeholders.

The study analyses that the reduction in debt equity ratio is due to increase in equity due to the inclusion of Minority Interest and dividends in Equity, regarding the sale of financial investments, IFRS recognises the same in fair value which in turn contributes to the increase in the denominator value.

Liquidity Ratio measures a firm's ability to meet short-term liabilities and its management's ability to confront adverse situations by maintaining adequate margin of safety.

Table 2 indicates that the percentage variation in both current and quick ratios from 2011 to 2012, increased from 1.86 to 16.52 and from 2.49 to 16.60respectively. A positive ratio informs lenders about the solvency of the company. A good liquidity ratio helps managers to meet their fixed obligations as well as in taking decisions regarding expansion, dividend declaration, investment decisions etc.

The strength of this ratio lies in reduction of current liabilities and in increment of current assets. When a company issues dividend, Indian GAAP requires companies to make a provision for dividend to be created before it is approved by shareholders. IFRS however, requires approval before payment of dividend. This reduces the provision for liabilities to considerable extent. Under IFRS sale of financial asset and liabilities are measured in fair value but in GAAP only short-term investments are measured at fair value.This reporting variation has increased current asset in IFRS and results in a better liquidity position.

Proprietary Ratio is a ratio between owner's fund and total assets. It examines the soundness of capital structure. Higher proprietary ratio indicates long term solvency position of a firm and a lower ratio implies greater risk for creditors.

As per Table 3, the % variation is approximately 6 per cent for the 2 years. Under IFRS a higher proprietary ratio represents soundness of capital structure, better security to creditors and a fair return to shareholders. Equity ratio has increased under IFRS with the inclusion of intangibles under assets and inclusion of minority interest within equity. This in turn led to reduction in denominator and increase in shareholders equity and the proprietary ratio.

Net Profit Ratio also known as return on sales ratio. It indicates a firm's efficiency and measures the relationship between net profit after tax and net sales.A high net profit ratio indicates high margin of safety for stakeholders.

From Table 4, it is observed that the net profit ratio under both the standards are similar but the percentage variation between the two is 0.70 and -0.13 for the year 2011 and 2012 respectively.The profitability ratio of a company is a parameter for investors to evaluate the riskiness of investment. Any creditors will use this ratio to estimate the firm's repaying capacity of debts and the Governments can use it to compute taxes.

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

Return on Equity measures the financial efficiency of a firm. Higher value indicates higher efficiency of firms in generating return on shareholders' investment. Table 4, represents a very minor difference in the ratios under the two standards. The reason being minority interest of company is included within equity in IFRS and in Indian GAAP it is presented separately from equity. IFRS facilitates investors, stakeholders and lenders to identify their share on returns of the company, after taking into account stake of minority interest.

Fixed asset turnover ratio measures the efficiency with which a firm uses its fixed assets to generate its sales revenue. Higher ratio indicates that assets are being efficiently utilised and a small amount of asset generates a large amount of sales. A low ratio implies that the firm's fixed assets are not fully utilised. Table 4 displays a low difference between the two measures. This is because leases of land are classified as operating leases in IFRS and lease advance are documented as income in profit and loss account. On the other hand, Indian GAAP treats these as finance lease and lists this under Property, Plant and Equipment. This reporting difference increase the denominator and reduce the ratio under IFRS.

Return on Capital Employed measures how efficiently a company can generate profit from its capital employed. It is considered as better indicator of firms' performance because it gauges management's ability to generate earnings from the pool of total capital that the company employs. ROCE in Table 4, indicates a decline under IFRS from 2011 to 2012 and under Indian GAAP it shows a growth. It is observed that due to low current liability since the method does not allow providing for dividend, there is anincreasein the denominator and eventually reduction in the ratio. The denominator also increases due to fair value accounting. This reporting difference resulted in reduced return on capital employed under IFRS.

Conclusion

Globalisation of capital market necessitates the need for a uniform and standard set of financial reporting rule that could be applied worldwide. IFRS implementation can bring revolution in the accounting world as it attempts to bring uniformity in financial reporting. It will bring transparency of financial statements and will facilitate an even comparison of financial statements across the countries. At present nearly 140 countries have adopted the IFRS wholly or by convergence of their national standards to the IFRS.

The result from our primary data analysis indicate respondents are not fully aware of IFRS. However, out of the pool of respondents the Chartered Accountants with MBA(Finance) degree are most aware of IFRS. To overcome the problem of insufficient knowledge on the part of the accounting professionals, the study recommends training and for future accounting professional or accounting students making IFRS as a part of future course curriculum is necessary. The apprehension amongst the Indian companiesas to the working of the standards needs to be resolved. The

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

probable reasons are that the staff is completely unfamiliar with the new standards and there is no training and reference provided to them. Hence training appears to be the need of the hour for Indian companies.

The secondary study on Wipro indicate the impact of adoption of IFRS on accounting figure and key financial ratios. It is observed that the formats of the financial statements are dissimilar and hence the amounts vary. The study by employing financial ratio analysis finds that under IFRS there is a marginal increase in debt equity ratio, also growth is seen in liquidity ratios, interest coverage ratio but no significant increase in any of the profitability ratios. The major reasons for variation in ratios could be attributed to principle based IFRS standard.It uses fair value accounting and there is a difference in accounting for leases under IFRS and IGAAP.IFRS uses balance sheet approach to deferred taxes. Further, the total of current liabilities is deducted from assets to indicate net current assets under IGAAP whereas, under IFRS total assets and liabilities are represented separately.

To conclude, it can be said that though the adoption of IFRS seems to be difficult and expensive, this will give very substantial and significant benefits in future. IFRS is highly transparent and will enable management to escape multiple reporting by adhering to a common reporting platform. Shifting from Indian GAAP to IFRS will be beneficial for India especially in terms of banking sector which is severally affected by loan defaults.Therefore, consistent implementation and application of IFRS must become a reality.

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ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014,
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Table1
Debt Ratios

RATIOS	IFRS		IGAAP		Variation in %	
	2011	2012	2011	2012	2011	2012
Interest coverage Ratio	33.61	20.98	81.35	21.30	-58.68	-1.51
Debt Equity Ratio	0.55	0.52	0.63	0.60	-13.76	-12.16

Table 2
Liquidity Ratio

RATIOS	IFRS		IGAAP		Variation in %	
	2011	2012	2011	2012	2011	2012
Current Ratio	2.31	2.32	2.27	1.99	1.86	16.52
Quick Ratio	2.21	2.23	2.16	1.92	2.49	16.60

Table 3
Equity Ratio

RATIO	IFRS		IGAAP		Variation in %	
	2011	2012	2011	2011	2012	2011
Proprietary Ratio	0.77	0.79	0.72	0.75	6.58	5.63

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

Table 4
Profitability Ratio

RATIOS	IFRS		IGAAP		Variation in %	
	2011	2012	2011	2012	2011	2012
Net-Profit Ratio	0.17	0.15	0.17	0.15	0.70	-0.13
Return-on Equity	0.22	0.20	0.23	0.21	-5.26	-5.56
FixedAsset T/O	5.72	6.52	5.62	6.51	1.80	0.12
Return on Capital Employed	0.24	0.23	0.23	0.25	5.79	-6.49.

Appendix

Appendix 1

A. Liquidity Ratios

• Current Ratio: Current Assets / Current Liabilities

• Quick Ratio: Current Assets- (Inventory + Prepaid Expenses) / Current Liabilities

Debt Ratios

• Debt Equity Ratio: Total Liabilities / Stockholders Equity

• Interest Coverage Ratio: *EBIT / Interest Expense

Equity Ratio

• Proprietary Ratio: Stockholders Equity / (Total Assets Intangibles)

B. Profitability Ratios

• Current Ratio: Current Assets / Current Liabilities

• Net Profit Ratio: Net Profit after tax / Net Sales

• Return on Equity: Net Income / Stockholders Equity

• Fixed Assets Turnover Ratio: Net Sales / Average Total Assets • Return on Capital Employed: *EBIT/(Total Assets - Current Liabilities)

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

*Earnings before interest and tax

The percentage difference between the ratios under IFRS and Indian GAAP is calculated by:

$$\text{Percentage Difference} = \frac{\text{Ratio under IFRS - Ratio under Indian GAAP}}{\text{Ratio under Indian GAAP}} * 100$$

Sample of Response

Appendix 2

IFRS Implementation – Issues and Challenges				
		What is your Educational Qualification?		
		MBA (Finance)	Chartered Accountant & MBA(Finance)	M.Com & MBA (Finance)
		Count	Count	Count
Do you have knowledge of IFRS?	No knowledge			
	Partially aware			
	Fully aware			
Is it justifiable to term fixed assets as property, plant and equipment in India for the purpose of accounting?	YES (IFRS)			
	No (IFRS)			
Under coverage of related party, from the following which should be considered appropriate for the accounting purposes in India?	Only relatives of KMP			
	Close family member of the individual (IFRS)			
In India, in which way out of the following should the assets be depreciated?	Each part individually (IFRS)			
	As a full asset (GAAP)			
Under coverage of post-employee benefit, which of the following should be covered?	Entity and/or related party of the entity			

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

	Not to the related parties specifically			

IFRS Implementation – Issues and Challenges				
		What is your Educational Qualification?		
		MBA (Finance)	Chartered Accountant & MBA(Finance)	M.Com & MBA (Finance)
		Count	Count	Count
Can the concept of functional currency and presentation currency be successfully used in India?	Yes (IFRS)			
	No (GAAP)			
In India, the interest to be charged in the joint venture should be accounted using which method?	Proportionate consolidation method or equity method (IFRS)			
	Proportionate consolidation method only (GAAP)			
Under IFRS, guidance on indentification, classfication, recognition and measurements are given in extensive detail explaining them in four different categories. Should India adopt the same structure?	Yes			
	No			
What should be the treatment Repurchase of own share?	Treasury share and shown as deductible from the shareholders equity			
	Should be cancelled and			

ISSN 0976-7193 (Print) ISSN 2349-2317 (Online); DOI: 10.16962/EAPJMRM/ISSN.2349-2317/2014, Volume 10 Issue 3

	cannot be kept as treasury stock			
Which is the best suited method for increasing the knowledge of IFRS?	Events			
	Seminars			
	Mandatory teaching course			
	Short-term course			
	Not required			