

A COMPARATIVE ANALYSIS ON APPLICATION OF IGAAP AND IND AS IN SELECT INDIAN COMPAINES USING GRAY'S INDEX OF CONSERVATISM

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Abstract

The Ministry of Corporate Affairs, Govt. of India has notified 39 Ind-AS converged with IFRS which are applicable in a phased manner starting from the financial year 2016-17. Ind AS is entirely a new concept for Indian companies and so also its consequences of implementation. There are a large number of differences in existing GAAP and the new Ind AS which will ultimately impact companies' performance indicators significantly. In this paper the researcher has made an attempt to make an analysis of degree of conservatism under the two standards in reporting of earnings and revenue. Based on the financial statements of 12 listed companies of India as a sample; the study finds that both Ind AS and IGAAP are equally conservative in reporting of earnings whereas the degree of conservatism is less under Ind AS in reporting of equity. To measure degree of conservatism; the study makes use of Gray's Index of Conservatism as used by various earlier studies.

Keywords: *converged, IFRS, earnings, equity*

Introduction

Accounting standards in India are issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) and these are largely based on IFRS. However, because of its sensitive local conditions including conflicting legal and economic environment, India has not been able to keep pace with the developments and amendments made in IFRS. In the year 2006, the ICAI started to set accounting

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standards in parity with IFRS. As a result the existing accounting standards announced and issued after AS-14 (Accounting for Amalgamation) are almost in line with IFRS.

In 2009, India made a commitment towards the convergence of Indian accounting standards with International Financial Reporting Standards (Called Ind-AS) at the G-20 summit held at Pittsburgh, USA. Following this, the Ministry of Corporate Affairs came out with a road map for the implementation of Indian Accounting Standards (Ind-AS) converged with IFRS starting April 2011. This was for all Indian companies other than banking, insurance and non-banking finance companies. Because of some integration issues and political compulsions we could not kick start the Ind-AS at that time. In his first budget speech in July 2014, our present Finance Minister proposed that Ind-AS would be a reality soon.

Following the proposal made by the finance minister, the Ministry of Corporate Affairs, Government of India started notifying Ind-AS (approved by NACAS) to be implemented in a phased manner. Till now, the MCA has notified 39 Ind-AS which are applicable in India in the following manner-

- Entities could voluntarily adopt Ind-AS from the accounting year 2015-16.
- Mandatory adoption of Ind-AS is to be exercised in a phased manner as shown below
 - a. All listed and unlisted companies having net worth of 500 crores or more will follow Ind-AS from the accounting year 2016-17
 - b. All listed companies along with unlisted companies having net worth of more than 250 crores will follow Ind-AS from the accounting year 2017-18
 - c. Unlisted companies having net worth of less than 250 crores will follow Ind-AS from the accounting year 2018-19 onwards.

Whenever a company gets covered under the roadmap, Ind AS becomes mandatory, its holding, subsidiary, associate and joint venture companies will also have to adopt Ind AS (irrespective of their net worth).For the purpose of computing the net worth, reference should be made to the

definition under the Companies Act, 2013. In accordance with section 2 (57) of the Companies Act, 2013, net worth is computed as “Net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, writing-back of depreciation and amalgamation.”

Banking companies, insurance companies, NBFCs and SMEs are exempted from mandatory adoption of Ind-AS for the time being. However, this is evident from the recent announcements made by the RBI and IRDA that banking and insurance companies are also going to join the bandwagon very soon.

1.1 Statement of the Problem:

As mentioned above, the Ministry of Corporate Affairs, Government of India has laid down the road map for implementation of Ind AS starting from the financial year 2016-17; it becomes obvious that within a very short period of time Ind AS will become the new reality for all Indian Corporate houses. Though, there are some companies which already have the experience of reporting their financial statements under IFRS due to their listings outside India, the number of such companies is very low. Consequently, India is very new to the concept of IFRS and same is the case of Indian preparers and users of financial statements. This has set the ground for researchers and professionals to provide inside projections on the new standard.

A number of studies have already been conducted to show the differences between the existing AS and the new Ind AS. Unfortunately, majority of such studies are in the form of theoretical comparison among IGAAP, IFRS and Ind AS without making any empirical interpretations. This study is an attempt to provide some analytical comparison between the reported values under existing AS and Ind AS.

1.2 Objectives of the Study:

The objectives of the present study may be summarized as follows:

1. To analyze conservatism on IGAAP and Ind AS in reporting of net profits.
2. To analyze conservatism on IGAAP and Ind AS in reporting of equity.

3.0 Review of Literature:

Vardia et. al. (2016), in their study concluded that therefore the adoption of IFRS positively and significantly improved the quality of accounting information in the area of value relevance. The study also investigated the value relevance of financial information of Indian Listed Companies. The overall result on accounting presented in the study indicated that earning per share, book value of equity and share price of companies have significantly improved following IFRS adoption.

The study conducted by KPMG (2016) which was based on a sample of 71 companies listed in BSE; found that 24 out of the total companies reflected an increase in revenue by around 8.51% while 34 companies reflected a reduction in revenue by around 3.74%. According to the study, EBITDA showed a marginal reduction for the covered companies as a whole. Of the 71 companies that have reported their results as per Ind AS, 38 saw an increase in EBITDA by 4.68% whereas 33 saw a reduction in their EBITDA by 6.42%. The key changes that impacted EBITDA were the changes in accounting for revenues, foreign currency fluctuations, financial instruments, business combinations etc.

Tawiah et. al. (2015), made a conservatism analysis on Indian GAAP and IFRS using Gray's Index of Conservatism (GIC). The study which was based on five years' financial statements of two Indian companies namely Tata Motors and Infosys; found that IFRS is more conservative in reporting of liquidity as compared to IGAAP. On the contrary, for Infosys Technologies limited, the leverage ratios of IFRS were higher than AS, meaning that AS was more conservative and prudent on the computation of leverage ratio. However, there was a close similarity between the two standards regarding the reporting of equity ratio. The study further concluded that Ind.AS would provide current and quality accounting information on accounting ratios but the quality level would not be same over the years.

The study made by Barth et al (2008), on 1896 firms across 23 countries found that IFRS increased the accounting quality than the previously used local GAAP. They concluded that IFRS users are exposed to less earnings management, more timely recognition of losses, and more value relevance of accounting amounts than those entities using only domestic GAAP.

4.0 Research Methodology:

In order to analyse earnings conservatism, the reported net profit under IGAAP vis-à-vis Ind AS for the quarter ended 30th June, 2015 have been used. On the other hand, to measure balance sheet conservatism, the reported equity under IGAAP vis-à-vis Ind AS as on 31st March, 2016 have been used. The said net profit and equity data are obtained from the reconciliation statements which have been provided in accordance with circular CIR/CFD/FAC/62/2016 issued by SEBI dated July 05, 2016 on account of implementation of Ind-AS by listed companies.

Though, all companies falling under the 1st phase of implementation of Ind-AS have published the reconciliation between net profit under IGAAP and Ind AS (restated) for the 1st quarter, 2015, yet the number of companies who have published equity reconciliation is very few. Thus, while selecting the companies for study, purposive sampling method has been used and only those companies have been selected who have published reconciliation of both net profit and equity.

4.1 The profile of companies selected for study:

The 12 companies selected for the study are Wipro, Infosys, TCS, Dr Reddy, RIL, Bharti Airtel, Mahindra & Mahindra, IOC, ITC, HUL, Inter Globe Aviation and Vedanta Resources. Out of these, maximum 3 companies are from IT sector and 1 company each from various other industrial sectors ranging from automotive to Pharmaceuticals.

4.2 Concept of conservatism:

Accounting conservatism says that in no case profits and assets should be overstated or losses and liabilities should be understated. The US Financial Reporting Standard Board defines accounting conservatism as a prudent

reaction to uncertainty to try to ensure that uncertainty and risk inherent in business situations are adequately considered. Further, Feltham and Ohlson (1995) defines two types of conservatism namely balance sheet conservatism which is the persistent undervaluation of shareholders' equity book value and earnings conservatism is reflecting bad news more quickly than good news.

4.3 Gray's Index of Conservatism (GIC):

The index proposed by Gray (1980) popularly known as Gray's Index of Conservatism or Comparability Index was the first to quantify the impact of different national accounting practices on profit measurement. Using this index, Gray found the results in German and French companies were more conservative than those of UK companies. The formula for calculating Gray's Index is given by-

$$(GIC) = 1 - \frac{(\text{New GAAP Numbers} - \text{Old GAAP Numbers})}{\text{New GAAP Numbers}}$$

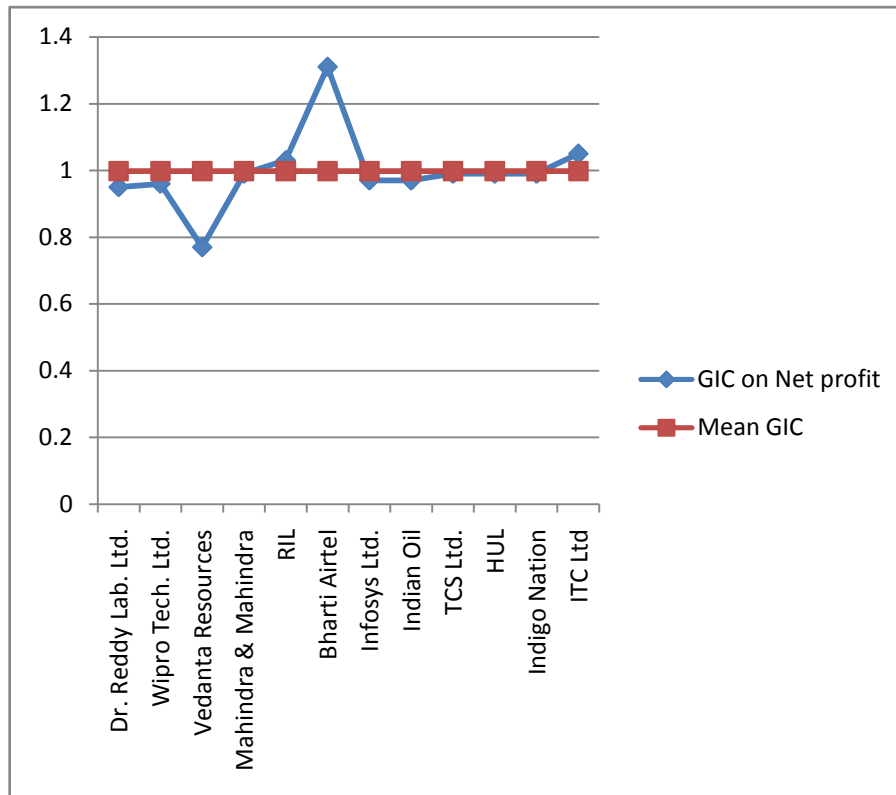
Interpretations of GIC:

GIC=1 means both the accounting standards are equally conservative, GIC>1 means the new standard is more conservative than the previous standard and GIC<1 means the new standard is less conservative than the previous standard. Gray went further to set a conservatism degree scale for various entities depending on the index value. (.95<GIC>1.05) is the neutral region which indicates the degree of conservatism between the two standards is equal or nearly equal. The sub-divisions in this region are 0.95-0.99, 1 and 1.01- 1.05.(GIC<.95) is the region which indicates that the previous standard is more conservative than the new standard. Sub-divisions in this region are below 0.5, from 0.5to 0.74 and from 0.75to 0.95. (GIC>1.05) is the region which implies the new standard is more conservative and the degree of conservatism is subdivided as 1.06to 1.25, 1.26 to 1.50 and more than 1.50.

5.0 Analysis and Discussion:

5.1 Net Profit Conservatism on IGAAP and Ind AS:

Figure 5.1 GIC on reported net profit:

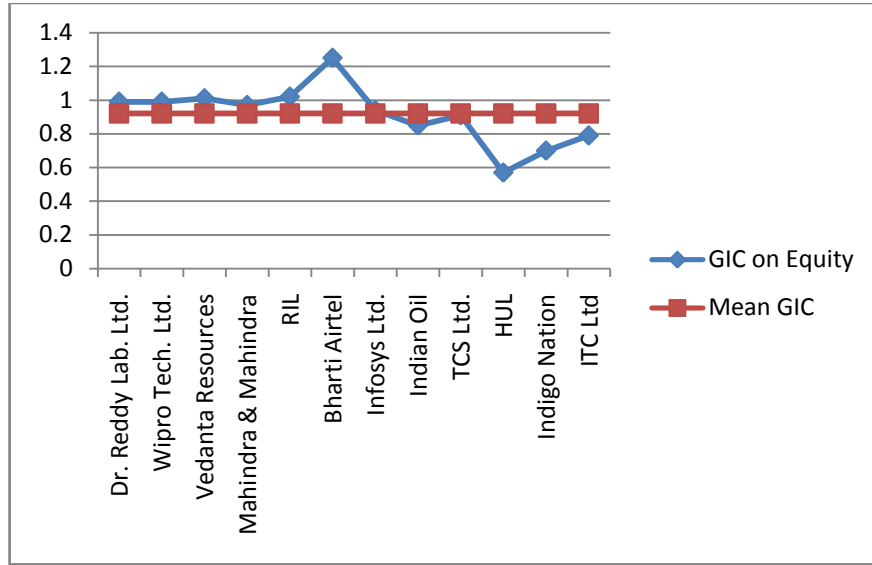


Source: Published financial statements of sample companies

GIC calculated on the sample companies shows that except three companies namely RIL, Bharti Airtel and ITC; Ind AS is less conservative than the previous GAAP in reporting of net profit. However, in all companies other than Bharti Airtel and Vedanta Resources, GICs calculated on net profit range between 0.95 and 1.05 indicating moderate degree of conservatism of both the standards which is also reflected by SD of 0.12. GIC on reported net profit of Bharti Airtel and Vedanta Resources fall in the two extremes of Gray's Conservatism model. The mean GIC of 0.998 indicates that the both the accounting standards are equally conservative in reporting of net profits when all companies are taken together.

5.2 Equity Conservatism on IGAAP and Ind AS:

Figure 5.2 GIC on reported Equity:



Source: Published financial statements of sample companies

GICs calculated on Bharti Airtel and HUL are at the two extremes. In case of Bharti Airtel, GIC reflects that Ind AS is more conservative whereas in case of HUL, GIC reflects that Ind AS is less conservative than the previous GAAP. The mean GIC of 0.92 indicates that Ind AS is less conservative as a whole but the degree of conservatism is moderate. However, the variation in the conservatism level in equity reporting among different companies is higher with SD of 0.17 as compared to that in case of reporting of net profit.

6.0. Findings and Conclusion:

The study has measured the level of conservatism in reporting of net profit and equity under the two accounting standards i.e. IGAAP and Ind AS. The study has found that both the accounting standards are similar with regard to conservatism level in reporting of net profit with the mean GIC value of 0.998. However, the results are not same when individual companies are taken in to account. The calculated value of standard deviation (0.12)

reflects the degree of variation in conservatism level among different companies.

Further, the study reveals that Ind AS is less conservative in reporting of equity which is reflected in the mean GIC value of 0.92. However, there is higher degree of variation in the result among different companies as reflected by standard deviation (0.17) of GIC values.

The study therefore concludes that there is no such evidence to believe that Ind AS is more conservative than previous IGAAP in reporting of net profit and equity. In fact, it is less conservative than IGAAP in reporting of equity.

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