



Impact of IFRS Convergence in India: An Evidence of Adoption of Indian Accounting Standards on Selective NBFCs

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ABSTRACT

The emerging global market pushed all the economies in the world to switch to International and uniform standards of accounting i.e., IFRS. The present study focuses on adopting the International Financial Reporting Standards (IFRSs) in India on the top 10 non-banking financial companies based on their turnover. The study seeks to determine whether IFRS adoption leads to higher quality financial reporting. The paper attempts to measure the scope and size of the differences in a selected set of financial ratios calculated with data reported according to the traditional Accounting Standards (AS) and under Ind AS/ IFRS provisions. The research study came to a conclusion that in most cases, the computed ratios as per old AS are higher than IFRS inferring that IFRS is more conservative and prudent. However, while doing the hypothesis testing, it is pertinent to say that the differences in the ratios calculated as per old AS and the new standards are not significant.

Keywords: IFRS convergence, IND AS, financial reporting, accounting quality, ratios

INTRODUCTION

International Financial Reporting Standards (IFRS) are supreme and globally used accounting standards that bring more transparency to the accounting world. These standards enable the stakeholders to compare the financial results of any enterprise at par with other international companies working globally, and certainly, a more informed person can reach an improved decision in economic affairs. These IFRS also strengthen the accountability of the financial reporting by plummeting the reporting differences followed by different countries. Earlier, every country had its own accounting standards that were prepared according to its native needs and economic environment. However, with the world being a global market, the necessity arose for common and uniform standards of accounting and the breach was occupied by IFRS. The result is that several countries have either already adopted IFRS or are in the transition phase for the adoption of IFRS.

In India also, the adoption of IFRS is still in a transition phase. The process was initiated in a phased manner starting in 2015. Before 2015, financial reporting in India followed the Accounting Standards (AS), published by the Accounting Standard Board (ASB) in consultation with the Institute of Chartered Accountants of India (ICAI). In 2015, MCA notified the "Indian Accounting Standards" (Ind AS), under section 133 of the Companies Act 2013. Ind AS has been formulated keeping in view the Indian economic & legal environment and the simultaneous objective to converge with IFRS Standards. The copyright of IND AS is held by the IFRS Foundation itself. These are the standards issued under the supervision of the Accounting Standard Board (ASB) only. Indian Accounting Standards are almost similar to IFRS but with a few carve-outs and variations.

In India, the implementation of IND AS was done in a phased manner so as to provide ease to the industry. MCA notified the roadmap for adoption of IND AS by entities in a phased manner starting from 01.04.2015 to 01.04.2017 (**Table 1**).

Table 1: Timeline for India's transition towards IFRS Adoption

Phase I 1st April 2015 and onwards	Voluntary adoption by companies
Phase II 1st April 2016	Mandatory for the following type of companies (along with the comparatives of the previous year) -Listed as well as Unlisted companies whose net worth is more than Rs.500 Cr. and the Parent, Subsidiary, Associate, and Joint Venture of above-mentioned companies
Phase III 1st April 2017	Companies that are listed/or in process of listing and Unlisted companies having a net worth of or more than 250 Cr
Phase IV 1st April 2018	Mandatory applicability to all Banks, NBFCs, and Insurance companies whose Net worth is more than or equal to INR 500 crore
Phase V 1st April 2019	All NBFCs whose Net worth is more than or equal to INR 250 crore but less than INR 500 crore.

The present paper focuses on the impact of IFRS adoption on Non-Banking Financial Companies (NBFCs) and aims to analyse whether the new set of accounting standards are more conservative and prudent and shows a true and fair view of the financial statements.

The said objective is sought to be achieved through various ratios i.e, Solvency ratios, Profitability ratios, and Earning Ratios. Gray Index of conservatism is also applied to evaluate the impact of this adoption and the hypothesis is tested for significance of the results with the aid of T-test. This study focuses on the first year of mandatory adoption of IND AS to explore the differences in accounting figures and values on the financial statements of the previous year. Same-year data has been taken for analysing the impact of this adoption.

LITERATURE REVIEW

Numerous research has been conducted to study the impact of IFRS in Indian and International contexts. In the Indian context, most of the study that has been done is limited to analysing the impact of IND AS/IFRS on Indian corporate. Not a single study has been done in the context of NBFCs.

Various ratios and accounting figures have been used to analyse the impact of IND AS on the financial statements as in the study done by Nageshwar Rao, D. D. Bedia, Kshema Shrivastava (2020) which revealed a significant quantitative impact of IFRS on selected ratios and figures. Teena Thomas and Tomy Mathew (2019) also analyzed the financial statement under two sets of accounting standards and concluded a significant difference in leverage ratios as per both sets of standards. Also, a study done by K.V. Achalapathi and. P. Bhanu Sireesha (2015) showed a statistically significant increase in liquidity, profitability, and valuation after IFRS adoption, whereas few studies show no significant impact on financial ratios after the implementation of IFRS as in the study by Nisha Kalra and Shilpa Vardia (2016).

Some of the authors have made their contribution in analysing the impact of IFRS and IND AS through some other determinants, like Kamath R and Desai R (2014) examined the impact of IFRS adoption on the financial activities of a sample of eight Indian companies and concluded that there was an improvement in investment activities and operating activities due to IFRS adoption. However, no improvement or increase was observed in financial risks or debt covenants. A similar study has been done by Suchita Shukla (2015) wherein the author examined the impact of IFRS on a sample of 10 listed companies and found no significant improvement in financial risk, investment activities, operating activities, and debt covenants.

In the international context too, many studies are in place that has examined the impact of IFRS on financial statements like a turkey-based study done by Serkan Terzi, Recep Oktem & Ilker Kiymetli Sen (2013) concluded statistical difference in various ratios and financial statements prepared in accordance with local GAAP and IFRS. Also, an Israel study done by A. Markelevich, L. Shaw, and H. Weihs, (2010) also supported the same. Michela Cordazzo (2014) in her study based in Germany and Italy showed changes in the magnitude of key financial ratios after the adoption of IFRS.

OBJECTIVES AND SCOPE

In this research paper, data for the top 10 NBFCs have been collected. The criteria for choosing these NBFCs is the turnover for the financial year 2017-18. Data has been collected from the annual reports of these NBFCs. Same year data has been collected and analysed. NBFCs were required to adopt IND AS from 01st April 2018, so the first financial statements that were prepared using IND AS were for the financial year 2018-19, and the previous year's data was restated to bring the old data to uniformity, so, we have the financial statement for 2017-18 as per the old AS and the restated ones for the same year in the annual reports of 2018-19.

Most of the studies that have been done in the Indian context are based on the impact of IFRS on Indian companies. No study has been conducted in the context of non-banking financial corporations. The focus of this paper is to analyse the impact of IFRS on NBFCs via various ratios. The Gray index of conservation is used to analyse which set of accounting practices is more prudent than the other. This Index was given by Gray to assess whether one accounting practice is more prudent than the other. The formula for this index is:-

$$1 - [(New\ GAAP\ values - Previous\ GAAP\ values) / New\ GAAP\ values]$$

DATA INTERPRETATION AND ANALYSIS

This paper analyses the solvency ratios, profitability ratios, and earnings ratios based on the same-year data available for the year 2017-18, prepared following Indian GAAP and IFRS. Both the sets of a financial statement have been analysed, and the Gray index of conservation is calculated on various ratios to analyse whether one set of accounting standards is more prudent than the other. Also, P-value is calculated to conduct the hypothesis testing. The null hypothesis for all the ratios is:

Ho1 – IFRS adoption does not significantly affect the solvency ratios on NBFCs

Ho2 – IFRS adoption does not significantly affect the Profitability ratios on NBFCs

Ho3 – IFRS adoption does not significantly affect the Earnings ratios on NBFCs

While analyzing the results for solvency ratios (Table 2), we find that in the case of the Debt equity ratio, IRFC, Mahindra finance, and Muthoot finance ltd shows an index of more than 1 while other companies show an index of less than 1. In the case of the Debt ratio, STFC, IRFC, Mahindra Finance, and Muthoot finance shows an index of more than 1 while there is a near index of 1 for other companies. In the case of equity ratio, IRFC, Mahindra Finance, and Muthoot finance show an index greater than 1 while other companies have an index of less than 1. However, in the case of capitalization ratio, the ratio is below 1 for all the companies.

Now, moving to the profitability ratios (Table 2), in the case of Gross Profit ratio, PFC, REC, Bajaj Finserve Ltd, HDB Financial services ltd, Cholamandalam Investment, and finance company ltd and L & T Finance ltd shows an index of more than 1 and the index for other companies is below 1. For the Net profit Ratio, the Index is more than 1 for PFC, REC, HDB Financial services ltd, Cholamandalam Investment, and finance company ltd, and L & T Finance Ltd and the index is less than 1 for other companies. In the case of Return on equity, the Index is more than 1 for IRFC, HDB Financial Services Limited, Cholamandalam Investment, and finance company ltd and L & T Finance Ltd and others show an index of less than 1. In the case of Return on Assets, the Index is more than 1 for PFC, REC, HDB Financial Services Limited, Cholamandalam Investment and finance company ltd and L & T Finance Ltd and others show an index of less than 1.

On Analysing the Earnings Ratios (Table 2), in the case of Earnings per share ratio, REC, Bajaj fin serve Ltd, HDB Financial Services Limited, Cholamandalam Investment, and finance company ltd and L & T Finance ltd shows an index of more than 1 and other company shows an index of less than 1. In the case of Price Earnings Ratio, PFC, STFC, IRFC, Mahindra Finance, and Muthoot finance Ltd show an index of more than 1 while others show an index of less than 1.

While analysing Company-wise data (Table 3), in the case of Power finance corporation, there is an index of less than 1 for all the solvency ratios. Only the Debt ratio is near 1, the rest of the ratios are around 0.75. The index of the profitability ratios is more than 1 except for the Return on equity ratio which is 0.95. The Earning ratio for the company has an index of less than 1 and the price-earnings ratio is more than 1.

In the case of Rural Electrification Corporation Ltd., there is an index of less than 1 for all the solvency ratios. The index of the profitability ratios is more than 1 except for the Return on equity ratio which is 0.95. The Earning ratio for the company has an index of more than 1 and the price-earnings ratio is less than 1.

In the case of Bajaj Finserve Ltd, there is an index of less than 1 for all the solvency ratios, and also the index for the capitalization ratio is very low at 0.56. The index of the profitability ratios is less than 1 except for the Gross Profit Ratio which is more than 1. The Earning ratio for the company has an index of more than 1 and the price-earnings ratio is less than 1.

In the case of Shriram Transport Finance Company Ltd, there is an index of less than 1 for all the solvency ratios except Debt Ratio which is equivalent to 1. The index of the profitability ratios is less than 1 for all the ratios. The Earning ratio for the company has an index of less than 1 and the price-earnings ratio is more than 1.

In the case of Indian Railway Finance Corporation Ltd, there is an index of more than 1 for all the solvency ratios except capitalization ratio. The index of the profitability ratios is less than 1, except for the Return on Equity Ratio which is equivalent to 1. The Earning ratio for the company has an index of less than 1, and the price-earnings ratio is more than 1.

In the case of Mahindra & Mahindra Financial Services Ltd, there is an index of more than 1 for all the solvency ratios except the capitalization ratio which is very low at 0.58. The index of the profitability ratios is less than 1 for all the ratios. The Earning ratio for the company has an index of less than 1 and the price-earnings ratio is more than 1.

In the case of HDB Financial Services Ltd, there is an index of less than 1 for all the solvency ratios, and the index for the capitalization ratio is very low at 0.59. The index of the profitability ratios is more than or equal to 1. The Earning ratio for the company has an index of more than 1 and the price-earnings ratio is less than 1.

In the case of Muthoot Finance Ltd, there is an index of more than 1 for all the solvency ratios except the capitalization ratio which is very low at 0.24. The index of the profitability ratios is less than 1 for all the ratios. The Earning ratio for the company has an index of less than 1 and the price-earnings ratio is more than 1.

In the case of Chola mandalam Investment and finance co. Ltd, there is an index of less than 1 for all the solvency ratios. The index of the profitability ratios is more than or equal to 1. The Earning ratio for the company has an index of more than 1 and the price-earnings ratio is less than 1.

In the case of L & T Finance Ltd, there is an index of less than 1 for all the solvency ratios, and the index for the capitalization ratio is very low at 0.59. The index of the profitability ratios is more than 1. The Earning ratio for the company has an index of more than 1 and the price-earnings ratio is less than 1.

Table 2: Ratios for Selective NBFCs in India

RATIOS	Power Finance Corporati on Limited	Rural Electrifi cation Corpor ation Limited	Bajaj finserv e Ltd	Shriram Transp ort Finance Compa ny	Indian Railway Finance Corporati on Limited	Mahindra & Mahindra Financial Services Limited	HDB Financial Services Limited	Muthoot finance Ltd	Chola mand alam Investment and Finance Company Limited	L&T Finance Limited
A. solvency Ratios										
1. Debt Equity Ratio	0.73	0.92	0.94	0.99	1.04	1.09	0.95	1.02	0.87	0.97
2. Debt Ratio	0.96	0.99	0.99	1.00	1.00	1.01	0.99	1.00	0.98	0.99
3. Equity Ratio	0.76	0.93	0.96	0.99	1.03	1.08	0.96	1.02	0.89	0.98
4. Capitalization Ratio	0.78	0.78	0.56	0.63	0.87	0.58	0.59	0.24	0.61	0.59
B. Profitability Ratios										
1. Gross Profit Ratio	1.27	1.15	1.11	0.65	0.83	0.79	1.01	0.99	1.07	2.73
2. Net Profit Ratio	1.23	1.03	0.70	0.67	0.82	0.71	1.02	0.98	1.07	2.47
3. Return on Equity	0.95	0.96	0.64	0.66	1.00	0.76	1.00	0.96	1.05	2.47
4. Return on Assets	1.25	1.03	0.67	0.67	0.97	0.71	1.04	0.95	1.18	2.53
C. Earnings Ratios										
1. Earnings Per Share	0.87	1.05	1.03	0.61	0.98	0.86	1.02	0.98	1.06	2.47
2. Price Earnings Ratio	1.14	0.95	0.97	1.64	1.02	1.16	0.98	1.02	0.94	0.41

Table 3: Company-wise Analysis

	mean 2017-18	mean 2018-19	Standard deviation 2017-18	Standard deviation 2018-19	p value
A. solvency Ratios					
1. Debt Equity Ratio	5.87	6.24	2.11	2.23	0.18
2. Debt Ratio	0.84	0.85	0.04	0.05	0.34
3. Equity Ratio	6.87	7.24	2.11	2.23	0.18
4. Capitalization Ratio	0.53	0.84	0.16	0.04	< 0.0001
		-			
B. Profitability Ratios		-			
1. Gross Profit Ratio	24.02	24.06	9.29	9.97	0.98
2. Net Profit Ratio	15.56	16.54	6.42	6.21	0.40
3. Return on Equity	13.25	14.59	5.40	5.67	0.13
4. Return on Assets	2.05	2.19	1.22	1.35	0.42
C. Earnings Ratios	-				
1. Earnings Per Share	42.86	46.73	51.01	53.49	0.41
2. Price Earnings Ratio	0.66	0.79	0.96	1.11	0.40

Source: calculated from the data compiled by the scholar

On testing the hypothesis, it is observed that the p-value for solvency ratios is more than 0.05 except for the capitalization ratio. For all the ratios except the Capitalization ratio (Table 3), the P-value is more than .05, so the null hypothesis is accepted that IFRS adoption does not significantly affect these ratios in totality. However, for the capitalization ratio, we can say that the IFRS adoption has significantly affected the capitalization ratio.

In the case of profitability ratios, the calculated P-value is more than 0.05, thereby, inferring that the null hypothesis is accepted. Here, the adoption of IFRS has not significantly affected the profitability Ratios. In the case of earnings ratios, the calculated P-value is more than .05, resulting in the acceptance of the null hypothesis. Here, the adoption of IFRS has not significantly affected the earnings Ratios.

Conclusions

The impact of IFRS adoption has been widely discussed and the early-adopting countries have witnessed its advantage in financial reporting. The paper empirically tested the impact of IFRS adoption on the financial activities of a sample of ten Indian Non-banking Financial corporations. This study provides a comparison between old AS and IND AS that whether one set of Accounting Standards is more prudent and conservative than the other using the Gray Comparability Index for 10 NBFCs. The analyses reveal that, in the case of profitability and Earnings Ratios, the index is more than 1 or near to 1 for most of the companies. However, in the case of solvency ratios, the index is less than 1 for most companies. In general, the computed ratios as per old AS are higher than IFRS in the case of Profitability and Earnings ratios inferring that IFRS is more conservative and prudent. Also, it implies that the adoption of IFRS has resulted in a more true and fair view of the financial results.

For the solvency ratio, the computed ratios as per old AS is less than IFRS inferring that old AS is more conservative and prudent in Solvency ratio reporting. The hypothesis testing indicates that the impact of IFRS is similar to old AS because P-value for all the ratios is more than 0.05 except for the capitalization ratio inferring that there is no significant impact on ratios after IFRS adoption on all ratios except the capitalization ratio.

Overall if we analyse the results, we can say that these IFRS are more prudent and conservative than the old As. However, while doing the hypothesis testing, it is pertinent to say that the differences in the ratios calculated as per old AS and the new standards are not significant.

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