Impact Of Local Accounting Standard On IFRS For Defining Firm's Capital Structure: An Analysis Based On Indian Companies

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Abstract

In this study, the main purpose is to examine the impact of Indian Accounting Standard on International Financial Reporting Standards (IFRS) for defining capital structure components, which has been expressed as ratios. The study employed an innovative design known as "same firm-year" research design (2010-11) and effort is being made to understand its impact. Regression analyses were used to test the statistical significance of this impact and ANOVA were used to test the hypothesis.

Main finding from the study is that Indian Accounting Standard has a great impact on IFRS for disclosing the capital structure components. IFRS and Indian Accounting Standards are interrelated for defining the capital structure components. The study found that Indian AS and IFRS are inter-related for disclosing the capital structure components.

Key Words: IFRS, IAS, Regression Analysis, ANOVA, Capital structure, Ratio, Same Firm-Year

I. Introduction

In an open economy, there is a need for common set of business language which is easily understandable for all. On basis of this concept International Accounting Standard Board formulated the international accounting standards. The importance of IFRS centered as they provide greater comparability of financial information for investors and also encourage them to invest across borders. Now it is being recognized as the premier global reporting standards of accounting information world over. Most of the countries in globe have already adopted this international standard. Keeping all things in mind the Core Group of Ministry of Corporate Affairs of India (MCA) has recommended convergence of IFRS in a phased manner from April 1, 2012. Till then, Indian corporate having global aspirations should consider voluntary adoption of IFRS.

Traditionally financial statement of the Indian companies has been disclosed as per Indian Accounting Standards. But when Indian companies prepare their financial statements as per International

Accounting Standard, there might be some conceptual difference which arises in terms of profitability, valuation of assets, and discloser of capital instruments.

When a firm raised its capital structure from different sources, then the mix of these sources is generally called capital structure. Company balance sheet shows the different proportion of debt, preferred and common stock which jointly represents the capital structure of that company.

As per IFRS, financial instrument is measured in terms of fair value; on the other hand traditional Indian accounting standard recognized the book value valuation. In this paper it is tried to find out how much International Financial Reporting Standards are inter-related to Indian Accounting standards for defining capital structure components which are measured in terms of ratio, when Indian companies adopt IFRS first time and disclose financial statement by both the accounting standards.

II. Review of Literature

Ibiamke et.al (2014) disclosed how financial ratios are affected by IFRS adaptation in Nigeria. They found that IFRS adaptation does not differ significantly but through gray Comparability Index, they show that IFRS negatively affects financial ratios. Balios Dimitrios et.al (2013) studied the impact of IFRS on ratio of listed and new listed companies of Athens Exchange. They found that there is no significant effect from the adaptation and implementation of IFRS in Greece. Susana Callao (2007) has done a research on the effects of IFRS adaptation on the comparability and relevancy of financial reporting in Spanish firms. They stated that most of the ratios significantly differ due to application of IFRS. Dr. Edward Lee et.al (2008) conducted a study on the impact of IFRS on Cost of Equity Capital. Lantto and Sahlstrom (2009) studied the impact of International Financial Reporting Standards adoption on key financial ratios and revealed increase in profitability ratios and decrease in price to earnings ratio; decrease in liquidity ratio; increase in gearing ratio and decrease in equity ratios. The results of study indicated that the adoption of IFRS changes the magnitudes of key accounting ratios of Finnish companies by considerably increasing the profitability ratios and gearing ratio moderately, and considerably decreasing the PE ratio, equity and quick ratios slightly. Ishaya Luka Chechet and Abdul Jeet Lee Badmus Olayiwola (2014) conducted a study in Nigeria on the relationship between capital structure and profitability. They conclude that debt ratio was negatively correlated with profitability ratio. Dr Anirban Ghatak (2012) shows how IFRS impacts valuation of merger and acquisition on Indian banks. He found that purchase method

under IFRS- 3 maintains uniformity and value of goodwill does not show same results under IFRS. B. Kapoor and Jyoti Rahul (2013) demonstrate some issues and challenges faced by India for implementing IFRS. They have also suggested some prospective areas if Indian companies adopt IFRS.

III. Objectives of Study

Review of literature disclosed that where a country changed its accounting language from local standard to IFRS, the relationship between financial figures also changes. So, on the basis of this concept, the objectives of study are:

1. To find out the relationship between IFRS and Indian AS for defining Equity to Assets Ratio.
2. To find out the relationship between IFRS and Indian AS for defining Current Liability To Equity Ratio.
3. To find out the relationship between IFRS and Indian AS for defining Debt To Equity Ratio
4. To find out the relationship of IFRS and Indian AS for defining Debt To Assets Ratio

IV. Methodology

This section, demonstrates the research sample together with the method of data collection, measurement of variable and the method of statistical analysis.

Sources of Data and Sample Size

For defining the relationship between IFRS and Indian AS for defining capital structure, I have included six Indian companies (1. Wipro Ltd. 2. Infosys Ltd. 3. Rolta India Ltd. 4. Noida Toll Bridge Ltd 5.Great Eastern Electronics Ltd. 6. Dabur India Ltd.) who have adopted IFRS voluntarily till 2014. Capital structure ratios based on figures obtained from financial statements are constituted according to the two set of accounting standards, Indian AS and IFRS for the same year (2010-11). ICAI and Ministry of Corporate Affairs jointly announced the initial year for adopting IFRS, which is 2010-11. For that reason I have selected this specific financial year. Science adaptation of IFRS has still not been made mandatory.

Variable and Hypothesis

In this study, the selected variables were collected from the Company's Balance Sheet and Income Statement. Selected variables help to calculate the ratios related to company's capital structure. Following hypothesis has been formulated to determine whether there is any difference between IFRS and Indian AS for preparing financial statement.

H_{01}: IFRS and Indian AS are two independent set of accounting standards for defining Equity to Assets ratio calculated on Indian AS based and IFRS based financial statement.

H_{02}: : IFRS and Indian AS are two independent set of accounting standard for defining Current Liability to Equity Ratio calculated on Indian AS based and IFRS based financial statement.

H_{03}: IFRS and Indian AS are two independent set of accounting standards for defining Debt to Equity Ratio calculated on Indian AS based and IFRS based financial statement.

H_{04}: IFRS and Indian AS are two independent set of accounting standard for defining Debt to Assets Ratio calculated on Indian AS based and IFRS based financial statement.

V. Design of Statistical Analysis

In this study firm's capital structure was defined in terms of ratio. Major capital structure ratios are:

Equity to Assets Ratio	EAR
Current Liability To Equity Ratio	CLER
Debt To Equity Ratio	DER
Debt To Assets Ratio	DAR

Multiple regression equations have been formulated to prove the objectives and two way ANOVA is considered to test the hypothesis.

Following equations are being formulated to measure the relationship between IFRS and Indian AS for disclosing firm's capital structure which is measured in terms of ratio. Where IFRS based capital structure ratios are dependent variable and India AS based capital structure ratios are independent variables.

$$IFRS\ (EAR) = \alpha + \beta_1\ IAS\ (EAR) + e \quad (1)$$

$$IFRS\ (CLER) = \alpha + \beta_1\ IAS\ (CLER) + e \quad (2)$$

$$IFRS\ (DER) = \alpha + \beta_1\ IAS\ (DER) + e \quad (3)$$

$$IFRS\ (DAR) = \alpha + \beta_1\ IAS\ (DAR) + e \quad (4)$$

VI. Analysis and Findings

A. Equity to Assets Ratio

Regression Statistics	Value
R Square	0.718435687
Adjusted R Square	0.648044609
Standard Error	0.084982447
Observations	6

Above regression results, show that R Square value is 0.718 and the Adjusted R Square is 0.648 which is more than 60%. So we can conclude that more than 60% of IFRS based Equity to Assets ratio's portion can be defined by the AS based Equity to Assets ratio.

H_{01}: IFRS and Indian AS are two independent set of accounting standard for defining Equity

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to Assets ratio calculated on Indian AS based and IFRS based financial statement.

On the other hand we can see that calculated F value (6.206) is higher than the significant F value (0.0330). It indicates that we can reject the null hypothesis and conclude that IFRS and Indian AS are not two independent set of accounting standard for defining Equity to Assets ratio. There is some inter-relationship between these two.

B. Current Liability To Equity Ratio

Regression Statistics	Value
R Square	0.844141414
Adjusted R Square	0.685176768
Standard Error	0.11909724
Observations	6

Above regression results, show that R square value is 0.844 and the adjusted R square is 0.685 which is more than 60%. So we can conclude that more than 60% of IFRS based Current Liability to Equity ratio portion can defined by the Indian AS based Current Liability To Equity ratio.

ANOVA					
	df	SS	MS	F	5% Level of Significance F
Regression	1	0.102699	0.102699	7.24042	0.054612549
Residu	4	0.056	0.014		

al		737	184		
Total	5	0.159436			

ANOVA					
	df	SS	MS	F	5% Level of Significance F
Regression	1	0.07371	0.073710395	6.20634582	0.033066364
Residual	4	0.028888	0.007222016		
Total	5	0.102598			

H_{02}: IFRS and Indian AS are two independent set of accounting standard for defining Current Liability to Equity Ratio calculated on Indian AS based and IFRS based financial statement.

On the other hand we can see that calculated F value (7.246) is higher than the significant F value (0.0546). It indicates that we can reject the null hypothesis and conclude that IFRS and Indian AS are not two independent set of accounting standards for defining Current Liability to Equity ratio. There is some inter relationship between these two.

C. Debt To Equity Ratio

Regression Statistics	Value
R Square	0.959709287
Adjusted R Square	0.949636609

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Standard Error	0.116496696
Observations	6

Above regression results, show that R Square value is 0.959 and the adjusted R square is 0.949 which is more than 60%. So we can conclude that there is a huge influence of Indian AS on IFRS for defining debt to equity ratio.

ANOVA					
	df	SS	MS	F	Significance F
Regression	1	1.293069761	1.29307	9.27846	0.000617119
Residual	4	0.054285921	0.013571		
Total	5	1.347355682			

H_{03}: IFRS and Indian AS are two independent set of accounting standards for defining Debt to Equity Ratio calculated on Indian AS based and IFRS based financial statement.

Above ANOVA table shows that calculated F value (9.278) is more than tabulated F value (0.0006). It indicates that we reject the null hypothesis and conclude that IFRS and Indian AS are not two independent set of accounting standards for defining Debt to Equity ratio. There is some inter relationship between these two.

D. Debt To Assets Ratio

Regression Statistics	Value
R Square	0.845838059
Adjusted R Square	0.807297574
Standard Error	0.09027823
Observations	6

Above regression analysis for IFRS based and Indian AS based Debt to Assets ratio show that R Square value is 0.845 and the Adjusted R Square is 0.807 which is more than 60%. So we can conclude that there is a significant influence of Indian AS on IFRS for defining debt to equity ratio.

ANOVA					
	df	SS	MS	F	Significance F
Regression	1	0.178869	0.178869	15.94674131	0.009414505
Residual	4	0.032601	0.00815		
Total	5	0.21147			

H_{04}: IFRS and Indian AS are two independent set of accounting standard for defining Debt to Assets Ratio calculated on Indian AS based and IFRS based financial statement.

Above ANOVA table shows that calculated F value (15.94) is more than tabulated F value (0.0009). It indicates that we can reject the null

hypothesis and conclude that IFRS and Indian AS are not two independent set of accounting standards for defining Debt to Assets ratio. There is some inter relationship between these two.

VII. Conclusion

Study examines the impact of Indian AS on IFRS for defining the components of capital structure. Using the regression equations to analyze the effect along with ANOVA for testing the statistical significance, the study found that Indian AS has significant impact on IFRS for defining the capital structure ratio in India at 5% confidence level. These findings led us to the conclusion that IFRS is not a separate and independent set of accounting standard as compared to Indian accounting standard, or simply they are inter-related.

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