Impact of Adoption of Indian Accounting Standards on Financial Statements of Indian IT Companies

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Abstract: Globalization has opened up the new markets as well as availability and sourcing of funds across the borders. Nowadays various foreign ventures are actively doing business in Indian and Indian entities are working in other countries as well. Hence entities need to be in pace with the accounting and business practices followed in other countries. Every country has a different set of accounting practices and standards. It needs a harmonized and single set of standards which should be followed by everybody so that the financial data can be compared and analyzed for different entities in different countries. IFRS has emerged as a single set of high-quality written standards for financial reporting. IFRS is being adopted rapidly around the world to improve accounting quality and enhance the comparability of financial statements through a uniform set of standards for financial reporting. To get the global Approach in India, ICAI converged and harmonized the Indian GAAP with IFRS and introduced the new standards called Indian Accounting standards (Indian AS). Due to the introduction of new standards, there was variation in the reporting of financial statements. In the present study, the researcher has compared the quantitative changes in the financial statements of selected IT companies because of adoption if Indian AS. The present study has considered the key financial aspects i.e. net worth, comprehensive income and net profits for comparison under Indian GAAP and Indian AS. Results of the study in hands revealed that net worth and comprehensive income is increased however net profit is decreased after the adoption of Indian AS of sampled companies.

Keywords: Indian AS, Indian GAAP, Financial Statements, IFRS

Introduction

Accounting standards are the norms which are used for financial reporting. These are the tools which help in proper presentation and reporting of financial statements. In India, generally accepted accounting standards (Indian GAAP) are used to present the financial statements. However, to become globally competitive it is very important to adopt and follow the international standards for financial reporting. Hence to be in pace with the International Financial Reporting Standards, Indian Accounting Standards formulated by ICAI were notified by the Ministry of Corporate Affairs (MCA) under Companies rule 2015. MCA introduced the applicability of Indian Accounting Standards in a phased manner.

Phase I

In the first phase, Indian AS became mandatory from 01/04/2016 for the companies whose net worth is greater than or equal to Rs. 500 crore. It is applicable for both listed and unlisted companies.

Phase II

In the second phase, Indian AS became mandatory from 01/04/2017 for the companies which are listed or in the process of being listed whose net worth is greater than or equal to Rs. 250 crore but less than Rs. 500 crore.

Phase III

In the third phase, Indian Accounting Standards held mandatory from 01/04/2018 for all Banks, NBFC, and Insurance companies whose net worth is more than or equal to Rs 500 crore.

Note: - *Applicability of Indian AS on banks has been deferred for 1 year and on insurance companies, it has been deferred for 2 years.*

Phase IV

In the fourth phase, all NBFCs having a net worth more than or equal to INR 250 crore but less than INR 500 crore are covered. Indian AS is mandatorily applicable to them with effect from 1st April 2019.

Note: - For calculation of net worth the previous three Financial Years (2013-14, 2014-15, and 2015-16) are checked.

Indian Accounting Standards provide a different and improved set of rules and practices as compared to existing Indian GAAP. The new accounting standards recognize substance over form hence it gives importance to accurate reporting over just complying with legal provisions. They mandate fair value to compute financial statements. There are variations in presentation and computation of data in different financial aspects. Below mentioned are the different areas where variation can be observed under Indian AS:-

- Presentation of financial statements
- Intangible assets
- Impairment of Assets
- Employee Benefits
- Segment reporting
- Revenue recognition
- Provisions and contingencies

- Business Combinations
- Financial instruments
- Property plant and equipment
- Taxes
- Depreciation
- Share-based payments

Presentation of Financial Statements

Indian GAAP 1 specifies to disclose the extraordinary items separately in the statement of profit and loss. It does not specifically require disclosure of judgments by management with regard to significant accounting policies or other notes. It does not require the reporting of the statement of changes in equity in the financial reports. Retained earnings, other reserves and movement in share capital are presented in the notes to accounts.

Indian AS-1 prohibits the presentation of any item of income or expense as extraordinary under the financial statements. It requires disclosure of critical judgments made by management while adopting the significant accounting policies. It requires the presentation of the statement of changes in equity with the retrospective effects of the application on each component of equity including the total comprehensive income for that period. Equity reconciliation is required to be prepared between the opening and closing balances for each component while separately disclosing each change.

Intangible Assets

Under Indian GAAP 26, Intangible assets are measured at cost. The useful life of the asset cannot be indefinite. Generally, the useful life of an intangible asset is presumed to be up to ten years. The useful life is counted from the date when the asset is available for use. Goodwill is amortized over a period up to five years in case of amalgamation in the nature of purchase. Under Indian AS 38, valuation of intangible assets can be done either at cost or revalued amounts. Useful life may be taken as definite or indefinite. Goodwill is not amortized but tested for impairment at least once in a year or before that if there is an impairment indication.

Impairment of Assets

Under Indian GAAP 28, goodwill and other intangible assets are subject to impairment and tested for the same if the indication of impairment is seen. Indian GAAP 26 clears out the treatment of those intangible assets which are not available for use or amortized over a period for more than ten years. Such intangible assets should be compulsorily assessed for impairment at least once in a year specifically at the end of the financial year. Here it is clear that indication of impairment is not required. In the case of goodwill impairment loss is reversed if it is under specific conditions. Such impairment loss should be due to some specific external event which is exceptional in nature and the effect of the same may be reversed by the occurrence of the subsequent external event. Under Indian AS 36 intangible assets which are not available for use including goodwill are needed to be tested at least once in a year. Similarly, for those intangible assets which have an indefinite life, impairment should be tested at least once in a year. However, the impairment can be done more than once in a year if the indication of impairment is seen. The impairment loss recognized for goodwill cannot be reversed in any subsequent year.

Employee Benefits

Under Indian GAAP 15, actuarial gains and losses are required to be recognized immediately and accounted in the statement of profit and loss. Termination benefits are treated as a liability. However, it may be treated as an expense if there was a past event due to which present obligation arise and to settle such obligation there is a possibility of an outflow of resources of economic value. Past service cost is treated as expense until the benefits become vested on a straight-line basis. In case the benefits are already vested, it is immediately treated as an expense. Curtailment is recognized as it occurs. However, it is accounted at the time of restructuring if it is linked with a restructuring. Under Indian AS 19, actuarial gain and loss of defined benefit obligation are treated under other comprehensive income if it arises due to the calculation of present value of the obligation or variation in the actuarial assumption. To recognize the termination benefit liability, the entity must ensure that it can no longer revoke the offer of such benefits or occurrence of the event of restructuring whichever is earlier. However, restructuring cost should include the payment of termination benefits. Past service cost (including curtailment) is treated as an expense on the event of occurrence of curtailment or amendment in the plan or restructuring whichever is earlier.

Segment Reporting

Under Indian GAAP 17, there are two types of segments one is the primary segment and other is secondary segment based either on the products or services or on geographical Areas. Classification is a little ambiguous hence some companies claim that they have only one segment and if a new segment is to be introduced respective data for the comparison is required.

Under Indian AS 108, Segments are identified and reported on the basis of management and internal reports of the operating areas. If there is a change in the reporting of segments due to change in the organizational structure of a company, past data regarding information for previous periods is restated.

Revenue Recognition

As per Indian GAAP 9, consideration for the contract is recognized as revenue. Cash discounts, rebates or schemes are reported as expenditures. Interest is recognized on a time proportion basis. Revenue is recognized for completed services on proportionate completion method. Revenue is reported on the net of excise duty. Under Indian AS 18 revenue is recognized on the fair value of measurement. Cash discounts, rebates or Schemes are reduced from revenue. Interest is recognized on the basis of effective interest method. Revenue would be recognized in that period in which services would be rendered on the percentage completion method. Excise duty collected is included in the revenue.

Provisions and Contingencies

As per Indian GAAP 29, Provisions are recognized on the basis of legal obligations. However, the amounts of provisions are not discounted. Under Indian AS 37, Provisions are recognized on the basis of constructive obligations and are discounted on the present value. Increase in liability is treated as borrowing cost.

Business Combinations

Indian AS 103 applies to almost all the business combinations such as acquisitions, amalgamations and business under common control. However, it is not applicable to joint venture combinations and mere acquisition of assets that does not amount to a business combination. Transactions between business combinations under common control should be accounted for using the 'pooling of interests' method. Other business combinations are accounted for using the purchase method. Goodwill shall not be amortized. It shall be tested for impairment at least once in a year or more times if there are clear indications of impairment. Under Indian GAAP, there is no comprehensive standard dealing with all business combinations. Indian GAAP-14 applies only to amalgamation. Indian GAAP 21, 23 and 27 apply to accounting for investment in subsidiaries, associates, joint ventures, respectively in consolidated financial statements. In case of amalgamation in the nature of purchase, all the assets and liabilities of the acquired company are accounted at book value or fair values. Here, goodwill is amortized over a period up to ten years. In the case of amalgamations in the nature of merger, assets, reserves and liabilities of transferor Company are recorded at carrying amounts. Here, the pooling of interest method is used.

Financial Instruments

Indian GAAP does not provide for the fair valuation of financial assets and liabilities. Generally, 'Incurred Credit Loss Model' is used for ascertaining the provisions on assets. Indian AS requires the reporting of financial assets and liabilities on their fair value. Due to which the net profits and the net worth of the companies will be positively impacted. For compound instruments, split accounting is applicable which may have a positive or negative impact on net worth. 'Expected Credit Loss Model' is applicable to financial assets which may cause a negative impact on net worth or profit.

Property Plant and Equipments

Under Indian GAAP, major spares and stand-by equipment are recorded as inventory. Major overhaul expenses are treated as repair and maintenance expenses. Under Indian AS 16 major spares and overhaul expenses are recognized as property, plant and equipment. Hence it may result in a positive impact on net profit and net worth of the companies.

Taxes

Under Indian GAAP, the income statement approach is used. In case of carrying forward of losses and unabsorbed depreciation, deferred tax assets are recognized if there is a virtual certainty. Deferred tax charge is accounted in the statement of profit and loss. Under Indian AS, Balance sheet approach is used which results in additional deferred tax charge. To record deferred tax assets, reasonable certainty is required. Now, more companies may record deferred tax assets.

Table-1: Summary of Major Changes under Indian GAAP and Indian AS.

Aspects	**Indian GAAP**	**Indian AS**	**Impact**
Revenue	Revenue is calculated net of excise and duties	Revenue is calculated by adding excise duty	Revenue will be higher, Margin will be lower and EPS will be neutral
Employees Stock Option Plan (ESOP)	ESOP cost is booked on intrinsic value base	ESOP cost is booked on fair value base	Employee cost is likely to be increased
Proposed Dividend	Proposed dividend is recognized in the same year	Proposed dividend is recognized in the year when approved by the shareholders	The book value of the company at the end of the year is likely to be increased however for high dividend paying companies Return on equity may be lower.
Assets and liabilities	Assets and liabilities are recognized on book value	Assets and liabilities are recognized on fair value, Goodwill would be tested annually.	High goodwill companies will see volatility in their earnings
Investment	Current investment is measured at cost or market value	Current investment is measured at fair value	Higher volatility in other income, Cash-rich companies will be more impacted
Redeemable preference shares	Redeemable preference shares are treated as part of the equity	Redeemable preference shares are treated as a liability	Higher debt to equity and lower EPS
Major Repairs	Major Repair charges are treated as expenses	Major Repair Charges are allowed to be capitalized	It may lead to lower EPS
Financial instruments	No provision for recording of financial assets and liabilities on fair value	It is compulsory to record financial assets and financial liabilities on fair value	Generally a positive impact on net profit can be seen and net worth as well

Objectives of the Study

The objective of the study is to find out the impact of Indian Accounting Standards on net worth, comprehensive income and net profits of selected IT companies.

Research Methodology

To achieve the objectives of the present study, secondary data for the financial year 2015-16 is used. As per the MCA notification Indian AS were made applicable from 1/04/2015, hence the financial reports prepared as on 31/03/2016 are considered. For that purpose Annual reports for the year 2015-16 have been analyzed of 5 IT companies i.e. Infosys Limited, Wipro Limited, HCL Technologies Limited, Tech Mahindra Limited and TCS Limited. Equity reconciliation and Profit reconciliation has been studied to ascertain the net worth, comprehensive income and net profits. For analysis and interpretation of financial statements of the sampled companies, simple average, Gray's comparability Index and percentage are used.

Comparability Index for Net worth:-

$$1-\frac{Net\ Worth\ (Indian\ AS)-Net\ worth\ (Indian\ GAAP)}{Net\ Worth\ (Indian\ AS)}$$

Comparability Index for Comprehensive Income:-

$$1-\frac{Comprehensive\ Income\ (Indian\ AS)-Comprehensive\ Income\ (Indian\ GAAP)}{Comprehensive\ Income(Indian\ AS)}$$

Comparability Index for Net Profit:-

$$1-\frac{Net\ Profit\ (Indian\ AS)-Net\ Profit\ (Indian\ GAAP)}{Net\ Profit\ (Indian\ AS)}$$

Values calculated under Indian AS are taken as the benchmark. Impact of Indian AS on financial statements is assessed hence values calculated under Indian AS are used in the denominator. Interpretation of the index is as follows:-

- If the value of the index is one, it means it is a neutral index and there is no impact of Indian AS.
- If the value of the index is greater than one it means the values calculated under Indian GAAP are higher than calculated under Indian AS.
- If the value of the Index is less than one. It implies that the values calculated under Indian AS are increased as compared to values calculated under Indian GAAP.

Table-2: Gray's Comparability Index for Net Worth

Net Worth (Rs in Crore)			
Company Name	Indian AS	Indian GAAP	Gray's Index
Infosys	61744	57826	0.936544442
TCS	71427	65863	0.922102286
HCL	27601.43	27605.8	1.000158325
Tech Mahindra	14783.6	14569.7	0.985531264
Wipro	46366	44911	0.968619247

From the above table, it is clearly seen that Gray's Index is less than one except HCL which infers that net worth has been increased due to the adoption of Indian AS for Infosys, TCS, Tech Mahindra and Wipro. However, the net worth of HCL has been decreased due to the adoption of Indian AS. Major factors behind an increase in net worth are, increase in the value of intangible assets due to fair valuation, decrease in the value of provisions, deferred tax assets and impact of business combinations.

Table-3: Gray's Comparability Index for Total Comprehensive Income

Total Comprehensive Income (Rs. in Crore)			
Company Name	Indian AS	Indian GAAP	Gray's Index
Infosys	13780	13759	0.998476052
TCS	24607	24375	0.990571789
HCL	5729.44	5661.45	0.988133221
Tech Mahindra	32634	31593	0.968100754
Wipro	9227.9	9008.9	0.976267623

In the above table, Gray's index for all the companies is less than one which means comprehensive income has been increased for all the companies due to the adoption of Indian AS. The main reason behind the increase in comprehensive income is foreign exchange translation.

Table-4: Gray's comparability Index for Net Profit

Net Profit			
Company Name	Indian AS	Indian GAAP	Gray's Index
Infosys	13489	13678	1.014011417
TCS	24338	24375	1.001520256
HCL	5601.68	5661.45	1.010670013
Tech Mahindra	30266	31593	1.043844578
Wipro	8957.1	9008.9	1.005783122

From the above table, it is apparent that Gray's index is greater than one which concludes that there is a decrease in net profit in all the companies due to the adoption of Indian AS. The major factor behind the decrease in net profit are taxes, impacts of business combinations, employee benefits cost and increased depreciation.

Table 5:- Average Impact on Net Worth, Comprehensive Income and Net Profit

Financial Aspect	Percentage Change	Increase (No. of companies)	Decrease (No. of companies)
Net worth	3.98%	4	1
Total comprehensive income	1.61%	5	0
Net profit	-1.47%	0	5

The above table shows the Average impact of adoption of Indian AS on net worth, comprehensive income and net profit. The average Net worth is increased by 3.98%. Out of 5 sampled companies, one company i.e. HCL has shown a decrease in net worth. Total comprehensive income is increased by an average of 1.61% in all the 5 sampled companies. Net profit is decreased by 1.47% in all the 5 sampled companies.

Conclusion:

Adoption of Indian As has impacted various financial aspects of the balance sheet and statement of profit and loss. Some examples are Employee benefits, property plant and equipments, revenue recognition, share-based payments, taxes, depreciation, valuation of financial instruments etc. In the present study, only three aspects have been analyzed and compared i.e. net worth, comprehensive income and net profits of selected IT companies. The inferences drawn after analyzing the financial statements reveal that the net worth increased by 3.98% and comprehensive income increased by 1.61% taking the average of the 5 IT companies considered in the study. However Net profits have been decreased by average 1.47% as calculated under Indian AS. Reasons behind the increase in net worth are the retrospective impact of business combinations, deferred taxes, provisions, property plant equipments and fair valuation of instruments. Factors behind a decrease in net profit are depreciation, taxes etc. Major factor behind the increase in comprehensive income is foreign exchange translation. As a whole, Indian AS has impacted the financial statements in a positive way and better extent. Presentation and reporting under Indian AS is more appropriate and fair as compared with previous Indian GAAP. Measurement of Assets and liabilities on fair value basis has increased the reliability and accuracy of the financial statements.

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