

DOES IFRS MODE OF ANNUAL REPORTING MEET THE EXPECTATIONS OF THE INVESTOR? A CASE STUDY OF DR. REDDY'S LABORATORIES LIMITED

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ABSTRACT

The process of Globalization has brought the entire world's business under one umbrella enabling a lot of Multinational corporations to expand the businesses in various countries. While the multinational company is established in a non local country, the need of common accounting standard is felt in order to report the financial performance to the stakeholders as well as to mobilize the capital across the globe. Therefore, there is a need to bring commonness in the accounting standards used by different countries worldwide. The International Financial Reporting Standards (IFRS) are a set of accounting standards that are practiced by more than hundred countries around the world. Among the different stakeholders of a company, the role of investors is most vital as they invest their hard earned money in the securities issued by it and are interested in the financial performance to ensure that their investment is safe and properly utilized. It is important to examine the effect of new accounting standard on various accounting values in a financial statement. This paper attempts to analyze the impact of IFRS adoption on property, plant and equipment by Gray Index of Conservatism and to elicit the investor expectations towards the IFRS.

Key Words: IFRS, Transparency, Investor Confidence, Gray Index of Conservatism

INTRODUCTION

The process of Globalization has brought the entire world's business under one umbrella enabling a lot of Multinational corporations to expand the businesses in various countries. While the multinational company is established in a non local country, the need of common accounting standards is felt in order to report the financial performance as well as to mobilize the capital across the globe. Therefore, there is a need to bring commonness in the accounting standards used by different countries worldwide.

In common parlance accounting is referred to as a language through which a business communicates with its stakeholders and the annual reports provide vital information regarding performance of a company in a given period. In the absence of common accounting standards worldwide, it will be difficult for the investors to understand the financials of a company and to take prompt investment decisions.

The International Financial Reporting Standards (IFRS) are a set of accounting standards that aim at bringing uniformity in the accounting standards across the world and more than 100 countries around the world are following the IFRS. Among the different stakeholders of a company, the investors form a

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vital part as they invest their hard earned money in the securities issued by it and have keen interest in the performance of the company before and after the commitment of the funds in the form of capital. Therefore, it is relevant to analyze the impact of IFRS adoption on accounting values and to elicit the investor perceptions regarding the corporate reporting under IFRS.

REVIEW OF LITERATURE

The research articles related to the topic were reviewed and the following research articles were found useful for the paper.

Shobana Swamynathan¹ on harmonization of accounting practices with IFRS has found that the process of harmonization has brought many benefits to the corporate reporting. It was concluded that the process has improved the accounting quality, measured in terms of cash flow persistence and cash flow predictability.

Archana Bhatia² commented that the confidence of international investor will enhance and the stock prices of Indian companies will be valued correctly. The inflow of funds from FIIs and other international investor will accelerate and will help in growing Indian economy further. At the same time, the accounting professionals will get more global opportunities.

Dimple Singhal³ on opportunities to investors reported that Indian reporting practices will be significantly affected by the convergence process. This harmonization process would bring a lot of benefits to Indian companies and investors. Further, it was concluded that comparison of financial statements has become easy and is providing better information for decision making.

Katta Ashok Kumar⁴ on financial ratios of Wipro limited concluded that there is a considerable increase in liquidity ratios, equity ratios and interest coverage ratio. The major reason could be due to principle based IFRS standard which suggests fair value accounting. The overall results of the study indicated that adoption of fair value accounting and strict requirement in adhering to accounting standards have strengthened the financial figures and provided decision makers a transparent, true and fair accounting picture.

Heejeong Shin et al⁵ on IFRS adoption and investors perceptions in Korea found that accruals quality has improved since IFRS adoption and investors give more weight to information risk in pricing firms with low accruals quality after adoption of IFRS. Moreover, the findings of the study provide evidence that market-based earnings management from financial statements worsens after IFRS adoption.

Keerthana and Ambily⁶ on opportunities and challenges of IFRS adoption tried to assess the benefits of IFRS adoption and have analyzed the perception of various stakeholders and concluded that convergence to IFRS is unavoidable for Indian economy since it opens new business avenues globally. Further, it was reported that majority of the stakeholders believe that the convergence will be beneficial to the investors and provides better corporate governance.

Review of literature on IFRS adoption suggests that good number of studies are on its impact and have been made in various dimensions. However, a micro study taking specific assets as variables for an impact study through inductive analysis is not to be found. It is felt that the impact of IFRS on annual reporting on assets, especially on Property, Plant and Equipment is to be studied along with the expectations of the investors so that relevance is pertinently brought out. Accordingly, a case study is chosen for this paper.

OBJECTIVES

1. To study the impact of IFRS on Property, Plant and Equipment
2. To analyze the perceptions of the investors on corporate reporting under IFRS

METHODOLOGY

This paper is based on both primary and secondary data. To study the impact of IFRS on Property, Plant and Equipment, the secondary data has been collected from the published annual reports of Dr Reddy's Laboratories Limited which has adopted IFRS voluntarily before the financial year 2016-17 and followed dual reporting of the financial results till the IFRS adoption was made mandatory in India with a different name such as Ind AS. It is not out of context to mention here that Ind AS is the Indian version of IFRS. The Gray Index of Conservatism is used to study the impact of IFRS adoption of accounting figures of property, plant and equipment of Dr Reddy's Laboratories Limited. Accordingly, Dr. Reddy Laboratories Limited is chosen as the Case study for the present article. To elicit the opinions of investors on the expected benefits of IFRS adoption, the primary data was collected from 200 Investors in Hyderabad city on the concepts transparency in financial statements and investor confidence.

IMPACT OF IFRS ON ANNUAL REPORTING AND INVESTOR EXPECTATIONS

In general, it is expected that a change in accounting standards followed in the corporate reporting process shall bring in new benefits to the stakeholders and new set of accounting standards i.e., IFRS shall bring more benefits to the stakeholders. The annual report of a company is expected to present a transparent view and is reliable to gain the investor confidence. Due to fraudulent practices adopted by the corporate, the real owners have suffered a huge loss in the past decades. Therefore, it is imperative to build confidence of the investors through the financial statements and IFRS can play a crucial role in this process.

To understand the dynamics of IFRS and the utility of the new standards over Indian GAAP, the property, plant and equipment component of the balance sheet of Dr Reddy's Laboratories limited has been selected to perceive the impact of IFRS and the related benefits to the investors like transparency in financial statement and investor confidence. As a sequel to this, the values reported under the Indian GAAP and IFRS of property, plant and equipment have been analyzed to explore into the reasons for differences under the Indian GAAP and IFRS and the outcomes of IFRS adoption and to conclude on the dynamics of IFRS adoption on this component.

Table 1: Property, Plant And Equipment of Dr Reddy's Laboratories Limited

(Rupees in Indian Millions)

Year	IGAAP Rs.	IFRS Rs.	Difference in Rs.	Difference in Percentage	Gray Index of Conservatism
2010-11	33855.00	29642.00	4213.00	12.44	0.87
2011-12	25732.00	33246.00	-7514.00	-29.20	1.29
2012-13	31416.00	37814.00	-6398.00	-20.37	1.20
2013-14	37496.00	44424.00	-6928.00	-18.48	1.18
2014-15	41837.00	48090.00	-6253.00	-14.95	1.14
2015-16	46296.00	53961.00	-7665.00	-16.56	1.16
TOTAL	216632.00	247177.00	-30545.00	-14.10	1.14

(Source: Annual Reports)

ANALYSIS BY GRAY INDEX OF CONSERVATISM

The Gray Index of Conservatism also known as Gray Index of Comparison is considered to be a good tool to assess the variations in the accounting figures arrived at by using different sets of accounting standards. It represents a very good mechanism in estimating the comparability of accounting data⁷. In this paper, the Gray Index of Conservatism is used to measure the impact of IFRS on accounting figures in the component Property, Plant and Equipment of Dr Reddy's Laboratories limited for the financial years 2010-11 to 2015-16. After 2016, dual reporting has not been there. Hence comparison could be possible upto 2015-16. Hence the data after 2016 is not selected for the study.

$$\text{Gray Index of Conservatism: } 1 - \frac{\text{Value}_{IGAAP} - \text{Value}_{IFRS}}{\text{Value}_{IGAAP}}$$

The Results of the Gray Index of Conservatism will be interpreted as follows:

- Index is 1 when the values of two sets of IGAAP and IFRS result in the same value
- Index is higher than 1 when the IFRS values are higher than those pertaining to IGAAP values
- Index is lower than 1 when the IFRS values are lower than those pertaining to IGAAP values

Accordingly, the degree of conservatism according to Gray Index of Conservatism is understood further in three ways:

Conservatism or pessimism – the IFRS are more prudent than the Indian GAAP when an index < 0.95

Neutrality when the index values between 0.95 and 1.05

Optimism or less conservatism – the IFRS are less cautious than the Indian GAAP for an index over 1.05

It is evident from table 1 that the Gray Index values are higher than 1.05 in all years except the year 2010-11. Hence, the results of Gray Index of Conservatism show that there is optimism in accounting figures recorded under the IFRS over Indian GAAP except 2010-11. In other words, there is less conservatism in the accounting values recorded under IFRS. One probable reason for this could be the fair value approach under IFRS while valuing the component Property, Plant and Equipment. Therefore, it may be concluded that IFRS are prudent than Indian GAAP in the valuation process of property, plant and equipment.

IFRS AND TRANSPARENCY IN FINANCIAL STATEMENTS

The best definition of transparency in business world is financial statements of high quality. As per the dictionary, there are so many definitions available. The main objective for preparing the transparent financial statement is, the statements must be interesting and easily understandable. However, many scholars argue that the appropriate meanings of the word transparency are very clear, easily understood, candid, and frank.

It is evident from table 1 that the value of property, plant and equipment is recorded in accordance with the principles of IFRS where the valuation is done at fair value unlike Indian GAAP and provides a detailed guidance on treatment of various items in valuing the property, plant and equipment in a company. The valuation of property, plant and equipment under IFRS show a higher value leading to transparency in valuing the asset.

On the other hand, transparency may be understood as a situation where the investors have ready access to required financial information such as annual reports and related disclosures about a company. Transparency ensures the investors as to how much risk they will be exposed to by investing in the company and also helps them to make more knowledgeable investment and financial decisions. Transparency is more if information is more.

To know the perceptions of the investors about the transparency after the implementation of IFRS/Ind AS, survey is conducted by administering a questionnaire to the different sectors of investors, which include the Undergraduate and Post Graduates and the responses are classified on Likert's scale and presented below:

Table 2: Transparency increases after implementation of IFRS

Qualification	Response	No. of Respondents	Percent
Undergraduate	Strongly Disagree	0	0.0
	Disagree	3	9.4
	No Opinion	3	9.4
	Agree	16	50.0
	Strongly Agree	10	31.2
Total		32	100.0

(Source: primary data)

It is evident from table 2 that 50 percent of undergraduate investors agree that implementation of IFRS will bring transparency in financial statements, 31.3 percent strongly agreed that implementation of IFRS will bring transparency in financial statements. Totally, 81.3 percent undergraduate investors have replied positively that transparency increases after implementation of IFRS. On the other hand, 9.4 percent of undergraduates opined that there is no opinion on the statement given. At the same time 9.4 percent respondents disagreed with the statement.

Table 3: Transparency increases after implementation of IFRS

Qualification	Response	No. of Respondents	Percent
Post Graduate	Strongly Disagree	4	2.4
	Disagree	5	3.0
	No Opinion	19	11.3
	Agree	61	36.3
	Strongly Agree	79	47.0
Total		168	100.0

(Source: primary data)

It can be inferred from table 3 that a large number of post graduate qualified investors strongly agreed that transparency will increase after the implementation of IFRS. A total of 83.3 percent post graduate

investors responded positively that transparency will increase after the implementation of IFRS. Further, 11.3 percent respondents replied no opinion on the statement transparency increases with the implementation of IFRS. On the other hand, 2.4 percent strongly disagreed with the statement that transparency will increase after the implementation of IFRS.

The difference in the level of agreement in table 2 and 3 of the undergraduate and post graduate investors is relatively less on a five point scale. In order to know whether the difference is significant in the opinions of the investors on the basis of educational qualification, a paired sample t – test was used to test the difference in mean values and the following hypotheses were developed:

H_0 : There is no significant difference in opinions of investors that transparency increase with the implementation of IFRS

H_1 : There is significant difference in opinions of investors that transparency increase with the implementation of IFRS

Result: t value = -1.4909

H_0 is rejected at 5% level of significance.

Hence, it is concluded there is significant difference in opinions of the undergraduate and post graduate investors on the concept that transparency increase with the implementation of IFRS. Further, it can be concluded that though both of them agreed that transparency increases with the implementation of IFRS, there is degree of difference in their perception. Post Graduate are more emphatic in concluding firmly compared to under graduates.

IFRS AND INVESTORS CONFIDENCE

The investor confidence may be defined as willingness of an investor to engage him in the investment opportunities based on the perceived risk and return. This necessitates the understanding of two elements:

- i) Optimism of the investor regarding the risk and return of the investor on the securities issued by the companies
- ii) Trust in the company's actions and decisions with respect to protection against potential losses both inside and outside environment

According to Hans Hoogervorst, Chairman International Accounting Standards Board (IASB) adoption of International Financial Reporting Standards will enhance foreign investors confidence in the Indian market⁸.

Though there are lots of factors that an investor will consider while evaluating an investment proposal, the most important factor is the return that he is receiving on the investment made by him due to the existence of opportunity cost. Generally, the earning per share is considered to be vital factor to decide whether a share is rewarding positively on the investment made. Additionally, the fortune of the company is another factor that builds confidence in an investor.

Table 4: IFRS enhances the confidence in Investors

Qualification	Response	No. of Respondents	Percent
Undergraduate	Strongly Disagree	1	3.1
	Disagree	1	3.1
	No Opinion	3	9.4
	Agree	12	37.5
	Strongly Agree	15	46.9
Total		32	100.0

(Source: primary data)

It can be seen from the table 4 that 46.9 percent undergraduate qualified investors have strongly agreed that implementation of IFRS will enhance the confidence in investors and on a total basis 84.4 percent undergraduate investors are in favour of the statement. On the other extreme, a small percent i.e., 3.1 percent strongly disagreed that IFRS will enhance the confidence in global investors and 9.4 percent of the respondents expressed no opinion on the statement that implementation of IFRS enhances the confidence among the investors worldwide.

Table 5: IFRS enhances the confidence in Investors

Qualification	Response	No. of Respondents	Percent
Post Graduate	Strongly Disagree	0	0.0
	Disagree	0	0.0
	No Opinion	5	3.0
	Agree	58	34.5
	Strongly Agree	105	62.5
Total		168	100.0

(Source: primary data)

The table 5 shows the summary of responses provided by the post graduate investors on the dimension that IFRS enhances the confidence of investors. It is evident from the table 5 that 62.5 percent of post graduate qualified investors strongly agreed that implementation of IFRS enhances the confidence in investors and a total of 97 percent responded positively that IFRS enhances investor confidence.

On observation, it is found that the level of difference in agreement percent of undergraduate and post graduate investors is slightly high. In order to know whether this difference is significant a paired sample t – test was used to test the difference in mean values and the following hypotheses were developed:

H_0 : There is no significant difference in opinions of the investors that Implementation of IFRS enhances confidence in global investors

H_1 : There is significant difference in opinions of the investors that Implementation of IFRS enhances confidence in global investors

Result: t value = -1.4248

H_0 is rejected at 5% level of significance.

Hence, on the basis of educational qualification there is significant difference in opinions of the investors that Implementation of IFRS enhances confidence in global investors. Hence, the Post Graduates are significantly high in emphasizing that investor's confidence gets enhanced when IFRS is implemented.

CONCLUSION

The adoption of IFRS in corporate reporting brings a lot of benefits. The main benefits that accrue with the implementation of IFRS are comparability of financial statements worldwide, increased transparency and investor confidence. On the basis of data analysis through Gray Index of Conservatism it can be concluded that there is optimism in accounting figures recorded under the new accounting standards i.e., IFRS over Indian GAAP. The reason for this change in accounting figures under IFRS of property, plant and equipment could be use of fair value approach under IFRS. Therefore, it may be concluded that IFRS are more prudent than Indian GAAP in the valuation process of assets like property, plant and equipment. On the other hand, the annual reporting under IFRS meets the expectations of the investors and the level of agreement on the expected benefits of implementation of IFRS/ Ind AS is highly positive. However, there is significant difference in opinions provided by the investors on the basis of their educational qualification on the qualities like transparency and investor confidence in the financial statements.

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