# CHAPTER – 2

**RESEARCH METHODOLOGY**

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2. **RESEARCH METHODOLOGY**

2.1 **Introduction**

Research in common parlance refers to a search for knowledge. Once can also define research as a scientific and systematic search for pertinent information on a specific topic. In fact, research is an art of scientific investigation. The Advanced Learner’s dictionary of Current English lays down the meaning of research as “a careful investigation or inquiry especially through search for new facts in any branch of knowledge.” Redman and Mory define research as a movement, a movement from the known to the unknown. It is actually a voyage of discovery. We all possess the vital instinct of inquisitiveness makes us prob and attain full and fuller understanding of the unknown. This inquisitiveness is the mother of all knowledge and the method, which man employs for obtaining the knowledge of whatever the unknown, can be termed as research.

The purpose of research is to discover answers to questions through the application of scientific procedures. The main aim of research is to find out truth which is hidden and which has not been discovered as yet. Through each research study has its own specific purpose. The present study is an attempt to understand the implications of changing importance of IFRS in the situation and the process of migration in adopting IFRS. The purpose of the study is to make an in-depth study of global financial reporting language i.e. IFRS.

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries.

They are progressively replacing the many different national accounting standards. The rules to be followed by accountants to maintain books of account which is comparable, understandable, reliable and relevant as per the users internal or external. IFRS began as an attempt to harmonies accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. They are sometimes still called by the original name of International Accounting Standards.
IAS. IAS was issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC).

On April 1, 2001, the new IASB took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards International Financial Reporting Standards (IFRS).

IFRS are used in many parts of the world, including the European Union, India, Hong Kong, Australia, Malaysia, Pakistan, and GCC countries, Russia, South Africa, Singapore and Turkey. As of August 2008, more than 113 countries around the world, including all of Europe, currently require or permit IFRS reporting and 85 require IFRS reporting for all domestic, listed companies, according to the U.S. Securities and Exchange Commission.

It is generally expected that IFRS adoption worldwide will be beneficial to investors and other users of financial statements, by reducing the costs of comparing alternative investments and increasing the quality of information. Companies are also expected to benefit, as investors will be more willing to provide financing. Companies that have high levels of international activities are among the group that would benefit from a switch to IFRS. Companies that are involved in foreign activities and investing benefit from the switch due to the increased comparability of a set accounting standard. However, Ray J. Ball has expressed some skepticism of the overall cost of the international standard; he argues that the enforcement of the standards could be lax, and the regional differences in accounting could become obscured behind a label. He also expressed concerns about the fair value emphasis of IFRS and the influence of accountants from non-common-law regions, where losses have been recognized in a less timely manner.

2.2 Review of Literature

Poor corporate disclosure and transparency became an important issue in Asian countries following the Financial Crisis of 1997/98. Despite subsequent regulatory attempts to increase corporate disclosure in many Asian countries, concerns remain
about weak levels of disclosure in the region. For example, the Opacity Index study 2004 (Kurtzman, Yago, Phumiwasana, 2004) shows that to invest in the eight Asian countries in our study would require at that time an average annual return 3.02% more than comparable investments in the USA to compensate for additional risk created by lack of disclosure in these countries.

IFRS are generally thought to be more comprehensive than domestic GAAP of most countries (with the exception of US GAAP). Studies have investigated the impact of IFRS adoption on earnings quality, on cost of capital, and on the value relevance of profits and book value (for example, Barth, Landsman & Lang 2008; Daski, Hail, Leuz & Verdi, 2008; Armstrong, Barth, Jagolinzer & Reidl, 2010; Horton & Serafim, 2010; Clarkson, Hanna, Richardson & Thompson, 2011; Landsman, Maydew & Thornock, forthcoming). However, little is known about whether IFRS adoption has led to an increase in disclosure levels - in Asian countries or elsewhere. The likely reason is that disclosure is not measured in computerised databases such as Compustat Global Vantage or Worldscope, and so not readily accessible by researchers. Yet high disclosure levels are an important component of quality financial reporting and help to reduce information asymmetry between a firm and its stakeholders. We provide results of a hand-collected 441 item IFRS-based disclosure checklist for matched samples of 256 companies from eight Asian countries in both 2002 and 2007. These countries are Australia, China, Hong Kong, and the Philippines which adopted IFRS between those years, and Japan, India, Singapore, and Malaysia which did not.

Ball (2006) points out that the adoption of IFRS, now in more than 100 countries, although driven by global integration of markets, may not produce high quality financial statements in practice because of political and legal barriers to successful implementation at the country level. Studies show both country-level and firm-level factors are important determinants of governance choices (including disclosures) (Doidge, Karolyi & Stulz, 2007) and voluntary IFRS adoption (Francis, Khurana, Martin, & Perera, 2008). Ball, Robin & Wu (2003) show that, in four Asian countries (Hong Kong, Malaysia, Singapore & Thailand), firms report earnings which are less timely in terms of loss recognition than earnings in some common law countries (Australia, Canada, UK, USA) but about the same as in some code-law countries (France, Germany, Japan). They argue that poor timeliness of earnings in the four Asian
countries is associated with factors/incentives such as the system for setting and enforcing standards, the influence of inside stakeholders such as families and banks on financial reporting decisions, political influences, tax incentives, and enforcement mechanisms (Ball et al., 2003, pp241-246).

A separate stream of research commencing with Gray (1988) and building on the work of Hofstede (1980) suggests that cultural factors influence corporate disclosures. In a study covering 42 countries, Hope (2003) finds that corporate disclosures are consistently associated with legal system type, but he also finds disclosures associated with cultural variables. He concludes that cultural differences may well be a valid determinant of disclosures. I examine whether the cultural dimension of “secrecy”, derived by Gray (1988) from Hofstede’s cultural values and measured by Braun & Rodriguez (2008), is associated with changes in disclosure in IFRS adopting Asian countries.

Several studies have examined the determinants of disclosure in individual Asian countries (for example, Hossain, Tan & Adams, 1994; Ho & Wong, 2001, 2002; Hannifa & Cooke, 2002; Chau & Gray, 2002; Morris et al., 2004; Ali, 2005; Sutthachai & Cooke, 2009; Wan-Hussin, 2009); however none examines the effect of IFRS adoption on disclosures. Furthermore, these studies do not deal with the fact that some firm-level determinants are influenced by country-level factors; for example, Japanese companies tend to be larger than those from other countries in the region. These differences in turn are driven by macro-level factors, such as, amongst many things, economic development: as Japan’s economy is among the largest in the Asian region, it tends to have larger firms.

Recently there has been a push towards the adoption of IFRS developed and issued by the International Accounting Standards Board (IASB). The increasing growth in international trade, cross border financial transactions and investments which unavoidably involves the preparation and presentation of accounting reports that is useful across various national borders, has brought about the adoption of IFRS by both the developed and developing countries (Armstrong et al., 2007). The process of adoption received a significant boost in 2002 when the European Union adopted a regulation 1606/2002 requiring all public companies in the territory to convert to IFRSs
A number of African countries including Nigeria, Ghana, Sierra Leone, South Africa, Kenya, Zimbabwe and Tunisia among others have adopted or declared intentions to adopt the standards. In particular, Nigeria adoption of IFRS was launched in September, 2010 by the Honourable Minister, Federal Ministry of Commerce and Industry – Senator Jubriel Martins-Kuye (OFR) (Madawaki, 2012). The adoption was planned to commence with Public Listed Companies in 2012 and by end 2014 all stakeholders would have complied. As at today, banking sector has fully implemented. This is considered a welcome progress for developing countries especially some of those that had no resources to establish own standards.

There are proponents as well as opponents who have arguments for and against the global adoption of IFRS. According to Barth (2007), the adoption of a common body of international standards is expected to have the following benefits: lower the cost of financial information processing and auditing to capital market participants as users, familiarity with one common set of international accounting standards instead of various local accounting standards by Accountants and Auditors of financial reports, comparability and uniformity of financial statements among companies and countries making the work of investment analysts easy, attraction of foreign investors in addition to general capital market liberalization. Ball (2006) stated that many developing countries where the quality of local governance institutions is low, the decision to adopt IFRS will be beneficial. Lipsey and Chrystal (2003) noted that FDI often generates somewhat higher-paying jobs than might otherwise be available to local citizens, it generates investment that may not be possible with the local resources only, it links the recipient economy into the world economy in manners that would be hard to achieve by new firms of a purely local origin. According to Lipsey and Chrystal (2003) the FDI alters country’s comparative advantages and improves its competitiveness through technology transfer and effects myriad externalities, domestic investment which can alter a country’s volume and pattern of trade in many income enhancing directions. Countries that suffer from corruption, slow-moving, or ineffectual government are likely to resistant the change (La Porta et al., 1999) but in such countries, the opportunity and switching costs are lower which makes the possibility of adopting IFRS advantageous. Kumar (2007) the foreign capital has the potential to deliver enormous benefits to developing nations. in addition to helping bridge the gap between savings
and investment in capital-scarce economies, capital often brings with it modern technology and encourages development of more mature financial sectors. Capital flows have proven effective in promoting growth and productivity in countries that have enough skilled workers and infrastructure. Some economists believe capital flows also help discipline governments’ macroeconomic policies.

GAB (2012) stated that one of the demerits that will be experienced by countries adopting of IFRS include: forgoing the benefits of any past and potential future innovations in local reporting standards specific to their economies. Single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures (Armstrong et al., 2007). The Nigeria accounting regulatory includes: the Companies and Allied Matters Act 1990 which stipulate the format, content and scope of the financial statements, disclosure requirement and auditing. It also requires that financial statements of companies comply with statements of accounting standards (SAS) issued from time to time by NASB and audit carried out in accordance with generally accepted auditing standards. Secondly, Nigerian Accounting Standards Board (NASB) Act No.22 of 2003 as the only independent body responsible for developing and issuing SAS for preparers and auditors of financial statements of business concern and government agencies (Madawaki, 2012). Although many countries have faced challenges in their decisions to adopt IFRS, its wide spread adoption has been promoted by the argument that the benefits outweigh the costs (Iyoha and Faboyede, 2011). The existing theoretical models imply that FDI is beneficial for host country’s economic growth. According to traditional economic theory (law of diminishing returns), FDI will tend to concentrate in less developed countries, where there exist greater opportunities to achieve higher returns. In order for FDI to become productive in developing countries, the following conditions should exist: (i) the existence of a minimum threshold level of human capital (Borensztein et al, 1998), improved domestic infrastructures (de Mello, 1999), and a developed local financial systems (Alfarø et al, 2006). Out of all, the last prerequisite seems to have more weight in order for FDI to flow into any developing country and have a measurable impact on economic growth. Lack of these requirements has resulted in imbalanced in the FDI distribution across many developing countries. Some of the countries are facing difficulties in attracting foreign investors. FDI is considered as an important channel for direct technology distribution and may be the major vital conduit
for technology transfer because of the scarcity of financial resources and the urgent
need for reconstruction in many developing countries (Hossein & Yazdan, 2012).
Within this framework it is expected that FDI will contribute to economic growth,
indirectly by accelerating the diffusion of general purpose technologies (Hossein &
Yazdan, 2012).

There are different streams of IFRS literature. One stream investigates the impact of
IFRS adoption on earnings quality and finds mixed results (Cuijpers & Buijink, 2005;
Gassen & Sellhorn, 2006; Barth et al. 2008; Tendeloo & Vanstraelen, 2005). Another
stream of research examines the value relevance of IFRS in comparison with local
GAAP (Hung & Subramanyan, 2007; Bartov et al. 2005; Goodwin et al. 2008). The
third stream of research examines the impact of IFRS adoption on cost of capital (Leuz
& Verrecchia, 2000; Daske, 2006). There are also other streams of IFRS literature that
examine factors influencing disclosure on transition to IFRS (Kent & Stewart, 2008;
Palmer, 2008), relevance of accounting classification in the IFRS era (Nobes, 2008),
impact of particular IFRS on harmonization (Morais & Fialho, 2008) and value
relevance (Chalmers et al. 2008).

Proponents of IFRS often claim that IFRS adoption leads to greater and higher-quality
disclosures. When compared with local accounting standards in most countries, IFRS
is considered as being more fair-value-oriented, reducing accounting flexibility allowed
for the issuers of financial statements, and incorporating the effects of economic events
on firm performance into financial statements in a timely manner (Coopers & Lybrand
Regulators and investors have commonly expressed the view that more the transparency
and higher the quality in accounting, lower is the cost of capital for adopting companies
(Levitt, 1998; IASB, 2002). The lower cost of capital is based on the theory that higher
information quality lowers the estimation risk of future returns (Barry & Brown, 1985)
and this lowers the information asymmetries between managers and investors that lower
the choices of adverse selection, thus increasing liquidity and ultimately lowering the
required rate of return (Diamond & Verrecchia, 1991).

It is generally accepted that under internationally recognized standards such as IFRS or
USGAAP the quality of accounting is high, as shown by earlier studies. Amir, Harris
and Venuti (1993) have shown that 20-F reconciliations of USGAAP are of value relevance and there are economic benefits for the investors. Using 20-F filings to reconcile from IFRS to USGAAP for financial years ending before November 15, 2007, Liu and O’Farrell (2011) study a sample of US-listed foreign companies using IASB-IFRS and their matched US-listed foreign companies using Regional-IFRS from the same industry and find that it is possible to directly measure the comparability between accounting measures prepared under IFRS and USGAAP.

Botoson (1997) has shown that higher disclosure levels tend to bring down cost of control. Leuz and Verrechhia (2000) have shown that adoption of USGAAP/IFRS reduces factors that affect information asymmetry like bid-ask spread and low volume, and thus help in reaping economic benefits for adopting companies.

Daske (2006) has found a relationship between cost of capital and disclosure policy for German companies but his results show that the risk for companies adopting USGAAP/IFRS has increased which is counter intuitive and no explanation can be given for the results, as the author has also expressed doubt on the method of estimating the cost of capital.

While these studies focus on the impact of IFRS adoption on the disclosure quality, the other stream of research focuses on the association between the disclosure quantity or level and a firm’s voluntary adoption of IFRS. Ding et al. (2005) report that IFRS require more comprehensive disclosures than do most countries’ domestic standards.

The information asymmetry literature suggests that greater disclosure mitigates the adverse selection problem and enhances liquidity, thereby reducing the cost of equity through lower transaction costs and/or stronger demand for a firm’s securities (Amihud & Mendelson 1986). Diamond and Verrechhia (1991) also find that higher information quality lowers the information asymmetries between managers and investors, thus lowering the choices of adverse selection hence increasing liquidity and ultimately lowering the required rate of return. Tweedie (2006) argues that IFRS will “reduce the cost of capital and open new opportunities for diversification and investment return”.

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Auer (1996) in his study compares the Swiss GAAP and IFRS and finds that IFRS-based earnings announcements convey significantly higher information contents than local GAAP. Jermakowicz (2004) in his study examines the adoption of IFRS by BEL-20 companies in Belgium to analyse the application of IFRS in the consolidated financial statements of Belgian publicly traded companies. In Belgium, and several other European countries, a close link exists between accounting and taxation. The study has thrown some insight into IFRS implementation problems based on a survey sent to BEL-20 companies. The survey focused on the impact IFRS conversion had on companies, their internal organization and accounting and finance strategy.

In a similar study, Tendeloo and Vanstralen (2005) examine whether adoption of IFRS is associated with lower earnings management and the results indicate that, in general, adopters of IFRS cannot be associated with lower earnings management. The study uses a sample of German companies, because, in Germany, a relatively large number of companies chose to voluntarily adopt IFRS prior to 2005. Controlling for other differences in earnings management incentives and enforcement mechanisms, the study found that the German companies that have adopted IFRS engage significantly less in earnings management, as compared to German companies reporting under domestic GAAP.

Beckman et al. (2007) in their investigation of financial statements footnotes disclosures with a sample size of 22 German firms making 59 reconciliations of net income and stockholders’ equity as reported under Germany’s Commercial Code (HGB) to either IFRS or US, found German aggressiveness and conservatism in reporting and market valuation. Cordeiro et al. (2007) measure the impact of the application of IFRS to financial information of Portuguese public companies. The results show that the Balance Sheet and Income Statement structures of the firms studied suffered relevant accounting conversions in the process of compliance.

In one of the major work on studying economic consequences due to mandatory IFRS reporting Daske et al. (2008) with a sample of 26 countries for a period from 2001 to 2005 found that, on an average, market liquidity increases around the time of introduction of IFRS. Capital market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong. Capital market also
affects most of the firms that voluntarily switch to IFRS, both in the year when they switch and again later, when IFRS become mandatory. Many adopting countries make concurrent efforts to improve enforcement and governance regimes.

In another major recent study by Aubert and Grudnitski (2011), by taking a sample across 13 countries and 20 industries, two-stage analysis was conducted on the impact and importance of mandatory adoption of IFRS on European Union. Results showed significant differences in return on assets for firms computed under IFRS and local Generally Accepted Accounting Principles. Specifically, there was no statistical support for any of the samples to show that, accounting information under IFRS was any more value relevant than the accounting information derived using local accounting principles. In another study taking European Union as sample, Byard et al. (2011) use control sample of firms that had already voluntarily adopted IFRS at least two years prior to the mandatory adoption date. They found that analysts’ absolute forecast errors and forecast dispersion decrease relative to this control sample only for those mandatory IFRS adopters domiciled in countries with both strong enforcement regimes and domestic accounting standards that differ significantly from IFRS.

Major and Marques (2009) in their study assess the relationship between the application of IFRS, corporate governance and firm performance in Portugal with a sample of 240 observations, in 80 firms, over the period of 2003-2005. Results show that Portuguese companies that follow Portuguese Securities Market Commission (CMVM) recommendations have a higher level of firm performance, which indicates an important link between financial and managerial accounting, however, the level of compliance with the recommendations is still low.

Lantto and Sahlstrom (2009) in their study examine the impact of IFRS adoption on key financial ratios using Finland as the sample country. The results clearly show that the adoption of IFRS changes the magnitude of the key accounting ratios. Moreover, it also found that adoption of fair value accounting rules and stricter requirements on certain accounting issues are the reasons for the changes observed in accounting figures and financial ratios. In this regard, the results of the present study indicate that the adoption of IFRS changes the magnitudes of the key accounting ratios of Finnish companies by considerably increasing the profitability ratios and gearing ratio.
moderately, and considerably decreasing the PE ratio and equity and quick ratios marginally. The results indicate that the increase in the profitability ratios and the decrease in the PE ratio can be explained by increase in the income statement profits.

In another study using financial ratios based on profitability, activity, liquidity and solvency, Padrtova and Vochozka (2011) compare the informative value of financial statements of CEZ Inc. drawn up under IFRS and Czech accounting standards for 2004 and 2005. The financial analysis results proved the impact of IFRS implementation on financial performance of the company. Financial statements prepared under Czech accounting standards showed the company healthier than financial statements drawn under IFRS.

Similarly, Beuren et al. (2008) in their study developed on economic-financial indicators of 37 English companies suggested divergences between IFRS and USGAAP indicating significant correlation between differences of these indicators.

However, in contrast, Ferrer et al. (2011) investigate how liquidity and leverage ratios exert significant effect on the degree of compliance with IFRS disclosures as measured by disclosure indexes constructed from Balance Sheets and Income Statements of 100 publicly listed companies in Philippines. Multiple regression analysis based findings suggest that none of the indices exert a significant effect on the financial variables based on computed t-statistics. The study accepts null hypotheses that liquidity and financial leverage have no effect on IFRS when expressed in terms of Balance Sheet and Income Statement indices.

Kabir et al. (2010) in their study find contrasting results using New Zealand firms from 2002 to 2009 that absolute discretionary accruals were significantly higher under IFRS than under pre-IFRS NZGAAP, suggesting lower earnings quality under IFRS than under pre-IFRS NZGAAP. In another work, Hellman (2011) studies the impact of IFRS on financial statements of 132 largest Swedish-listed companies as December 2005, and finds out the differences between Sweden’s voluntary adoptions of IFRS during 1991-2004. With regard to the EU’s international standards voluntary adoption before 2005, results indicate that firms on an average used the flexibility offered by the soft adoption regime to manage earnings and shareholders’ equity upwards. In another study
on the impact of IFRS adoption in Europe and Australia on the relevance of book value and earnings for equity valuation, Clarkson et al. (2011) use a huge sample of 3,488 firms in 2004 and 2005 and control for non-linear effects, they find no change in price relevance for firms either in Code Law or Common Law countries after IFRS adoption, thus contradicting results from linear pricing models.

Zhou et al. (2009) studied China-emerging economy as sample country-to investigate whether firms adopting IFRS have higher earnings quality as compared to non-adopting firms in an emerging market. The results suggest some improvement in the quality of accounting information associated with the adoption of IFRS. The findings point to the need for a stricter enforcement mechanism of accounting standards in emerging markets. Enforcing the same sentiment, Liu et al. (2011) examine the impact of IFRS on accounting quality in China, a regulated market, using a sample of 870 firms that were mandated to follow the new standards. Results of the data from 2005 to 2008 show that changes are less likely to result from changes in economic conditions but from changes in market. This study is important because it provides direct evidence on the question whether IFRS can be relevant to markets that are still disciplined mainly by regulators than by market mechanisms.

In the only descriptive study using Indian banking industry, Firoz et al. (2011) critically analyse financial statements like business per employee, capital and reserve, investments and advances, net non-performing assets ratios and the impact thereon on relevant provisions of IFRS. The authors conclude that certain issues need clarity from tax authorities as well as from Reserve Bank of India to ensure successful IFRS implementation by banking industry.

From the above, it is important to observe that majority of the studies in IFRS are concentrated in the developed nations. It is because countries in European Union, Australia and New Zealand have mandated IFRS way back in 2005, there are various studies trying to understand the post-adoption scenarios. Since the USA and India are going to mandate IFRS, these studies are more futuristic in nature.

Studies using emerging countries as their samples are very rarely done. Except for one study on Indian banking industry and another two on China, none of them have focused
on other issues pertaining to IFRS implementation in emerging economies. From the above literature review, it is apparent that none of the research has directly been able to relate the impact on economic activities like investments, financial risks, diversifications, mergers and acquisitions and other key financial functions by the adoption of International Financial Reporting Standards by Indian companies. The intuition is that adoption of IFRS is viewed as a commitment to better disclosure, which may have various impacts on Indian companies, which is required to be researched and thus check the impact on economic activities after adoption of IFRS by Indian companies.

2.2.1 IFRS Adoption Impact on FDI and the Economy

The IFRS is a global GAAP, setting principles–based and globally accepted standard published by the IASB to support those who adopted in the preparation and presentation a high quality, transparent and comparable financial statements that will aid easy interpretation. Okoye & Akenbor (2012), the perceived challenges to be presented by IFRS adoption and implementation includes: the intrinsic problems of aligning with IFRS pointed out that international accounting clearly has a language problem (Ukpai, 2002), Adams (2004) claimed that where an accounting standard conflicts with government policy, the standard is revised such as the LIFO method of stock valuation not allowable for tax purpose in Nigeria, Another problem inherent with the adoption of IFRS is the universal tendency to resist change (NASB 2010). Gambari (2010) noted that the successful adoption of IFRS entails assessing technical accounting, tax implications, internal processes, and statutory reporting, technology infrastructure, and organizational issues. FDI has been defined in several ways. According to Kumar (2007) FDI which involves building long-term relationships with enterprises in foreign countries can be made in several ways. First, and most likely, it may involve parent enterprises injecting equity capital by purchasing shares in foreign affiliates. Second, it may take the form of reinvesting the affiliate’s earnings. Third, it may entail short- or long-term lending between parents and affiliates. To be categorized as a multinational enterprise for inclusion in FDI data, the parent must hold a minimum equity stake of 10 percent in the affiliate (Kumar, 2007). Garkovic and Lavin (2002), noted that economic rationale for offering special incentive to attract FDI frequently is
derives from the belief that foreign investment produces externalities in the form of technology transfer and spillovers. DeGregorio (2003), while contributing to the importance of FDI noted that it allows a country to bring in technologies and knowledge that are not readily available to domestic investors and increases productivity throughout the economy (Oyetoye et al., 2011). Jeffrey and Spaulding (2005) also stated that FDI advantage includes; circumventing trade barriers, hidden and otherwise making the move from domestic export sales to a locally-based national sales office and capability to increase total production capacity Opportunities for co-production, joint ventures with local partners, joint marketing arrangements. In recent times, it was revealed that FDI in Nigeria have been declining (NASB, 2010). According to NEF (2011) the trend shows that the value declined from $6.9 billion in 2007 to about $4.602 billion in 2008 and $3.94 billion in 2009 and $6.1b in 2010. The decline in 2010 was due to ongoing uncertainty related to the proposed Petroleum Industry Bill (PIB) as well as political unrest in the some section of the country. The new FDI was estimated at $6.8bin 2011. Nigeria is the third largest recipient of FDI in Africa after Angola and Egypt.

2.2.2 IFRS Adoption Impact on Earnings Quality

Improvement of accounting earnings quality depends on at least two factors: high quality accounting standards and a country’s overall investor protection (Soderstrom and Sun, 2007). This was noted by Ewert and Wagenhofer (2005) who observed that high quality accounting standards reduced earnings management and improved reporting quality. Barth et al. (2006) suggested that firms that adopted IFRS were less prone to engage in earnings smoothing and were more likely to recognize losses in an appropriate manner. Similar findings were reported by Jennings et al. (2004) and again by Armstrong et al. (2010). Schipper (2005) argued that the adoption of IFRS in the European Union (EU) provided a more powerful setting in which to test the determinants and economic consequences of accounting quality because accounting standards across EU countries were consistent.

Ball (2001) argued that IFRSs provided high quality accounting information in a public financial reporting and disclosure system characterized by (i) training of the audit profession in adequate numbers, and high professional ability, (ii) independence from
managers to certify reliably the quality of financial statements, (iii) separation, as far as possible, of public financial reporting and corporate income taxation, so that tax objectives did not distort financial information, (iv) reform of the structure of corporate ownership and governance to achieve an open-market process for reliable public information, (v) establishment of a system for setting and maintaining high-quality, independent accounting standards, and (vi) perhaps most important of all, the establishment of an effective independent legal system for detecting and penalizing fraud, manipulation, and failure to comply with standards accounting and other required disclosure, including provision for private litigation by stockholders and lenders adversely affected by deficient financial reporting and disclosures. Biddle and Hillary (2006) found that high quality accounting information reduced the investment-cash flow sensitivity in market-based economies (strong investor protection) but not in bank-based or creditor-dominated economies.

Contrary to the above studies, van Tendeloo and Vanstraelen (2005), and Lin and Paananen (2007) examined the discretionary accruals of German firms adopting IFRS. They found that IFRS firms had more discretionary accruals, and that there was a low correlation between accruals and cash flows. Similarly Paananen, (2008) investigated whether the quality of financial reporting in Sweden increased after the adoption of IFRS and found that the quality of financial reporting (measured by the degree of smoothing of earnings) decreased after the adoption of IFRS. Platikanova and Nobes (2006) compared the information asymmetry component of the bid-ask spread among companies before and after the EU’s adoption of IFRS in 2005. They found a larger volatility in the information asymmetry component for UK and German companies. They also found that companies from countries where earnings management was more common exhibited a lower information asymmetry component compared to other countries. They interpreted this result as indicating that income smoothing reduced information asymmetry.

Besides accounting standards, accounting earnings quality is influenced by firm- and country-level investor protection rather than accounting standards (Leuz et al., 2003). Leuz et al. (2003) examined the relationship between investor protection and earnings management across 31 countries using non-financial industry data. They found that strong investor protection at a country level reduced the earnings management activities
of firms and thus led to higher accounting quality. Following the above studies, Shen and Chih (2005) used banking industry data to calculate earnings management across 48 countries based on the methodologies of DeGeorge et al. (1999) and Burgstahler and Dichev (1997). Their results showed that accounting disclosure (proxied by strong legal enforcement) more effectively explained variations in earnings management across countries. Similarly, earlier research indicated that in countries with strong investor protection regimes there was greater financial transparency (Bhattacharya et al. 2003; Bushman et al. 2004), and less earnings management - all of which could be interpreted as evidence of higher accounting quality (Ball et al. 2000; Hung 2000; La Porta et al. 1998, 2000, 2006; and Daske et al. 2008). Ball et al. (2003) argued that adopting high quality standards was a necessary condition for acquiring high quality information, without being a sufficient one, that is, country level investor protection.

Bushman and Smith (2001) suggest that strong country level investor protection gives rise to high quality accounting information, and that the interaction of these two variables positively affects economic growth. Similarly, Leuz et al. (2003) found that firms in countries with developed equity markets, dispersed ownership, strong investor rights, and legal enforcement engaged in less earnings management (Burgstahler et al. (2007)). Guenther and Young (2000) argued that in countries with strong investor protection there was a strong relationship between accounting earnings and actual economic events.

Daske et al. (2008) concluded that “investigating the joint effect of investor protection and IFRS adoption was an interesting avenue for future research” (p1132). The present international accounting setting provides an opportunity to address the impact of international governance arrangements - corporate, political, judicial and regulatory - on earnings quality. This paper argues that earnings quality is a joint function of investor protection and the quality of accounting standards, as proxied by IFRS. This view is based on the argument that accounting does not exist in a vacuum; that it is rather „a product of its environment” (for example, Mueller 1968; Nobes 1988 and 1992; Karim 1995; Armstrong et al. 2010). In summary, lower investor protection breeds managerial discretion within the organization which impedes production of high quality accounting numbers, - despite high quality accounting standards. Accounting corruption is likely to accompany socio-political corruption. Clean and reliable financial information remains elusive in a low investor protection environment.
2.2.3 IFRS Adoption Impact on Management Earnings

Soderstrom and Sun (2007) provide a schematic framework depicting determinants of accounting quality. They argue that accounting quality after IFRS adoption hinges on three factors: 1) the quality of the accounting standards; 2) a country’s legal and political system; and 3) financial reporting incentives from financial market development, capital structure, ownership structure, and tax system. However, as all these variables may link and interact with each other, they are difficult to model. Another methodological concern is the problem of omitted variables, since some other unobserved factors may also affect the quality of earnings. According to this framework, improvement of accounting quality rests on at least two factors: high quality accounting standards and a country’s overall institutional system.

First, the improvement of accounting quality is based upon the premise that IFRS itself is a set of high quality reporting standards. Adopting a common set of accounting standards improves earnings quality through the ease of monitoring and comparison of financial reports across borders, which puts pressure on management to report faithfully and truthfully and engage in less earnings management activities (Soderstrom & Sun, 2007). Consistent with this view, Ewert and Wagenhofer (2005) find that tightening accounting standards reduces earnings management and improves reporting quality. Similarly, Barth et al. (2008) find that firms adopting IFRS have less earnings management, more timely loss recognition, and more value relevance of earnings, all of which they interpret as evidence of higher accounting quality. Daske and Gebhardt (2006) also show that disclosure quality, as perceived by experts, has increased significantly under IFRS.

In contrast, opponents argue that adopting IFRS itself may not improve accounting quality. For example, Lin and Paananen (2006) examine changes in the patterns of earnings management activities over time, and suggest that IASB has not been effective in decreasing overall earnings management activities.

Besides accounting standards, accounting quality is also determined by a country’s overall institutional system and firms’ incentives for financial reporting (Ball et al., 2000; Ball et al., 2003). Leuz et al. (2003) perform a cluster analysis using La Porta et al. (1998)’s nine institutional variables to examine the systematic difference in earnings management across 31 countries. They report less earnings management in countries...
with stronger investor protection, since strong protection limits insiders’ ability to acquire private control benefits, and reduces their incentives to mask firm performance. Similarly, Burgstahler et al. (2007) examine the relation between earnings management and the interaction among ownership structure, capital market structure and development, tax system, accounting standards, and investor protection. They document that strong legal systems are associated with less earnings management. Ding et al. (2007) examine how a country’s legal system, economic development, the importance of stock markets, and ownership concentration shape the country’s accounting standards, which in turn affect the country’s quality of financial reporting. Soderstrom and Sun (2007) argue that cross-country differences in accounting quality are likely to remain following IFRS adoption, because accounting quality is a function of the firm’s overall institutional setting. Although conversion to IFRS is likely to improve earnings quality, it is only one of the determinants. Even after mandatory IFRS adoption, these country-level institutional variables continue to vary across countries.

In recent years, many researchers argue that the enforcement of accounting standards is as important as the accounting standards (e.g. Sunder, 1997). Strong IFRS enforcement puts great pressure on management and auditors to act faithfully and truthfully to comply with the standards, and contributes to comparability of financial statements across countries (FEE, 2002, 29). Ball et al. (2003) question the quality of financial statements prepared under IFRS, particularly in the presence of weak enforcement mechanisms. Holthausen (2003) predicts that adopting IAS1 by countries with weak enforcement mechanisms will likely lead to damaging the perceived quality of the standards, and suggests that it would be useful for the literature to begin to structure and quantify the country descriptions by developing more informative tests. Leuz et al. (2003) do not directly study the effect of accounting standards enforcement, but infer that countries with strong outsider protection are expected to enact and enforce accounting and securities laws that limit the manipulation of accounting information. Hope (2003) constructs a comprehensive measure of accounting standards enforcement and finds that strong enforcement encourages or forces managers to follow the rules.

Prior research on comparability has mainly focused on the differences between a specific domestic set of accounting standards and either IAS/IFRS or US GAAP (Gray, 1980; Meek, 1983; Alford et al., 1993). Several studies have used data from overseas, incorporating companies that have securities traded in the US. Most analyse the impact
of accounting differences using US GAAP reconciliations. This research line uses US GAAP as a benchmark and compares it with other GAAPs, such as UK GAAP (Weetman, Gray, 1990, 1991; Weetman et al., 1998; Adams et al., 1999), GAAPs of other European countries (Hellman, 1993; Whittington, 2000), Australian GAAP (Norton, 1995) and Japanese GAAP (Cooke, 1993). Other studies document the historical differences between IAS/IFRS and US GAAP and/or standard-setters’ efforts to eliminate these differences. This research suggests that efforts by standard-setters to address differences are proving successful in converging IFRS and US GAAP (Street, Shaughnessy, 1998; Street, Gray, 1999). Street et al. (2000) examine trends in 20-F adjustments by companies using IAS during 1995–1997 and 1995–2001, respectively. Both studies indicate that the materiality of differences decreased over time. Based on 20-F reconciliations provided by the population of US listed European companies filing IFRS-based statements with the SEC in 2005, Gray et al. (2009) examine whether ‘European’ and US GAAP measures of income and equity converged under IFRS. They find that for US listed European companies that adopted IFRS in 2005, there has been a significant de facto divergence from US GAAP in terms of income determination, in contrast to the expected convergence. Specifically, IFRS adoption resulted in a widening of the gap, in respect of the measurement of income compared to that previously existing between European and US GAAP.

From a regional perspective, some studies have examined the differences between Latin American accounting practices and international standards. Only a few studies on US GAAP comparability have included companies from developing countries (Rueschhoff, Strupeck, 1998; Davis-Friday, Rivera, 2000; Palacios et al., 2007). Rueschhoff, Strupeck (1998) find that differences in accounting principles cause extreme variations in reported earnings, shareholders’ equity and equity return for some developing countries (Mexico, Argentina and Chile). They observe that domestic GAAP are less conservative than US GAAP. The greatest disparities occur for the Mexican firms. Davis-Friday, Rivera (2000) analyse the 1995 and 1996 20-F reports filled with the SEC by Mexican firms. The results show that on average, earnings measured under Mexican GAAP is about 26 per cent greater than the US GAAP measure, and Mexican GAAP equity is on average 74 per cent greater than US GAAP equity. Palacios et al. (2007) examines the comparability between Latin American GAAP and US GAAP by studying 314 Forms 20-F reported by Latin American firms.
(Argentina, Brazil, Chile and Mexico) during the period 1997-2001. The study finds that for the period 1997-2001, Latin American earnings are 67 per cent higher than US earnings. Brazil was the least conservative country of the sample. The results indicate that the differences between Latin American and US GAAP are not significant, but have not narrowed during the period 1997-2001. The temporal trend in the use of adjustments has increased over time, suggesting a decline in the comparability of the financial statements.

2.2.4 IFRS Adoption Impact on Corporates

United Technologies Corporation started the process of IFRS implementation with the expectation to realize significant benefits. The company expects to gain access to foreign capital markets due to the implementation of uniform standards everywhere. It also expects an increase in mergers and acquisitions opportunities since the major challenge of conversion of financial statements to a uniform standard (US GAAP) would be removed because of IFRS. These benefits are apart from ones that it will realize due to the implementation of uniform accounting standards across its subsidiaries in many countries.

Another global company with subsidiaries in 70 countries was facing several challenges on account of different statutory reporting processes across its subsidiaries. It sought to reduce complexity, reduce risk and transparency and efficiency of its global financial organization. IFRS presented the opportunity to achieve the above objectives. The company implemented IFRS and realized several important benefits - improvements in its financial and tax reporting processes, treasury processes and internal controls. Streamlining of global financial operations led to simplification of processes and cost savings.

The two cases above illustrate some of the benefits that are expected from implementation of IFRS. Similar benefits are expected to result for Indian companies given the fact that most companies are expected to follow aggressive growth and expansion strategies in the short and medium term. However, there are other ways in which IFRS will impact Indian companies. This paper seeks to explore the impact of
IFRS on Indian companies with specific focus on the industries that are expected to shape the country’s economy in the future.

IFRS is going to have significant impact on the Indian Corporate largely due to the significance difference in the Indian GAAP and IFRS. Although the impact may differ from industry to industry, some big impacts would be common and crucial. The most important and most talked about is that under IFRS, balance sheet items would have to be fair valued compared to the current practice of carrying it at historical cost. This will certainly complicate the situation for companies which are in huge debt. Not only would they have to show increased debt positions which would impact their credit rating but would also impact their financial ratios. From lenders perspective, banks would have to show NPA at fair value creating tightened credit situations for them. A challenge for regulators and Indian companies would be on treating unrealized gains/losses when measured at fair value. Besides, distribution of unrealized gains as dividends within the contours of Companies Act 1956 is the debatable point.

In derivatives market, application of hedge accounting would reduce income statement volatility. However, this will entail onerous and stringent documentation requirements, mandatory effectiveness tests and determination of fair value based on observable inputs. In the case of derivatives, held-for-trading investments and investment properties, IFRS allows gains or losses on fair valuation to be recognized in profit or loss accounts for the period. Undoubtedly, this is quite a bold move to allow even unrealized gains to be captured in profit or loss accounts. In such a situation, there will be extra onus on the management to exercise better financial discipline; otherwise, the company may end up declaring dividends out of unrealized profits.

The impact continues for financial assets. Under IFRS, de-recognition of financial assets is a complex, multi-layered area that follows the principle of transfer of risks and rewards. In the Indian context, this will impact mainly the securitization activity. Securitization transactions where credit collaterals are provided or guarantee is provided to cover credit losses in excess of the losses inherent in the portfolio of assets securitized may not meet the de-recognition principles enunciated in IAS 39. This will result in failure of de-recognition test under IFRS and lead to collapse of securitization vehicles into the transferor’s balance sheets. Banks will need to assess the impact and consider the potential impact on capital adequacy and ratios such as return on assets.
The consequences for Indian companies are far wider than financial reporting issues and extend to various significant business and regulatory matters including compliance with debt covenants, structuring of ESOP schemes, payment structures, training of employees, modification of IT systems and tax planning. For example, the variable pay component of most TCS employees is about 30% of the total compensation package and this variable pay being based on items of Profit/Loss Account which will be defined differently under IFRS, the entire compensation package will need to be revised. Companies also need to communicate the impact of IFRS convergence to their investors to ensure they understand the shift from Indian GAAP to IFRS.

IFRS would also impact the way Indian companies look at debt and equity. For instance, under Indian GAAP, redeemable preference capital (shares that do not come with voting rights but which have a higher priority over ordinary shares in terms of dividend payments, and which can be redeemed at the discretion of the issuer or shareholder) has to be treated as equity. IFRS, however, will require it to be treated as debt. Based on substance of terms, instruments such as convertible debentures are likely to be shown partly under debt and partly under equity, since the embedded warrant option in such instruments will be separately identified and presented at its fair value. Contracts for supply of goods and services may get concluded (wholly or partly) as leases. Such changes might not only require a change in how to look at capital but would also require investors to be educated so that they can understand the changes in the balance sheet and financial ratios that accompany IFRS implementation. IFRS will bring with it the concept of functional currency. Indian entities may need to maintain their books in US dollars and report in the same currency to the National Stock Exchange and the Bombay Stock Exchange if the dollar is determined to be the currency for the primary economic environment in which it is operating, subject to regulatory approvals.

Apart from the core impact on finance department, secondary impact would be there on people, technology and processes. IT department will have to worry about questions like: How will running IFRS after Indian GAAP affect their method of updating their general ledger and chart of accounts? How should metrics and budgeting and forecasting applications be changed? Will differences in IFRS require new data entries? And how can they ensure that the data produced by the newly tweaked systems is clean?
Certainly new processes and systems would have to be put in place, people would have to be trained and all this would impact in terms of increased costs.

Finally, given the increased importance of corporate governance, the responsibility of board and audit committee of companies is set to increase. IFRS is a principle-based standard, unlike Indian GAAP, which is rule based. IFRS involves extensive use of judgment in selection of appropriate accounting policies and alternative treatments, including at the time of adoption. Also, IFRS requires valuations and future forecasts, which will involve use of estimates, assumptions and management’s judgments. All this implies that board members would have greater responsibility and accountability at hand. The biggest challenge for members charged with governance will be to manage stakeholder expectations in terms of meeting targets and key performance indicators, declaring dividends and explaining variations and volatility in earnings on a quarterly basis. This is a challenging task even now, but with the arrival of IFRS, the challenge is set to assume a different dimension.

More specifically IFRS is going to have different impact on different industry players in India. Let’s look at some of the significant industries in India and the impact of the IFRS on Indian companies in those industries. For Telecom Industry, unlike Indian GAAP where no specific guideline exists for revenue recognition for multiple elements contract, IFRS requires the recognition criteria to be applied separately to each transaction. The key issues will be to determine a) whether the various components of the transaction can be separated from a performance standpoint and commercial perspective and b) whether the fair value which distort the analysis of comparison of companies in same industry. Under IFRS the recognition criteria are usually applied separately to each transaction. This will not only structure things but also make the comparison easy across the industry. Moreover, many global IT companies are used ESOPs to retain and attract top
management employees for their Indian IT subsidiaries. Indian GAAP doesn’t require these Indian subsidiaries of foreign companies to account for ESOPs in compensation cost. This will be accounted for in IFRS thus impacting Indian subsidiaries in a major way. IT sector gets large outsourcing contracts from big customers. Such contracts are normally service contracts and revenue is accounted as and when services are provided. The pricing of the contract is also agreed on special terms considering the costs incurred by IT Company. Under Indian GAAP these contracts are considered as normal for providing services. However, in IFRS there is a possibility that these contacts will be considered as lease agreement depending on the substance of the arrangement between the IT Company and customer.

The Financial Statements would change significantly if these transactions are seen as lease agreements. The economic crisis has raised several challenges in the implementation/ adoption of IFRS. The primary challenge has been the concern raised over fair value accounting. It is now widely perceived that fair value accounting which is mandated by IFRS has intensified the crisis. This happened because accounting according to IFRS causes sharp volatility in earnings for stocks in banks, insurance and property companies. Volatile market prices of assets leads to considerably stronger fluctuation in results – there are substantial write ups during times of economic growth and write downs when markets perform poorly. While positive market development brings about increased flexibility due to higher valuations for assets, write-downs can dramatically impair an organization’s ability to do business. The adverse impact of fair value accounting can be gauged from the fact that in the last 6 years, bank shares have twice gone down by 40% while in the previous 30 years when fair value accounting played a minor role this had happened only once. This has led to calls from several quarters for a review of IFRS accounting. There is also a school of thought that believes that the fact that IFRS does not require reporting of potential future losses will lead to higher levels of risk taking by organizations.

Thus there is considerable concern that IFRS might lead to reckless actions on the part of organizations and the outcomes could be similar to the ones that we are witnessing now.
The economic crisis has forced the IASB to review IFRS related to consolidation and de-recognition of Off Balance Sheet vehicles, disclosure requirements for liquidity risk as well as fair value accounting principles.

Apart from concerns regarding the very nature of IFRS principles, there is an increasing view in the US industry that the adoption of IFRS should be slowed down and the target date should be pushed beyond the current one of 2016. A number of reasons are cited for this – high costs of implementing IFRS, lack of trained manpower, the requirement for three years of comparative results (which effectively means that IFRS has to be implemented as early as 2012). Similar concerns will be echoed in the Indian context given the fact that many industries have borne the brunt of the crisis as also the fact that local issues are also expected to create resistance towards economic growth in the short term.

How ready is Corporate India for this change? The buzz in this small world is that large companies within this realm have already taken strides to adopt IFRS by April 1, 2011. But the scene is not the same with most of the public interest entities! Although ICAI has said in its concept paper that it would come out with a separate accounting system for SME, in line with IFRS, but eventually down the line SME’s would also have to merge with the mainstream accounting standards. Steps to enable this transition and facilitate it smoothly have to begin from now. Even for major Indian Companies who would undergo the change from the set deadline there are many challenges.

Convergence to IFRS will greatly enhance an Indian entities’ ability to raise and attract foreign capital at a low cost. A common accounting language, such as IFRS, will help Indian companies benchmark their performance with global counterparts. The transition will also provide impetus to cross-border acquisitions, enable partnerships and alliances with foreign entities and lower the integration costs. So it is essential that Indian Companies start moving towards strategizing and implementing a smooth transition from Indian GAAP to IFRS.

International Financial Reporting Standards (IFRS) will have a key impact on all convergence firms in the telecom, media and technology (TCE) sectors in myriad ways.
These firms will have to implement component basis of accounting for fixed assets—these assets will get classified into different categories depending on their useful life and depreciation. Whenever any component of a fixed asset will get replaced, its cost will be capitalized and the old components net written-down value will be removed from the fixed assets block. This will be a significant change for telecom firms, which are quite capital intensive. Further, for telecom base terminal stations and tower sites, the costs for site restoration would need to be factored upfront and included in the cost of the asset components. The major challenge here would be that many times it may not be evident from the contract whether an obligation exists or not. In IFRS, a provision would have to be made based on constructive obligation rather than legal obligation, so in all probability, such costs would need to be estimated and provided at the inception period of the terminal station or base site.

For telecom firms, it will be critical to evaluate whether provision/receipt of infrastructure services constitutes or contains a lease arrangement under IFRIC-4 on Determining whether an Arrangement contains a Lease, particularly since it involves use of specific assets with a right to control the use of the asset.

It is expected that their financial statements would change significantly if it is determined that such transactions contain an element of lease and more so if it satisfies the criteria for a finance lease. Under Indian GAAP, such arrangements are considered as those for providing services and not a leasing activity. Technology firms may also have such arrangements under outsourcing contracts, data storage or network facility use arrangements, where IFRIC-4 will need to be evaluated for applicability.

Telecom companies provide package offers comprising handset, prepaid minutes, messages, discounts, special offers and other incentives. Technology firms also enter into lump sum contracts for sale of licences, implementation fees, warranty, maintenance and free upgrade services over a period of time. Media firms often bundle and market space across various products, programmes or channels and publications/portals. Under IFRS, a key issue will be to determine whether the various components of a transaction can be separated from an obligation performance standpoint and commercial perspective. In such cases, bundled contracts and multiple offerings under a package will require fair valuation of different components and revenues would be recognized accordingly. Indian GAAP does not provide any specific
guidance on this and hence, inconsistent practices are presently being followed by various firms.

Under IFRS-2 on “Share-based Payment”, share-based payments also cover non-employees. If certain non-employee obligations are settled through employee stock options (Esops), IFRS will require fair value accounting for such options and cost differential between grant price and fair value will have to be recognized, either as a reduction of revenue or operating expense. Moreover, subsidiaries will need to account for Esop costs for options granted to its employees by the parent company with corresponding impact in capital contribution by the parent as per the requirement of IFRIC-11 on IFRS 2—Group and Treasury Share Transactions. This is not required under Indian GAAP. Another key aspect is that Indian GAAP allows intrinsic method of accounting. Here the Esop cost is generally lower since it only takes into account the value of the option as at the date of its grant and does not capture the likely accretion in fair value over the entire vesting period. Share based payment costs are expected to increase on application of IFRS.

Media firms also have common practice of giving advertising space for other services. These barter transactions would need to be accounted for using fair value method, provided that goods sold or services rendered are in exchange for dissimilar goods or services. Indian GAAP is largely inadequate on this matter, resulting in varying accounting practices.

IFRS entails discounting of receivables and payables to their current values using expected interest rates. In telecom firms, this concept of time value of money will have impact on the amounts recorded for long-term security deposits, payables falling due after a year and revenues earned in advance for long-term subscription arrangements.

In summary, convergence to IFRS for the new-age convergence firms is not going to be a cakewalk and will need significant preparation well in advance, so that they are ready for the IFRS Goes Live event effective 1 April 2010.

India will move to IFRS starting 2011. Navin Agrawal is a director with Ernst & Young India Pvt. Ltd. This is the sixth in a series that analyses the impact of IFRS on industries and regulatory issues pertaining to its convergence with Indian GAAP.
The use of international financial reporting standards (IFRS) as a universal financial reporting language is gaining momentum across the globe. Over a 100 countries in the European Union, Africa, West Asia and Asia-Pacific regions either require or permit the use of IFRS. The Institute of Chartered Accountants of India (ICAI) has recently released a concept paper on Convergence with IFRS in India, detailing the strategy for adoption of IFRS in India with effect from April 1, 2011. This has been strengthened by a recent announcement from the ministry of corporate affairs (MCA) confirming the agenda for convergence with IFRS in India by 2011. Even in the US there is an ongoing debate regarding the adoption of IFRS replacing US GAAP.

Adopting IFRS by Indian corporates is going to be very challenging but at the same time could also be rewarding. Indian corporates are likely to reap significant benefits from adopting IFRS. The European Union's experience highlights many perceived benefits as a result of adopting IFRS. Overall, most investors, financial statement preparers and auditors were in agreement that IFRS improved the quality of financial statements and that IFRS implementation was a positive development for EU financial reporting (2007 ICAEW Report on 'EU Implementation of IFRS and the Fair Value Directive').

There are likely to be several benefits to corporates in the Indian context as well. These are:

- Improvement in comparability of financial information and financial performance with global peers and industry standards. This will result in more transparent financial reporting of a company's activities which will benefit investors, customers and other key stakeholders in India and overseas;
- The adoption of IFRS is expected to result in better quality of financial reporting due to consistent application of accounting principles and improvement in reliability of financial statements. This, in turn, will lead to increased trust and reliance placed by investors, analysts and other stakeholders in a company's financial statements; and
- Better access to and reduction in the cost of capital raised from global capital markets since IFRS are now accepted as a financial reporting framework for
companies seeking to raise funds from most capital markets across the globe. A recent decision by the US Securities and Exchange Commission (SEC) permits foreign companies listed in the US to present financial statements in accordance with IFRS. This means that such companies will not be required to prepare separate financial statements under Generally Accepted Accounting Principles in the US (US GAAP). Therefore, Indian companies listed in the US would benefit from having to prepare only a single set of IFRS compliant financial statements, and the consequent saving in financial and compliance costs.

- However, the perceived benefits from IFRS adoption are based on the experience of IFRS compliant countries in a period of mild economic conditions. The current decline in market confidence in India and overseas coupled with tougher economic conditions may present significant challenges to Indian companies.

- IFRS requires application of fair value principles in certain situations and this would result in significant differences from financial information currently presented, especially relating to financial instruments and business combinations. Given the current economic scenario, this could result in significant volatility in reported earnings and key performance measures like EPS and P/E ratios. Indian companies will have to build awareness amongst investors and analysts to explain the reasons for this volatility in order to improve understanding, and increase transparency and reliability of their financial statements.

- This situation is worsened by the lack of availability of professionals with adequate valuation skills, to assist Indian corporates in arriving at reliable fair value estimates. This is a significant resource constraint that could impact comparability of financial statements and render some of the benefits of IFRS adoption ineffective.

Although IFRS are principles-based standards, they offer certain accounting policy choices to preparers of financial statements. For example, the use of a cost-based model or a revaluation model in accounting for investment properties. This could reduce consistency and comparability of financial information to a certain extent and therefore reduce some of the benefits from IFRS adoption. IFRS are formulated by the
International Accounting Standards Board (IASB) which is an international standard-setting body.

However, the responsibility for enforcement and providing guidance on implementation vests with local government and accounting and regulatory bodies, such as the ICAI in India. Consequently, there may be differences in interpretation or practical application of IFRS provisions, which could further reduce consistency in financial reporting and comparability with global peers. The ICAI will have to make adequate investments and build infrastructure to ensure compliance with IFRS.

In addition to the above, there are several impediments and practical challenges to adoption of and full compliance with IFRS in India. These are:

- The need for a change in several laws and regulations governing financial accounting and reporting in India. In addition to accounting standards, there are legal and regulatory requirements that determine the manner in which financial information is reported or presented in financial statements. For example, the Companies Act, 1956 determines the classification and accounting treatment for redeemable preference shares as equity instruments of a company, whereas these may be considered to be a financial liability under IFRS. The Companies Act (Schedule VI) also prescribes the format for presentation of financial statements for Indian companies, whereas the presentation requirements are significantly different under IFRS. Similarly, the Reserve Bank of India regulates the financial reporting for banks and other financial institutions, including the presentation format and accounting treatment for certain types of transactions.

The recent announcement by the MCA is encouraging as it indicates government support for the timetable for convergence with IFRS in India. However, the announcement stops short of endorsing the roadmap for convergence and the full adoption of IFRS that is discussed in ICAI's concept paper. In the absence of adequate clarity and assurance that Indian laws and regulations will be amended to conform to IFRS, the conversion process may not gain momentum.
• There is a lack of adequate professionals with practical IFRS conversion experience and therefore many companies will have to rely on external advisers and their auditors. This is magnified by a lack of preparedness amongst Indian corporates as this project may be viewed simply as a project management or an accounting issue which can be left to the finance function and auditors. However, it should be noted that IFRS conversion will involve a fundamental change to an entity's financial reporting systems and processes. It will require a detailed knowledge of the standards and the ability to consider their impact on business transactions and performance measures. Further, the conversion process will need to disseminate and embed IFRS knowledge throughout the organisation to ensure its application on an ongoing basis.

• Another potential pitfall is viewing IFRS accounting rules as "similar" to Generally Accepted Accounting Principles in India (Indian GAAP), since Indian accounting standards have been formulated on the basis of principles in IFRS. However, this view disregards significant differences between Indian GAAP and IFRS as well as differences in practical implementation and interpretation of similar standards. Further, certain Indian standards offer accounting policy choices which are not available under IFRS, for example, use of pooling of interests method in accounting for business combinations.

• There is an urgent need to address these challenges and work towards full adoption of IFRS in India. The most significant need is to build adequate IFRS skills and an expansive knowledge base amongst Indian accounting professionals to manage the conversion projects for Indian corporates. This can be done by leveraging the knowledge and experience gained from IFRS conversion in other countries and incorporating IFRS into the curriculum for professional accounting courses.

• Ultimately, it is imperative for Indian corporates to improve their preparedness for IFRS adoption and get the conversion process right. Given the current market conditions, any restatement of results due to errors in the conversion process would be detrimental to the company involved and would severely damage investor confidence in the financial system.
2.2.5 IFRS Adoption Impact on Corporate Governance

Come 2011, and audit committees and board members of Indian companies will have to deal with convergence of Indian GAAP (generally accepted accounting principles) with International Financial Reporting Standards (IFRS), which will have a key impact on their functioning, roles and responsibilities. The audit committees and board members will have to handle this challenge in an effective manner.

One of the basic features of IFRS is that it is a principle-based standard, unlike US GAAP, which is rule based. IFRS involves extensive use of judgement in selection of appropriate accounting policies and alternative treatments, including at the time of adoption. Also, IFRS requires valuations and future forecasts, which will involve use of estimates, assumptions and management’s judgements. It has been observed that the combination of all these factors can have a significant impact on the reported earnings and financial position of an enterprise. So far, audit committees and board of directors largely had an oversight role on accounting matters. With IFRS, this role is set to get enhanced considerably.

Therefore, in the next two years, audit committees and boards in India will have to specifically focus on how well companies are geared for the transition to IFRS. The members responsible for governance will have to spend considerable time in ensuring appropriate convergence of Indian GAAP with IFRS. They must be aware of the options available under IFRS, the choices made and the reasons for making these choices. Further, they must understand the impact of convergence on significant accounting matters and their likely effect on financial statements.

IFRS will not merely be a technical accounting conversion. Convergence will impact most business aspects, including structuring of contracts with customers and vendors, performance appraisal parameters and reward plans, and managing external investor relations and communication. Therefore, it will be imperative for governing members to have a detailed knowledge of the impact of IFRS on a company’s business. How will it impact business processes, including the IT system? Is the core team leading the IFRS conversion process adequately trained or not? How will the company communicate the impact of IFRS to its investors and lenders? Will this result in any tax or regulatory issues?
It will be most critical for boards to monitor the quality and robustness of the conversion process and the road map to IFRS. Essentially, IFRS will be a significant change that will need to be managed properly.

Under IFRS, prior years’ errors and omissions will have to be effected through restatement of previously declared results, which will be a critical change from prevailing practices in India. With IFRS, the complexities involved in preparing financial statements will increase manifold, thereby increasing the risk of errors and omissions. There is a strong likelihood that Indian companies will start restating accounts soon, much like their peers in the US do. As many as 1,538 restatements were filed in 2006 by US companies.

Usually, investors and regulators look at any restatement negatively, so audit committees and board members will need to manage and address this risk effectively. Moreover, restatements may be viewed with suspicion by tax authorities in India, who may not be able to understand the changes emanating from convergence with the IFRS reporting framework.

A survey of audit committees and board members of at least 176 US corporations carried out by Ernst & Young in 2006 disclosed some interesting facts. Only 25% of the respondents indicated that they have a formal plan for dealing with financial errors and irregularities, and merely 40% had a formal continuing education process, with the time spent annually being around 10 hours for most members. The state of preparedness in India is unlikely to be any better, but with IFRS kicking in, all of this needs attention and needs to change. Board members will have to be prepared to commit significant time and resources to deal with business and accounting issues arising out of convergence with IFRS.

The biggest challenge for members charged with governance will be to manage stakeholder expectations in terms of meeting targets and key performance indicators, declaring dividends and explaining variations and volatility in earnings on a quarterly basis. This is a challenging task even now, but with the arrival of IFRS, the challenge is set to assume a different dimension. Audit committees and board members should start preparing for this challenge now.
India will move to IFRS starting 2011. Navin Agrawal is a director with Ernst & Young India Pvt. Ltd. This is the third of a series that will analyse the impact of IFRS on industries and regulatory issues pertaining to its convergence with Indian GAAP.

2.2.6 IFRS Adoption Impact on Financial Statements

This section briefly reviews more recent empirical studies conducted to examine the impact of IFRS on key financial aspects emanating from the financial statements of companies. Wong and Wong (2005) examined to explore the impact of not amortizing goodwill and identifiable intangible assets with in definitive lives on some commonly used valuation multiples of New Zealand listed companies. Results indicated that these have a significant downward effect on EV/EBIT and PE multiples. Hope et al. (2006) investigated the importance of IFRS in the context of global accounting standards harmonization and to know what institutional factors influence countries decision to voluntarily adopt IFRS. This study discerned a significant negative association between the adoption of IFRS and investor protection.

Lantto (2007) examined whether IFRS improved the usefulness of accounting information in a code law country that has a strong system of legal enforcement and high quality domestic accounting standards. The result of this study indicated that IFRS have improved the relevance of accounting information in Finland but they also highlighted the concern about reliability of those financial statement items that are prepared using judgement. Capkun et al. (2008) analyzed the impact of mandatory change in financial reporting standards in European Union and found that the transition from local GAAP to IFRS had a small but statistically significant impact on total assets, equity, total liabilities and among assets the most pronounced impact on intangible assets and property plant and equipment. It was examined by Ball (2008) whether an investor got benefit from implementing IFRS or it is just like a mirror which makes him “far from reality”. In case of direct benefit, IFRS offer increased comparability and hence reduced information costs and information risk to investors. And in case of indirect benefit, IFRS lead to a reduction in firms cost of equity capital, the researchers observed.
Extant literature generally makes comparisons between IAS and U.S. GAAP (e.g., Harris and Muller 1999; Ashbaugh and Olsson 2002), non-U.S. and U.S. GAAP (e.g., Amir, Harris and Venuti 1993) and across different local standards including U.S. GAAP (Ali and Hwang 2000; Ball, Kothari and Robin 2000). This literature, however, rarely compares IAS with local GAAP. Prior literature examines this question based on cross-sectional comparisons across different countries and concludes that the shareholder-oriented model is generally more value relevant than the stakeholder-oriented model (Ali and Hwang 2000; Ball et al. 2000). The literature, however, is unable to disentangle whether this finding is driven by the difference in accounting standards or other institutional factors such as shareholder protection or market development.

Recently there has been a push towards the adoption of IFRS developed and issued by the International Accounting Standards Board (IASB). The increasing growth in international trade, cross border financial transactions and investments which unavoidably involves the preparation and presentation of accounting reports that is useful across various national borders, has brought about the adoption of IFRS by both the developed and developing countries (Armstrong et al., 2007). The process of adoption received a significant boost in 2002 when the European Union adopted a regulation 1606/2002 requiring all public companies in the territory to convert to IFRSs beginning in 2005 (Iyoha and Faboyede, 2011). A number of African countries including Nigeria, Ghana, Sierra Leone, South Africa, Kenya, Zimbabwe and Tunisia among others have adopted or declared intentions to adopt the standards. In particular, Nigeria adoption of IFRS was launched in September, 2010 by the Honourable Minister, Federal Ministry of Commerce and Industry – Senator Jubriel Martins-Kuye (OFR) (Madawaki, 2012). The adoption was planned to commence with Public Listed Companies in 2012 and by end 2014 all stakeholders would have complied. As at today, banking sector has fully implemented. This is considered a welcome progress for developing countries especially some of those that had no resources to establish own standards.

There are proponents as well as opponents who have arguments for and against the global adoption of IFRS. According to Barth (2007), the adoption of a common body of international standards is expected to have the following benefits: lower the cost of
financial information processing and auditing to capital market participants as users, familiarity with one common set of international accounting standards instead of various local accounting standards by Accountants and Auditors of financial reports, comparability and uniformity of financial statements among companies and countries making the work of investment analysts easy, attraction of foreign investors in addition to general capital market liberalization. Ball (2006) stated that many developing countries where the quality of local governance institutions is low, the decision to adopt IFRS will be beneficial.

Lipsey and Chrystal (2003) noted that FDI often generates somewhat higher-paying jobs than might otherwise be available to local citizens, it generates investment that may not be possible with the local resources only, it links the recipient economy into the world economy in manners that would be hard to achieve by new firms of a purely local origin. According to Lipsey and Chrystal (2003) the FDI alters country’s comparative advantages and improves its competitiveness through technology transfer and effects myriad externalities, domestic investment which can alter a country’s volume and pattern of trade in many income enhancing directions.

Countries that suffer from corruption, slow-moving, or ineffectual government are likely to resistant the change (La Porta et al., 1999) but in such countries, the opportunity and switching costs are lower which makes the possibility of adopting IFRS advantageous. Kumar (2007) the foreign capital has the potential to deliver enormous benefits to developing nations. in addition to helping bridge the gap between savings and investment in capital-scarce economies, capital often brings with it modern technology and encourages development of more mature financial sectors. Capital flows have proven effective in promoting growth and productivity in countries that have enough skilled workers and infrastructure. Some economists believe capital flows also help discipline governments’ macroeconomic policies.

GAB (2012) stated that one of the demerits that will be experienced by countries adopting of IFRS include: forgoing the benefits of any past and potential future innovations in local reporting standards specific to their economies. Single set of accounting standards cannot reflect the differences in national business practices arising from differences in institutions and cultures (Armstrong et al., 2007). The Nigeria accounting regulatory includes: the Companies and Allied Matters Act 1990 which
stipulate the format, content and scope of the financial statements, disclosure requirement and auditing. It also requires that financial statements of companies comply with statements of accounting standards (SAS) issued from time to time by NASB and audit carried out in accordance with generally accepted auditing standards. Secondly, Nigerian Accounting Standards Board (NASB) Act No.22 of 2003 as the only independent body responsible for developing and issuing SAS for preparers and auditors of financial statements of business concern and government agencies (Madawaki, 2012).

Although many countries have faced challenges in their decisions to adopt IFRS, its wide spread adoption has been promoted by the argument that the benefits outweigh the costs (Iyoha and Faboyede, 2011). The existing theoretical models imply that FDI is beneficial for host country’s economic growth. According to traditional economic theory (law of diminishing returns), FDI will tend to concentrate in less developed countries, where there exist greater opportunities to achieve higher returns. In order for FDI to become productive in developing countries, the following conditions should exist: (i) the existence of a minimum threshold level of human capital (Borensztein et al, 1998), improved domestic infrastructures (de Mello, 1999), and a developed local financial systems (Alfaro et al, 2006). Out of all, the last prerequisite seems to have more weight in order for FDI to flow into any developing country and have a measurable impact on economic growth. Lack of these requirements has resulted in imbalanced in the FDI distribution across many developing countries. Some of the countries are facing difficulties in attracting foreign investors. FDI is considered as an important channel for direct technology distribution and may be the major vital conduit for technology transfer because of the scarcity of financial resources and the urgent need for reconstruction in many developing countries (Hossein & Yazdan, 2012). Within this framework it is expected that FDI will contribute to economic growth, indirectly by accelerating the diffusion of general purpose technologies (Hossein & Yazdan, 2012).

The IFRS is a global GAAP, setting principles–based and globally accepted standard published by the IASB to support those who adopted in the preparation and presentation a high quality, transparent and comparable financial statements that will aid easy interpretation. Okoye & Akenbor (2012), the perceived challenges to be presented by IFRS adoption and implementation includes: the intrinsic problems of aligning with
IFRS pointed out that international accounting clearly has a language problem (Ukpai, 2002). Adams (2004) claimed that where an accounting standard conflicts with government policy, the standard is revised such as the LIFO method of stock valuation not allowable for tax purpose in Nigeria. Another problem inherent with the adoption of IFRS is the universal tendency to resist change (NASB 2010). Gambari (2010) noted that the successful adoption of IFRS entails assessing technical accounting, tax implications, internal processes, and statutory reporting, technology infrastructure, and organizational issues. FDI has been defined in several ways. According to Kumar (2007) FDI which involves building long-term relationships with enterprises in foreign countries can be made in several ways. First, and most likely, it may involve parent enterprises injecting equity capital by purchasing shares in foreign affiliates. Second, it may take the form of reinvesting the affiliate’s earnings. Third, it may entail short- or long-term lending between parents and affiliates. To be categorized as a multinational enterprise for inclusion in FDI data, the parent must hold a minimum equity stake of 10 percent in the affiliate (Kumar, 2007). Garkovic and Lavin (2002), noted that economic rationale for offering special incentive to attract FDI frequently is derives from the belief that foreign investment produces externalities in the form of technology transfer and spillovers. DeGregorio (2003), while contributing to the importance of FDI noted that it allows a country to bring in technologies and knowledge that are not readily available to domestic investors and increases productivity throughout the economy (Oyetoye et al., 2011). Jeffrey and Spaulding (2005) also stated that FDI advantage includes; circumventing trade barriers, hidden and otherwise making the move from domestic export sales to a locally-based national sales office and capability to increase total production capacity Opportunities for co-production, joint ventures with local partners, joint marketing arrangements. In recent times, it was revealed that FDI in Nigeria have been declining (NASB, 2010).

According to NEF (2011) the trend shows that the value declined from $6.9 billion in 2007 to about $4.602 billion in 2008 and $3.94 billion in 2009 and $6.1b in 2010. The decline in 2010 was due to ongoing uncertainty related to the proposed Petroleum Industry Bill (PIB) as well as political unrest in the some section of the country. The new FDI was estimated at $6.8bin 2011. Nigeria is the third largest recipient of FDI in Africa after Angola and Egypt.
Large number of studies in various parts of the world analysed the impact of IFRS on corporates. They all found that the adoption of IFRS has had a positive impact on entities, financial reporting and wider economic settings. Daske et al. (2008) and Li (2010) examined the impact of IFRS adoption on international capital markets. Daske et al. (2008) found that firms adopting IFRS in the year of mandatory adoption experience large increases in market liquidity but mixed results for the cost of capital. However, Li (2010) examined the effect of IFRS on the cost of equity in the European Union and found that mandatory adopters of IFRS experience significant reductions in the cost of capital in the years of mandatory adoption, but only in countries with strong legal enforcement.

European Union and found that mandatory adopters of IFRS experience significant reductions in the cost of capital in the years of mandatory adoption, but only in countries with strong legal enforcement.

Other studies have examined the effects of IFRS adoption on accounting quality. Goodwin and Ahmed (2006) studied the impact of IFRS in Australia in relation to the size of entities. Smaller firms had fewer adjustments upon IFRS adoption and experienced increases in net income and equity. In contrast, larger firms had many adjustments, negligible increases to net income, as well as a decrease in equity. Their conclusion is that the adoption of IFRS has been found to have little impact on the accounting quality of smaller firms, and a larger impact on the accounting quality of larger firms. In a similar study, Goodwin, Ahmed and Heaney (2007) found, that on an average, IFRS caused increases in liabilities and leverage ratio and decreases in equity and earnings. These findings are consistent with the results of Hung and Subramanyam (2007), who focused on the detailed financial statement effects of adopting IFRS by using a direct comparison of financial statements prepared under IFRS and German GAAP.

Barth, Landsman and Lang (2008) examined an increase in accounting quality resulting from the adoption of IFRS in 21 countries that previously used domestic GAAP. They concluded that entities that prepare their financial statements under IFRS 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. They also concluded that the quality of accounting information is higher for firms that apply
IFRS than for those that do not. Additional information about the impact of IFRS adoption on financial statements comes from studies that extended the analysis to common financial ratios (Stent, Bradbury and Hooks 2010). Stent et al. (2010) found that adoption of IFRS in New Zealand led to a significant increase in liabilities and a decrease in equity for private sector entities. Adjustments to income taxes, employee benefits and financial instruments were the main reasons for increases in liabilities and decreases in equity.

With Indian GAAP (generally accepted accounting principles) converging with the International Financial Reporting Standards (IFRS), most accounting areas will undergo a significant change. The impact on financial statements of some of the changes are outlined in this article.

Negash (2008) examine the IAS adoption effect on the Johannesburg Securities Exchange (JSE) listed firms using a version of the Ohlson model (book value plus earnings and dividends). He applied a four-year window period to examine the value relevance of accrual accounting information in pre liberalization (pre IAS adoption period of 1989-1993) and post IAS adoption period (1998-2004). The study had a liberalization (integration) perspective and concluded that when scale effects were controlled the difference in panel regression r-squares vanished; suggesting that the value relevance of accounting information did not improve in the post IAS adoption period. Furthermore, the results indicated that the relationship between year-end equity prices and accrual accounting variables could no longer be explained by linear models.

Barth, Landsman and Lang (2008) develop a comprehensive index for financial reporting quality. It is composed of: (1) earnings management (including earnings smoothing) indicators, (2) timely recognition of losses, and (3) value relevance of accrual accounting information. Barth, Landsman, Lang & Williams (2008) examine these indicators using cross country data, pooled regression, control variables and matched samples, in pre IAS adoption and post IAS adoption periods. They concluded that IAS adoption has been associated with lower earnings management, more timely recognition of large losses and more association between equity prices and book value and earnings/returns. Earnings management was defined following Durtschi and Easton (2004), Brown and Higgins (2001) and Healy and Wahlen (1999). A number of papers
emerging from economies and Euro zone countries have documented that firms manipulate their financial statements to show small increases in profits or avoid reporting losses (Kinnunen & Koskela, 2003; Rabin & Negash, 2007).

2.2.6.1 Business Combinations

Under Indian GAAP, acquisitions are accounted at book values of identifiable assets and liabilities of the acquiree, with the excess of consideration over the net book value recognized as goodwill. Under IFRS, accounting is done for all assets including hidden intangibles at fair value. As the assets are recognized at fair value, amortization of these assets will reduce future year profits under IFRS.

IFRS requires expensing of acquisition-related costs, whereas the practice under Indian GAAP is to capitalize such expenses as cost of investment. Performance-related consideration paid to the acquiree, known as contingent consideration, is accounted at fair value under IFRS, with subsequent changes included in the profit and loss (P&L) account. Under Indian GAAP, the impact of contingent consideration is generally included in the cost of investment.

Generally, it is expected that IFRS accounting of business combinations will have a negative impact on the future P&L account of Indian companies.

2.2.6.2 Consolidation

Many Indian companies, for legal or operational reasons, operate through structured entities known as special purpose entities (SPEs). SPEs are common in securitization transaction, land acquisitions, outsourcing and sub-contracting arrangements. Many of these arrangements are not consolidated under Indian GAAP as they do not meet the definition of a subsidiary under the Companies Act. Under IFRS, many such SPEs may have to be consolidated as these entities are in substance controlled through an auto-pilot mechanism or through legal/contractual provisions determined at inception. The consolidation of SPEs under IFRS may have a substantial impact on the P&L account, net asset and gearing position, and also certain key ratios such as debt-equity.
As per the Accounting Standard – 23 (AS – 23) on consolidation of Financial Statement of entities, the consolidation of financial statements are purely based upon the ownership and control over the another organization. As per the existing Accounting Standards, consolidation is not mandatory for all organization. However, as per IFRS, the consolidation is mandatory for all the organization. The measurement and test of ownership shall also be change in the IFRS. It has covered the potential voting rights other than the actual stakeholders. The potential voting rights includes all those whose debts or shares are required to be converted in to equity capital of the company. Indian industries are not practicing any such type of inclusions for examining the applicability of standards on consolidation of financial statements.

The convergence of IFRS shall have impact on all the above things. It is difficult to measure the level of difficulty faced by the Indian banking industry for hedging the risk over investments and advances. At present, many representations have been received by the Institute of Chartered Accountants of India as well by the Ministry of Corporate Affairs from the Indian banking industry for deferment of convergence by some more periods. Further the convergence shall be required for prudential norms of Reserve Bank of India, because it would be difficult for Indian banks to make the two compliances at a single time for different classes of assets.

2.2.6.3 Employee Stock Ownership Plans (ESOPS)

Under IFRS, ESOPs are accounted using the fair value method, which results in a P&L charge. In contrast, Indian GAAP permits ESOPs to be accounted for using either the intrinsic value method or the fair value method, and most entities follow the intrinsic method. The intrinsic method does not result in a P&L charge unless the ESOPs are priced at a discount over the intrinsic price. Compared to Indian GAAP, IFRS will result in lower profits for companies that use ESOPs for remunerating employees.

IFRS involves much more than reorganizing the chart of accounts. It represents a change that cascades well beyond the finance department. Consequently, human resources issues may be a major concern. A conversion project will place increase in demands of the trained and professional personnel, which may come at a time when they are able to handle it. It shall enhance the wages cost as percentage of the total expenses for the bank. To illustrate, State Bank of India & its associates has 17.03
percent wages of their total expenses in financial year 2009 - 2010 as compared to 15.06 percent and 15.89 percent in 2008 – 2009 and 2007 – 2008. This cost shall further increase after the appointment of the trained and professional staff for the implementation of the IFRS in the bank.

2.2.6.4 Financial Instruments

IFRS requires a financial instrument to be classified as a liability or equity in accordance with its substance. For example, mandatorily redeemable preference shares are treated as a liability and the preference dividend is recognized as interest cost. Under Indian GAAP, classification is normally based on form rather than substance. Thus, these shares are recorded as equity and the preference dividend as dividend rather than as interest cost. Compared to Indian GAAP, IFRS will show the firm as more geared and profits would be lower as a result of preference dividends being treated as interest.

Many Indian companies use foreign currency convertible bonds (FCCBs) for their funding requirements. Under Indian GAAP, the redemption premium is charged to the securities premium, and the conversion option is not accounted for. Consequently, for many companies FCCBs result in minimal or no charge to the P&L account.

Under IFRS, FCCBs are split into two components—the loan liability and the conversion option. The loan liability accretes interest at market rates and is also adjusted for exchange rate movements. Thus, the charge to profits under IFRS are higher than under Indian GAAP. The conversion option is marked to market at each reporting date, and the impact is recognized in the P&L account. This will have a significant impact on the volatility of profits under IFRS. If the fair value of the underlying shares rises, mark to market of the conversion option would lead to losses in the P&L and vice-versa.

The Institute of Chartered Accountants of India has issued AS – 30, AS – 31 and AS – 32 respectively in parallel to International Accounting Standards – 39 (IAS – 39) on Financial Instruments. Financial Instruments: Recognition and Measurement is one of the typical standards for those organizations which use financial instruments in their financial statements especially banking industry. It shall have an impact over the income of the industry. To illustrate the forthcoming key standard IFRS 9, Financial
Instruments: Classification and Measurement prescribes two options for the classification of financial assets, i.e. amortized cost or fair value. Amortized cost classification is only permitted, if two conditions are met. First, the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flow. Second, the contractual terms of the financial asset gives rise to cash flows on specified dates that are solely payments of principal and interest on the principal outstanding. When there is more than one infrequent number of sales in a portfolio held at amortized cost, the entire portfolio would have to be accounted for at fair value.

It is important to note that a single entity may have more than one business model for managing its financial instruments, i.e. an entity may hold a portfolio of debt securities that it manages in order to collect contractual cash flows and another portfolio of similar debt securities that it manages in order to trade and realize fair value changes. Banks in India invest in government securities to comply with RBI’s statutory liquidity ratio prudential norms. As per current RBI rules, the majority of such investments are accounted for at amortised cost under the ‘held to maturity’ classification. Unless the bank has a clear strategy, sufficient expertise in their portfolio management and a demonstrable history of business models in place, it may well ‘taint’ an amortised cost portfolio with the result of having to measure the entire portfolio at fair value, causing undesired volatility in their financial statements.

**2.2.6.5 Derivatives**

Under Indian GAAP, companies may not have fair-valued derivatives and embedded derivatives on their books as there are no mandatory standards. Many that have fair-valued derivatives have not recognized losses as they claim those to be for hedging purposes. Under IFRS, all derivatives and embedded derivatives are fair-valued, and hedging is permitted only where stringent criteria relating to documentation and effectiveness are fulfilled. Therefore, in practice, many Indian companies may not be able to apply hedge accounting unless they develop appropriate systems to be able to do so. Consequently, these companies are likely to experience significant volatility arising out of gains and losses on the derivative portfolio.

Under the existing Accounting Standards – 30 (AS – 30) on Financial Instruments: Recognition and Measurement. The derivatives are valued at the fair value in the
Balance Sheet after making provision for difference in Income Statement for the fair value of such derivatives. The present standards do not require the documents for measurement for fair value for disclosures in the Balance Sheet and Income Statement. However, under the IFRS, all such documents for measurement of fair value must be documented. Besides the documents, hedge effectiveness testing and ineffectiveness testing are also required for measurement of fair value. However if hedge relationship for the qualifying cash flows can be established, fair value measurement need not be applied to such derivatives. It shall have direct impact over the re-measurement of the existing derivatives and hedging instruments.

2.2.6.6 Revenue Recognition

Under Indian GAAP, sales made on deferred payment terms are recognized at the nominal value of consideration. Under IFRS, they are accounted as a combination of financing and operating activity. The fair value of the revenue is recognized in the period of sale whereas the imputed interest amount is recognized as interest income over the credit term. Compared to Indian GAAP, revenue under IFRS will be lower, and earnings before interest, tax, depreciation and amortization will also be lower, as the financing component will be recognized as interest income.

IFRS will require companies to make significant new disclosures. The reviews of the 2005 financial statements of European companies indicate that financial disclosures under IFRS increased by more than 30%, compared with their previous disclosures.

2.2.7 IFRS Adoption Impact on Disclosure

From humble beginnings in 1973, through a series of reforms including the Comparability and Improvements Project (1989-1993) and the “core standards” project (Schweikart, Gray & Salter, 1996, p.113), IFRSs and their predecessors International Accounting Standards (IASs) have become since the early 2000s a serious challenge to US GAAP. In 2005, over 100 countries had adopted IFRS including countries of the EU. In Asia, IFRS was adopted for all companies by the Philippines, Australia and Hong Kong in 2005 and by China and New Zealand in 2007.
Adoption of IFRS did not happen in the same way for each of these countries, but for our purposes it was complete by 2007. In the Philippines, a gradual adoption of IAS/IFRS had been underway from 2001, but was complete in 2005 (IASPlus, Philippines, January and November 2005 updates). In Australia, despite a process of convergence of domestic GAAP with IFRS, many differences still remained between Australian GAAP and IFRS in 2005 when the final changeover occurred. IFRS were fully converged with Hong Kong standards in 2005 (IASPlus, Hong Kong, January 2005 update). In China, adoption of IFRS in 2007 was for listed companies only and contained “certain modifications that reflect China's unique circumstances and environment” (IASPlus, China, April 2006 update).

By contrast, domestic GAAP in our other four countries still remains different to IFRS. Singaporean GAAP will not be fully converged with IFRS until 2012 (IASPlus, Singapore, May 2009 update). Japan in 2011 deferred mandatory IFRS adoption but permitted some companies to adopt IFRS voluntarily (IASPlus Japan, June 2011 update). Malaysia finalised IFRS-compliant standards only in November 2011 (IASPlus, Malaysia, June and November 2011 updates). In 2011, India issued 35 new standards which were converged with IFRS but still contained significant differences from IFRS (IASPlus, India, February 2011 update).

Main focus is on IFRS disclosure rules. These are very extensive, much more than countries’ domestic GAAP. In our eight countries, the proportion of our IFRS-based disclosure checklist (discussed later) also contained in countries’ domestic GAAP in 2002 ranges from .43 (China) to .88 (Singapore) with five countries in the range .68 to .74. All else equal, we expect that the adoption of IFRS will lead to an increase in disclosure levels.
2.2.7.1 Country-Level Controls

As mentioned, Ball (2006) conjectures that the success of IFRS adoption will be dependent on the basic financial regulatory infrastructure of the adopting country.

COUNTRY LEGAL SYSTEM

The works of LaPorta et al., (1998, 1999) have had an important influence on empirical research into cross-country differences in accounting standards and practices. They show that countries with English common law legal systems tended to have better economic development, stronger capital markets, better accounting standards and better enforcement than countries with code law legal systems. The distinction between common-law and code law countries, and differences in enforcement and economic development have been used as country-level determinants in many recent accounting studies, using either the LaPorta et al. data or more recent measures, for example Ball et al. (2003).

La Porta et al. (1998, tables 5 & 6) show that countries with English common law systems have significantly better quality accounting standards than countries with German-origin legal systems, these countries in turn having significantly better quality accounting standards than countries with French-origin legal systems. For a series of enforcement mechanisms, La Porta et al. also found that civil law countries are significantly weaker than English common law countries. Since disclosure practices (not examined by La Porta et al.) will be influenced by both the quality of accounting standards and their enforcement, our first control proposition is that:

Control proposition 1: Disclosure levels in countries with common law legal systems will be higher than those in countries that have code law legal systems

Country legal system has the advantage of likely being an exogenous factor, given that legal systems have been in place for very long periods, often from countries’ colonial days – for instance, all English common law countries in our sample were once British colonies. However, legal system by itself is unlikely
to be a sufficient condition for corporate disclosure. Therefore, related but more proximal influences must also be explored.

**ENFORCEMENT**

Based on the aforementioned evidence of La Porta et al. (1998), the first of these more proximal factors is enforcement of laws. Where enforcement is strong, mandatory disclosure rules ensure better access to basic financial information. Where enforcement is weak, the mere adoption of IFRS by a country is one vital step towards improved transparency, but it is not a sufficient condition (Ball, 2006). Domestic standards, in some cases identical to IFRSs, coupled with comparatively weak enforcement mechanisms, are found in some Asian countries (Ball et al. 2003). Accordingly our second control proposition is that:

Control proposition 2: Corporate disclosure levels will be higher in countries where enforcement of rules is stronger.

Other studies use compilations of data from La Porta et al. (1998) to construct enforcement indexes (such as Francis et. al. 2005; Bhat, Hope & Kang, 2006). However, La Porta et al. did not cover China, so that approach is not available to us. Instead we measure enforcement using the Rule of Law variable, averaged for 2002 and 2007, from Kaufman, Kraay & Mastruzzi (2003). Rule of Law measures the extent to which citizens of a country have confidence in and abide by that country”s laws (Kaufman et al., 2003, p. 4).

**SIMILARITY OF LOCAL STANDARDS TO IFRS**

Another proximal variable to control for is the closeness of domestic GAAP to IFRS before the adoption of IFRS. Countries whose domestic GAAP in 2002 was closer to IFRS should have disclosure levels closer to IFRS and thus increase less after IFRS was adopted.

Control proposition 3: Corporate disclosure levels will be influenced by the closeness of domestic GAAP to IFRS
NATIONAL CULTURE

The cultural dimensions of uncertainty avoidance, power distance, individualism and masculinity derived by Hofstede (1980) and Hofstede & Hofstede (2005) were applied to accounting values and accounting practices by Gray (1988), and have since produced a stream of analytical and empirical papers in international accounting. Uncertainty avoidance measures the extent to which a society tolerates ambiguity and uncertainty. Power distance measures how a society handles inequality among its members. Individualism measures the extent to which individuals versus groups in society. Masculinity measures the extent to which masculine-type attitudes are preferred over feminine-type attitudes in a society.

Using Hofstede’s cultural dimensions, Gray (1988) developed the four accounting value dimensions of statutory control versus professional regulation of accounting, uniformity versus flexibility of accounting rules, conservatism versus optimism in accounting measurement, and transparency versus secrecy in accounting disclosures. The last of these dimensions – transparency versus secrecy - is of relevance to our disclosure study. Gray (1988, p. 11) argued: “the higher a country ranks in terms of uncertainty avoidance and power distance and the lower it ranks in terms of individualism and masculinity, then the more likely it is to rank highly in terms of secrecy.” Therefore we expect firms from such countries to have poorer financial reporting transparency. Put another way, firms will likely have higher disclosure levels if they come from countries with low uncertainty avoidance, low power distance, high individualism and/or high masculinity cultural scores. Accordingly, we expect that:

Control proposition 4: Corporate disclosure levels will be higher in countries with a lower secrecy orientation

We use the Secrecy measure provided by Braun & Rodriguez (2008), which is a mathematical combination of Hofstede’s four cultural dimensions of uncertainty avoidance, power distance, individualism and masculinity. Broadly speaking, for each Hofstede cultural dimension, Braun & Rodriguez (2008) calculate the difference between each country’s score and the mean score across 56 countries for that dimension. Each country then has “difference” scores for
uncertainty avoidance, power distance, individualism and masculinity. The secrecy score for each country is the sum of its “difference” scores for uncertainty avoidance and power distance minus its “difference” scores for individualism and masculinity. The resultant secrecy score thus makes use of all four Hofstede cultural dimensions and is influenced by the country’s relative position above or below the mean on each cultural dimension.

2.2.7.2 Firm-Level Controls

No single theory addresses all the incentives for firms” disclosures. Instead the problem has been examined from several theoretical perspectives including agency theory (Jensen & Meckling, 1976; Watts & Zimmerman, 1986); signalling theory (Spence, 1973) and related benefit-cost analyses (Verrecchia, 1983, 1990). However, these perspectives are consistent conceptually5 so all may be used in hypothesis development. At their core, our firm-level hypotheses are based on the relationship between those who control the firm on the one hand, and its external suppliers of equity or debt finance on the other.

The separation between outside owners and inside managers of companies creates agency costs (Jensen & Meckling, 1976). In the USA, separation between management and shareholders is common in listed companies (Berle & Means, 1932). However in Asian countries, family/insider control of companies is common (La Porta et al., 1999, Claessens, Djankov & Lang, 2000), so that the key agency problems are those between inside shareholders and outside shareholders. These agency problems include the transfer of wealth away from outside shareholders to insiders, a phenomenon known as “tunnelling” (Johnson, La Porta, Lopez-de-Silanes & Shleifer, 2000). Nobes (1998) characterises countries where insider ownership predominates as insider dominant countries. The larger the holdings of inside shareholders, the less likely will public disclosure of information occur because insiders have access to information internally and may also wish to hide any tunnelling activities from outsiders. La Porta et al.”s (1998) study shows that there is a strong negative correlation between the extent and effectiveness of investor protection laws and ownership concentration. They find that emerging markets tend to have relatively poor investor protection laws (bad laws per se, or good laws poorly enforced) and high ownership concentration, particularly
among East Asian firms. Thus inside control at the firm level could be associated with poor rule enforcement at the country level.

Conversely, the larger the cumulative holdings of small outside shareholders, the greater their demand for information and the more likely the company is to supply it, all else equal. Nobes (1998) characterises countries where outside shareholders predominate as outsider dominant countries.

Companies that have recently raised equity or debt finance, at home or abroad, are also likely to face pressures for increased disclosure, as is shown by the empirical evidence (for example, Firth, 1980; Meek, Roberts & Gray, 1995). Similarly, the multinationality of companies (which we proxy by whether they have international sales) will influence disclosure as a way for firms to provide information to current and potential customers or investors without local domestic knowledge of such firms (Jaggi & Low, 2000). Similarly, companies which rely extensively on debt financing from external sources face an information asymmetry problem with their lenders. Therefore, all else equal, there should be a positive association between disclosure and leverage.

Signalling theory (Spence, 1973), by which high quality firms take costly-to-copy actions that signal their superior quality to the market, is a theory consistent with reducing agency costs (Morris, 1987). Disclosures are one such costly signal. Signalling costs include direct preparation costs, proprietary costs and, in some cases, political costs, as well as the cost incurred if the signal is false. Quality can be equated with profitability and larger firm size. More profitable firms will disclose more so that investors can assess better the credibility of their reported earnings. For example, Miller (2002) reports that US firms with increases in earnings also increase their voluntary disclosures. Larger firms are expected to disclose more because they are usually more successful and wish to convey that information to the market. Also, larger firms, having more market power, might disclose more because, compared to smaller firms, they are less likely to face competitive losses (Hossain, Perera & Rahman, 1995). Larger firms may also disclose more because they have the accounting expertise to do so. Of course, larger firms might simply have more to disclose than smaller firms. An example is firm complexity: all else equal, a company which operates in many different businesses has more to tell the market than one which operates in only one line of business. Therefore we expect more diversified firms to be more transparent than less diversified firms.
Research has consistently found that larger firms disclose more than smaller firms (Foster, 1986; Chow & Wong-Boren, 1987; Meek, Roberts, & Gray, 1995; Hossain, Perera & Rahman, 1995); but the evidence on the association between disclosure and profitability and business complexity is mixed and inconclusive.

A company’s choice of audit firm can also act as a signal of quality (Bar-Yosef & Livnat, 1984). Larger audit firms, as typified by the now Big 4, are usually perceived to be of higher quality than smaller audit firms (DeAngelo, 1981; Chow & Wong-Boren 1987; Hossain et al., 1995). Larger auditors have incentives to ensure that client companies comply with accounting standards. Therefore the presence of a Big 4 auditor should be associated with better disclosure. Street & Gray (2001) show that companies claiming to comply with IFRSs in 1999 did so more comprehensively if they were audited by a large audit firm. In like fashion, the adoption of firm-level corporate governance mechanisms can act as a signal of quality. Such mechanisms are aimed at protecting outside shareholders. Therefore, I expect that internal corporate governance mechanisms will be associated with more disclosures, all else equal.

In summary, our fifth control proposition is that:

Control Proposition 5 Companies will have higher disclosure levels if they:

(a) They have more outside shareholders;

(b) They have fewer inside controlling shareholdings;

(c) They have recently raised equity or debt finance;

(d) They have international sales

(e) They are larger;

(f) They have more business segments;

(g) They are more profitable;

(h) They employ a Big-4 auditor; and/or

(i) They have more internal corporate governance mechanisms.
2.2.8 IFRS Adoption Impact on Financial Discussion

As emphasized by Laux and Leuz (2009a) “The recent financial crisis has led to a vigorous debate about the pros and cons of fair-value accounting”, involving not only academia and accounting regulators, but also the top political level such as the European Commission and the US Congress. However, the 2005 issuance of IFRS by the IASB as well as the systematically move towards market-based measures by the FASB and IASB since the mid-1980’s put the discourse on FVA on the accounting research agenda prior to the crisis (Hitz 2007). Additionally, the IASB and FASB joint conceptual framework project has further spurred the debate on FVA (Wittington, 2008).

In a paper in Ernst & Young’s IFRS Stakeholder Series named “How fair is fair value?” (Lindsell 2005) published at the abovementioned 2005 issuance of IFRS some of their major concerns regarding fair value accounting, as defined under IFRS, are highlighted. It is argued that while the changes in fair value of an asset or liability from one balance sheet to the next will result in corresponding performance gains and losses, the reliability of the measurement of the value is essential. More specifically, the concern is that IASB’s strive for relevance seems to overshadow the need for reliability and that: “reliability is a necessary precondition that must be met for information to be relevant”. The reliability problem is believed to be of significance in particular where no market value is available (e.g. as a consequence of illiquidity) and the fair value thus has to be determined by the use of a valuation model, often referred to as mark-to-model, where the fair value is actually a hypothetical and subjective prediction based on internally generated assumptions and estimates about the future. Barth (2006), however, argues that the question is not if, but how estimates of the future should be included in financial statements, as including them should result in more useful information for making economic decisions. The possible reliability problems mentioned above could be mitigated by the use of disclosures in the notes, according to the author.

Although Barlev and Haddad (2003) recognize that mark-to-model based fair values and non-perfect markets are issues, they argue that FVA - in contrast to historical cost accounting (HCA) - is more value relevant. Given that FVA measures the current value of assets and liabilities and does not leave room for manipulation to the same extent as
HCA, it is further suggested that reliability and transparency are increased. The point that is particularly accentuated is that the shareholders focus should be directed to the value of equity and its changes when reporting market values of the assets and liabilities. This not only increases the stewardship function and decreasing agency cost, but also the effective management of the firm.

Hitz (2007) studies the decision usefulness of fair value based reporting systems from a theoretical perspective, primarily from a measurement or valuation perspective and an information perspective. His findings indicate that there is theoretical support not only for disclosing prices obtained from sufficiently liquid markets but for full fair value accounting of financial instruments, despite reliability problems when such are not publicly traded. However, the case is found to be particularly weak for the use of FVA for non-financial items, given that mark-to-model measurements do not give relevant information about consensus expectations. Furthermore, Hitz (2007) refers to the “grave reliability concerns for fair values not taken from active markets” that are supported by empirical evidence.

Kolev (2009), on the other hand takes a different perspective when evaluating the reliability of mark-to-model estimates. Studying the association between stock prices and fair values of net assets, he finds it to be significant and positive. The same applies to the relation between net gains on mark-to-model assets and liabilities and quarterly returns as well as market reactions around the 10-Q filing dates, suggesting that investors find mark-to-model estimates sufficiently reliable to be reflected in firm value.

In a case study on the use of FVA in the US energy company Enron prior to its bankruptcy, Gwilliam and Jackson (2008) find that, besides the unreliability of third-party valuation estimates, management seemed to have a strong desire to avoid recognizing FVA losses through the income statement, in order to achieve targets and forecasts. Put in contrast to the Barth and Clinch (1998) findings that only negative asset revaluations where value relevant to investors in a study of the Australian market, Gwilliam and Jackson’s (2008) conclusions could be further enhanced.

Penman (2007) analyses the qualities of FVA in facilitating valuation and stewardship from a conceptual and a measurement or implementation perspective. He argues that
FVA is superior to HCA on a conceptual level under ideal settings, where there is a one-to-one relationship between exit prices and value to shareholders. However, even when exit prices can be observed in an active market, the one-to-one relationship is not present as soon as a firm holds net assets where value is added in some way. When actual prices cannot be observed and mark-to-model values are introduced, FVA is deemed even more inappropriate and HCA earnings based valuation more adequate. In contrast to the above, Hermann et al. (2006) argue for using fair value measurements for property plant and equipment, which neither should satisfy the one-to-one nor the active market conditions.

Where Lindsell (2005) ascertains that implementation of IFRS will inevitably increase volatility in the financial statements, Penman (2007) is concerned that FVA will bring price bubbles into them. When reviewing the post financial crisis debate on FVA, Laux and Leuz (2009a) identify two extremes, where the critics argue that it not only significantly contributed to the outburst, but also intensified the severity of the crisis. They however suggest that FVA is neither to blame nor just the messenger. Primarily, Laux and Leuz (2009a) argue that while FVA in its pure form might contribute to procyclicality in boom and bust times and may even cause downward spirals in financial markets, this does not apply in the same way to FVA as stipulated by the IFRS or US GAAP. Given that these standards allow for deviations from market prices under certain circumstances. Nevertheless, they acknowledge that allowing for such deviations creates an implementation problem. On the one hand, being too restrictive in allowing deviations does not mitigate the procyclicality issue. On the other, should the standard setters not be very restrictive, the probability that managers can use it to avoid making (required) write-downs increases, a risk that is confirmed by the findings of Gwilliam and Jackson (2008) in their Enron case study mentioned above.

In another study, contemporary to the one above, Laux and Leuz (2009b) examine the role of FVA in the financial crisis based on descriptive and empirical evidence and find little evidence for the claim that downward spirals and excessive bank asset write-downs were the result of FVA. Their findings are supported by a similar study by Barth and Landsman (2010). Mangnan (2009), however, finds that FVA as it is used by regulators may have amplified the crisis by severely undermining the financial
condition of institutions, in particular those holding assets in markets whose liquidity diminished.

In a pre-IFRS/IAS 40 implementation paper, Nordlund (2004) expresses concerns that: “The uncertainty of property valuations is probably of such a magnitude that the consistency of both the income statement and balance sheet may be questioned to a certain extent as a result of the application of the fair value model.”

Dietrich et al. (2001) studied the reliability of fair value estimates for investment property in the UK during the period 1988-1996, when investment companies where required to report fair values of investment property on the balance sheet under UK GAAP. By comparing actual sales prices on realized sales to previous reported fair value estimates, they find that the estimates understate actual selling prices but are considerably less biased and more accurate measures of selling price than under HCA.

Nellessen and Zuelch (2010) state that the valuation of property companies and fair value accounting for investment property under IAS 40 are closely related to each other as this is such companies main asset type and consequently, reported at true fair value, the net asset value should give an adequate indication of company value. By studying the association between the net asset value and market prices for a set of 76 listed European property companies during the years 2005-2007, they find that the variables deviate from each other as a result of insufficient reliability of the fair value estimates reported, which is manifested in lower deviations for companies traded at a low bid-ask spread and vice versa. A lower bid-ask spread should express more reliable fair values. The reliability problems of the fair value estimates is further linked to the limitation of appraisals and the diversity of applied appraising approaches.

Healy and Palepu (2001) argue that demand for financial reporting and disclosure arises from information asymmetry and agency conflicts between managers and outside investors. Management typically has better information than investors about the value of the business’ investment opportunities and also has incentives to overstate their value. Investors therefore face an information asymmetry problem when they make investments in companies. This, also known as the “lemons problem”, can potentially lead to a breakdown in the functioning of the financial market (Akerlof, 1970).
A common hypothesis is that IFRS in general will decrease information asymmetries in the market because i) IFRS is more market-oriented; and ii) IFRS disclosure requirements are larger (Raffournier, 2008). Studying the bid-ask spread is a common way to test market efficiency. A low spread between what buyers and sellers are willing to buy or sell a security for implies low information asymmetries. Platikanova and Nobes (2006) findings when studying 3,907 companies in the EU suggest that the bid-ask spread on average declines after IFRS adoption. Parallel to that result, Leuz and Verrecchia (2000) reach the conclusion that companies using IFRS exhibit smaller bid-ask spreads than those using German GAAP in a study on German companies. These two papers are in line with the hypothesis that IFRS decreases information asymmetry.

However, in a study on Swiss companies, Dumontier and Maghraoui (2006) show that the effect is limited to small companies. Studying the bid-ask spread in an IAS 40 setting, Muller et al.’s (2008) findings suggest that FVA implementation did not reduce the relative information asymmetries between property companies. However, prior to IAS 40, firms disclosing fair values experienced lower bid-ask spread than those who did not, indicating lower information asymmetry.

As indicated by Raffournier (2008), no clear conclusion can be drawn from these studies on implications of IFRS on forecast accuracy since the empirical evidence is mixed. Also, many studies were conducted in a single country and most of the studies deal with voluntary adoption.

When evaluating fair value accounting, Penman (2007) takes a perspective on the practical task where the accounting information is demanded and concludes that equity valuation is the objective of the financial analyst. Thus an analysis of the decision usefulness of IAS 40 might benefit from studying the usefulness to analysts in their forecasting. Furthermore, as most recent research on IAS 40 is constituted by value relevance studies, Barlev and Haddad (2003) stress that: “the value of financial reports does not depend on the statistical association between accounting and market returns.”

As emphasized by Cotter et al. (2010): “There is an extensive literature about factors affecting analyst forecast accuracy and dispersion, which is relevant to any predictions about the effect of adoption of IFRS on the properties of analysts’ forecasts.” In a study of companies voluntarily applying IFRS Ashbaugh and Pincus (2001) conclude that
analyst forecast accuracy improves after IFRS adoption. The sample consisted of 80 non-US firms of which almost half came from Switzerland or France. Hodgdon et al. (2008) come to the same conclusion, that compliance with the disclosure requirements of IFRS reduces information asymmetry and enhances the ability of financial analysts to provide more accurate forecasts. Unlike prior studies, which examine forecast accuracy using the consensus or mean forecast, Hodgdon et al. (2008) examine forecast accuracy at the individual analyst level. Hope (2003) finds that the level of accounting policy disclosures is negatively related to consensus forecast errors, after controlling for firm and country level variables that may affect analyst forecasts.

A study on German companies by Ernstberger et al. (2008) also suggests that the forecast accuracy is higher for estimates based on IFRS or US GAAP data compared to forecasts based on German GAAP data. Furthermore, in the year of transition of standard the forecast accuracy is significantly lower than in other years, i.e. forecast error is higher. Cotter et al. (2010) find results that suggest that IFRS adoption is related to a reduction in absolute forecast error for a sample of Australian companies. On the other hand, they also find that forecast dispersion increases in the post IFRS period, although the effect is not as strong as in the case of forecast error. Glaum et al. (2011) similarly find that forecast accuracy increases for firms changing from local GAAP to IFRS.

In another Australian paper, Brown et al. (2012) aim to extend similar studies by considering a larger sample of strictly mandatory 2005 IFRS adopting firms (11,220) from a wide set of countries (19) and over a longer period of time (2002-2009). The results support the studies above and further indicate that stronger enforcement of accounting standards is associated with better information environments.

However, there are a few papers that show the opposite compared to the abovementioned studies. Maghraoui (2008) suggests in a study on German companies that compliance with IFRS does not reduce the dispersion of analyst forecasts or forecast errors. These findings are supported by Daske (2005), who finds lower forecast accuracy as well as higher dispersion in a study of German firms, voluntarily adopting International Accounting Standards 1993-2002. Furthermore, Cuijpers and Buijink (2005) find that dispersion of analyst forecasts is higher for firms using IFRS than for
those using local GAAPs. The study included non-financial firms in the EU and compared companies which voluntarily used non-local GAAP in 1999 with local GAAP companies.

Acker et al. (2002) study forecast accuracy in the first year of implementing UK Financial Reporting Standard 3 and finds that analyst forecast error increase, suggesting that unfamiliarity with new standards might decrease accuracy. Moreover, according to Ball (2006), IFRS implementation could result in increased earnings volatility due to its focus on FVA, an anticipation which is confirmed by Barth et al. (2008). In a setting where the FVA component is substantial, increased volatility on account of IFRS might imply decreased forecast accuracy and higher dispersion (Cotter et al., 2010).

Assuming that IFRS adoption does effect in increased forecast accuracy, Horton et al. (2012) investigate potential causes for such improvements. Among other things they test whether improved accuracy might depend on increased opportunities for management in manipulating earnings to meet analyst forecast, but do not find evidence supporting that explanation.

Among FVA opponents, the disclosure of fair values are nonetheless often encouraged (e.g. Rayman 2007) and it could be argued that since fair values where already disclosed in most Swedish property companies before IAS 40 implementation in 2005, it should not make any difference having them on the balance sheet (e.g. Bengtsson, 2008). Research shows that analysts are more likely to cover firms that provide them with more and better information. Lang and Lundholm (1996) provide evidence suggesting that the quality of corporate disclosures affects analyst’s coverage decisions and also the accuracy of the forecasts.

Several studies have tested whether classification issues affect the judgments of financial analysts. Hirst et al. (2004) evaluate whether classification of gains and losses on financial assets and liabilities affected experienced sell-side analysts covering the banking sector. The study manipulated two variables: the reporting of gains and losses due to interest rate risk and the bank’s exposure to interest rate risk. The result of this study indicates that the analysts were only able to effectively adjust the valuation for
the higher risk of exposed banks when the financial statements of those banks applied full fair value accounting and it was stated on the balance sheet.

In the case when the information was disclosed in a footnote analysts did not fully adjust for this information.

A potential problem associated with our research design could arise if analysts face incentives discouraging forecast accuracy. Research, however, indicates that financial analysts have incentives to give as accurate earnings estimates as possible. The reward may be in the form of recognition, higher rankings or career advancement (Hong and Kubik, 2003). Mikhail et al. (1999) find that analysts are more likely to change brokerage firms or leave the profession altogether when their forecast accuracy is lower relative to their peers.

There are some further caveats that might have an impact on our results. It is shown that less experienced analysts are more likely to be fired for deviating from the consensus (Hong et al., 2000). Hence, less experienced analysts have incentives to trade off some accuracy and timeliness for the safety of being close to market consensus. Research furthermore establishes a linkage between analyst effort and optimism. McNichols and O’Brien (1997) find that analysts are more likely to cover firms for which they genuinely have positive views. When analysts initiate coverage of a company their forecasts are relatively optimistic. Nevertheless, according to the study, that optimism is justified by actual results. Moreover, analysts put down more effort covering these firms which leads to that forecast accuracy improves with optimism. McNichols and O’Brien’s (1997) evidence suggests that analysts’ monetary incentives create an asymmetry that leaves companies for which analysts have unfavorable views with less analyst coverage, analyst scrutiny and accurate forecasts. Previous research further shows that financial analysts tend to be rather optimistic in the way that the forecasts are systematically upward biased (Easterwood and Nutt, 1999) and in addition are revised rather slowly (Bartov et al. 2002). Moreover, other factors such as experience, workload or risk tolerance are commonly known to influence the quality of an individual analyst’s forecasts. Management actions might also have a direct or indirect effect of forecast accuracy. By announcing its own earnings guidance, management influences analysts’ expectations (Williams, 1996). Previts et al. (1994) mainly find evidence of substantial analyst effort to remove
nonrecurring items and focusing on what is often referred to as core or adjusted earnings as basis for forecasting. But the study also shows strong analyst reliance on management for information, which suggests that financial analysts have a role of intermediation.

2.2.9 IFRS Adoption Impact on Accounting Information

2.2.9.1 Accounting Quality

The qualitative characteristics are the characteristics used to identify the financial information that are useful to investors, lenders and creditors to make decisions on the basis of information in financial statements as well as provided in other ways. According to IFRS(2011), there are two fundamental qualitative characteristics: relevance and faithful representation, and four enhancing qualitative characteristics: comparability, verifiability, timeliness and understandability.

RELEVANCE

IFRS defines relevant financial information as having the capability to make a difference in the decisions made by users. Financial information is able to make a difference in decisions if it has predictive value, confirmatory value or both. Financial information has predictive value if it can be used to predict the future outcomes; financial information has confirmatory value if it provides feedback about previous evaluations (IFRS, 2011).

FAITHFUL REPRESENTATION

Faithful representation indicates financial information do not only need to be relevant, but must also faithfully represent the true phenomena. To be a faithful representation, a description should have three characteristics: complete, neutral and free from error. Complete description means information includes all necessary information; neutral descriptions is without bias in the presentation of financial information; free from error implies there is no error or omission in the description, but does not mean perfectly accurate (IFRS, 2011).
COMPARABILITY

Comparability is the qualitative characteristic that enables users to understand the similarity or difference among items. Unlike other characteristics, it involves at least two items (ibis). For the information to be relevant for investors to make decisions, it is important to be able to compare one company with others. Thus, it is necessary for companies to use the same accounting standards (IFRS, 2011).

VERIFIABILITY

Verifiability assists users to ensure the faithful representation of the economic phenomena. It can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation; indirect verification means checking the inputs to a model, formula or other methods and recalculating the outputs using the same methodology (IFRS, 2011).

TIMELINESS

IFRS defines timeliness as information are available in time to decision makers to be capable of influencing their decisions. Generally, the older the information, the less useful it is (IFRS, 2011).

UNDERSTANDABILITY

It indicates financial information is classified, characterized and presented clearly and concisely (IFRS, 2011).

Reporting information that is relevant, faithful, comparable, verifiable, timely and understandable facilitates users to make decisions with more confidence, further results in more efficient functioning of capital market and lower cost of capital. With this purpose, IASB intends to develop a single set of accounting standards that contains those qualitative characteristics, contributing to high quality accounting information.
The IASB has required firms to report “high quality, transparent and comparable information in financial statements” in order to make the market value of firms reflect the true economic value to greatest extent and efficiently assist investment decision. To achieve this goal, IASB has developed the single set of accounting standards IFRS to provide uniform and qualitative regulations for firms. Ball et al. (2006) stress that “IFRS promise more accurate, comprehensive and timely financial statement information, relative to the national standards they replace for public financial reporting in most of the countries adopting them, Continental Europe included”. Studies have been done to examine the changes in firms’ accounting quality associated with applying IFRS. Since IFRS is principle-based standards which have limited alternatives accounting measurements in order to better reflect firm’s economic value and performance, Ashbaugh and Pincus (2001) argue that IFRS improves accounting quality because limited alternatives restrict management’s opportunistic discretion in determining accounting amounts. By using data from publicly listed companies from 15 member states of the EU, Chen et al. (2009) find accounting quality is enhanced after the adoption of IFRS. Besides, Christensen et al. (2008) also find positive relationship between accounting quality and the IFRS adoption. However, the results of previous studies are not always consistent with each other. Panaanen (2008) does not find any evidence of improvement in accounting quality. Value-relevance of book value and earnings has no change under IFRS comparing to the value-relevance based on the German standards (Hung & Subramanyam, 2007). Tendeloo and Vanstaelen (2005) observe that firms under German standards and IFRS do not show any difference in earning management. The inconsistent research results generally stem from the following reasons: the lax enforcement of IFRS (Burgstahler et al., 2006), substantial noncompliance with IFRS, the lack of effective controls, the effect of economic environment (Barth et al., 2008), the difference in legislation and regulatory.

The prior researches measure accounting quality by mainly focusing on three dimensions: a) earnings management, expressed as both earnings smoothing and managing earnings towards a target; b) timely loss recognition; c) value relevance (Barth et al., 2008; Paglietti, 2009; Capkun et al., 2008). Lower earning management,
more timely loss recognition and higher value relevance of earnings and equity book value are regarded as evidences of better accounting quality.

Healy and Wahlen (1999) define earning management as “the attempts by managers to lead the stockholders about the economic performance of the company or to influence the outcome of the contracts that affect their compensation”. Less earning management usually corresponds to better accounting quality. There are two manifestations of earning management, earnings smoothing and managing earnings towards a target. Regarding earnings smoothing, it means the process of managing earnings to make the net income less variable. More earning smooth reflects lower earning variables, resulting in higher accounting quality. Managing earnings towards a target is defined as “the extent to which firms use accounting discretion to report small profits in order to avoid small losses, in this way misstating the real economic performance of a firm” (Leuz et al., 2003). Barth et al. (2008) find a decrease in earnings management (smoothing) following firms’ voluntary early adoption of IFRS. In contrast, Ahmed et al. (2010) find an increase in earnings management for mandatory adopters; the result obtained by Callao and Jarne (2010) shows that earning management has intensified since the adoption of IFRS in Europe; Capkun et al. (2013) also believe that earning management has increased after the adoption of IFRS due to the greater flexibility of accounting choices. Concerning to timely loss recognition, it relates to the ability of earnings reflecting losses on a more timely basis (Paglietti, 2009). Researchers stress that with higher accounting quality, large losses are recognized as they occur rather than being deferred to future periods (Lang et al., 2006). Barth et al. (2008) argue that timely loss recognition and earning smoothing are closely related, since earning smoothing does not allow large and frequent loss recognition. They predict that under IFRS earning smoothing is less comparing with national GAAP, thus large loss recognition are more frequently than those applying national GAAP. Contrarily, Brauer et al. (2011) do not find evidence that IFRS and German-GAAP firms differ with respect to the timeliness of loss recognition.

Value relevance is defined as “the ability of information that is presented by financial statements to capture and summarize firm value” (Kargin, 2013). Barth et al. (2001) expect that firms with higher accounting quality have higher connections between stock
price, earnings and equity book value, because higher accounting quality has better reflection on firm’s true value. Capkun et al. (2008) find out value relevance of earnings across firms in their samples under IFRS. Prather-Kinsey et al. (2008) study the influence of IFRS on value-relevance, information quality and cost of capital by using 157 listed companies in Europe. They find the adoption of IFRS enhances value relevance of accounting information, reduces cost of capital, and improve the accounting quality.

Following previous studies, this thesis investigates whether the accounting quality has been improved under IFRS by applying earning management, timely less recognition and value relevance as measure standards. One reason is that these dimensions are propitious to provide a deep insight into the sources of the difference in accounting quality among firms; another reason is that the three dimensions provide different perspectives to evaluate the accounting quality, therefore it benefits to better assessing the accounting quality when there are contradictory results between any two of them. For example, in Barth et al. (2008)’s study, they expect there is less accounting smoothing under IFRS related to it was with national GAAP, which raises the accounting variables and in turn lowers the accounting quality. However, the timely loss recognition with less accounting smoothing is larger, which means better accounting quality. In this case, the contradictory results could be solved with the third dimension: value relevance. If the value relevance is higher under IFRS than it was under the national GAAP, the accounting quality will be considered as higher than national GAAP, otherwise, the accounting quality will be regarded as lower than national GAAP.

2.2.9.2 Information Comparability

Information comparability is “the qualitative characteristic that enables users to identify and understand similarities in, and differences among items. Comparability does not relate to a single item, but requires at least two items.” (IASB, 2011). Even though an economic phenomenon can be authentically corresponded to various ways, allowing alternatives in accounting methods for the same economic phenomenon
eliminates comparability. As the trend toward globalization of the capital markets, “the need for a common language of business in financial statements is increasing in urgency” (Purvis et al., 1991). Since its establishment in 1973, the IASB has constantly and vigorously attempts to increase the level of international comparability of accounting figures. Surveys indicate the fruitful achievements of IASB by increasing the level of comparability during previous years (McKinnon & Janell, 1984; Nobes, 1987; Tang, 1994). Studies have shown several benefits associated with enhanced information comparability, such as IASB argues that more comparable information enables global markets to operate with less friction and FASB (1980) stresses that it greatly enhances the usefulness and value-relevance of accounting information. What’s more, a time-series comparison of financial statements of assists investors to have an intelligent judge about their investment value and manage it rationally. A cross-section comparison of financial statements allows shareholders and other stakeholders evaluate their equity and interest from a comparative perspective and efficiently manage their interests. Moreover, the cross-section comparison enhances the level of both national resource utilization and of international wealth allocation as well (Radebaugh et al., 1997). Numerous researches have examined the relationship between the adoption of IFRS and information comparability, and most of the results show positive association between them. Brochet, et al. (2011) stress that mandatory IFRS adoption leading to enhanced comparability; Yip and Young (2012) find out mandatory IFRS adoption improves cross-country information comparability by making similar things look more alike without making different things look less different.

Previous studies have examined the information comparability associated with IFRS adoption in various ways:

Daske et al. (2009) find out a general reduction in information asymmetry for firms voluntarily adopting IFRS with corresponding commitment to high quality implementation and interpret this as evidence of an increase in the comparability. Brochet et al. (2011) also stress that lessen information asymmetry by the reduction in private information benefits leads to enhanced information comparability. Information asymmetry was firstly propounded by George Akerlof, Michael Spence, and Joseph E. Stiglitz in the 1970s. It refers to that under marketing transactions, at least one party has more or better information than the other(s) which causes the party with more information to obtain more self-interests and harm the other parties’ interest, leading
the transactions to go awry as well as causing misinforming. The three economists were awarded the Nobel Prize in Economics in 2001 for their analyses of markets with asymmetric information.

Improved information comparability and reduced information asymmetry also result in lower cost of capital, especially for those multinational companies who are located in different countries (Li, 2010), therefore the reduction in cost of capital can also be regarded as a benchmark of enhanced comparability. Cost of capital is a term used in the field of financial investment to refer to the cost of a company's funds (both debt and equity), or, from an investor's point of view, the rate of return demanded by shareholders on a portfolio company's existing securities (Brealey et al., 2011). According to Epstein (2009) cost of capital is correlated to riskiness of investment and one element of the risk is that the financial statements do not authentically present what they are supposed to show. Thus, higher quality information disclosure could lead to lower risk, which in turn brings lower cost of capital (Lambert et al., 2006). Lee et al. (2010) find out that companies enjoy a great cost of equity capital reduction under IFRS; Armstrong et al. (2008) also point out the application of IFRS lowers information asymmetry between firms and investors and thus lead to lower cost of capital.

Analyst forecast accuracy is the accuracy of forecasts made by analyst regarding company’s earnings, profit, etc. De Franco et al. (2011) develop measures to investigate comparability and find out comparability is positively associated with analyst forecast accuracy. Horton et al. (2010) find that forecast errors decrease for companies that adopt IFRS relative to forecast errors of other companies. Tan et al. (2009) also stress that widespread IFRS adoption facilitates cross-border comparisons of financial data and therefore lowers the costs for financial analysts to follow firms from other countries and increase analysts’ forecast accuracy. They explain that IFRS brings cost benefits to analysts and thus enhances their forecast performance is because IFRS reduces information acquisition cost and processing cost since analysts do not need to learn a new set of accounting standards. In addition, since IFRS obliges companies to disclose more comprehensive and complete information, analysts have the chance to improve their forecasting performance because of the attainment of more accurate information.
Wang (2011) documents larger information transfers under the IFRS adoption and interprets this as evidence of IFRS increasing comparability. Such information transfer is related to the news in earning announcements, stock split announcements, management earnings forecasts, and cooperate security offerings (Hramnath, 2002; Tawatnuntachai & D’Mello, 2002). Information transfers occurs because a news announced by a company conveys information that has not been published before, and the stock price responds and adjusts itself accordingly. A premise for information transfer by earning announcement is comparable earning information. If earning information is not comparable, then earning announcement contains low value in predicting the value of other firms, leading to a low degree of information transfer (Yip & Young, 2012). Thus, the degree in information transfers represents the level of information comparability (Li & Kim, 2010). The result of Yip and Young (2012)’s research suggests that IFRS adoption is beneficial to information transfer and therefore improves information comparability.

Defond et al. (2010) use mutual fund ownership to capture cross-border investment and in turn to measure comparability, since mutual fund ownership represent a sophisticated set of investors that generally base their investment decisions on detailed analysis of financial statement and are likely to benefit from improved comparability. Cross-border investment refers to the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. In Defond et al.’s study, they find that improved financial statement comparability is related with increased mutual fund ownership and cross-border investment by reducing information acquisition costs for foreign investors. In addition to Defond et al.’s research, Florou and Pope (2009) study the IFRS adoption’s effect on foreign institutional investors and find institutional holdings increase for mandatory IFRS adopters; Bruggemann et al. (2011) examine the impact of global IFRS adoption on cross-border equity investments by individual investors and find IFRS adoption has the potential to reinforce cross-border equity investments by individual investors.

Since there is no consistent proxy to measure information comparability, this thesis will investigate whether the information comparability enhances following IFRS by
utilizing five proxies developed in the previous studies: information asymmetry, cost of capital, analyst forecast accuracy, information transfer, and cross-border investment. However, rather than adopting the quantitative method by analyzing data in the previous studies, this study will use a qualitative and narrative way to capture the empirical perceptions from professionals in the IFRS area to research a more comprehensive understanding and examine the information comparability under IFRS.

2.2.10 IFRS Adoption Impact on Economy By Companies

There are different streams of IFRS literature. One stream investigates the impact of IFRS adoption on earnings quality and finds mixed results (Cuijpers & Buijink, 2005; Gassen & Sellhorn, 2006; Barth et al. 2008; Tendeloo & Vanstraelen, 2005). Another stream of research examines the value relevance of IFRS in comparison with local GAAP (Hung & Subramanyan, 2007; Bartov et al. 2005; Goodwin et al. 2008). The third stream of research examines the impact of IFRS adoption on cost of capital (Leuz & Verrecchia, 2000; Daske, 2006). There are also other streams of IFRS literature that examine factors influencing disclosure on transition to IFRS (Kent & Stewart, 2008; Palmer, 2008), relevance of accounting classification in the IFRS era (Nobes, 2008), impact of particular IFRS on harmonization (Morais & Fialho, 2008) and value relevance (Chalmers et al. 2008).

Regulators and investors have commonly expressed the view that more the transparency and higher the quality in accounting, lower is the cost of capital for adopting companies (Levitt, 1998; IASB, 2002). Proponents of IFRS often claim that IFRS adoption leads to greater and higher-quality disclosures. When compared with local accounting standards in most countries, IFRS is considered as being more fairvalue-oriented, reducing accounting flexibility allowed for the issuers of financial statements, incorporating the effects of economic events on firm performance into financial statements in a timelier manner (Coopers & Lybrand 1993; Dumontier & Raffounier 1998; GAAP 2000).

In one of the major work on studying economic consequences due to mandatory IFRS reporting Daske et al. (2008) with a sample of 26 countries for a period from 2001 to
2005 found that, on an average, market liquidity increased around the time of introduction of IFRS. Capital market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong. Capital market also affects most of the firms that voluntarily switch to IFRS, both in the year they switch and again later, when IFRS become mandatory. Many adopting countries make concurrent efforts to improve enforcement and governance regimes.

Moreover, several studies provide empirical evidence suggesting that IFRS is of higher quality than local GAAP. Bartov et al. (2005) assess the value relevance of earnings produced under USA and German GAAP relative to that under IFRS, and finds that USGAAP-based and IFRS-based earnings are of higher value relevance than German GAAP-based earnings. Armstrong et al. (2008) examine the European stock market reaction to adoption of IFRS through an event study approach and find that, market perceives net benefits associated with either convergence of accounting standards or improved information quality by IFRS.

While these studies focus on the impact of IFRS adoption on the disclosure quality, the other stream of research focuses on the association between the disclosure quantity or level and a firm’s voluntary adoption of IFRS. Ding et al. (2005) report that IFRS require more comprehensive disclosures than the domestic standards of most countries. Lantto and Sahlstrom (2009) in their study examine the impact of IFRS adoption on key financial ratios using Finland as a sample country. The results clearly show that, the adoption of IFRS changes the magnitude of the key accounting ratios. Moreover, it also found that, adoption of fair value accounting rules and stricter requirements on certain accounting issues are the reasons for the changes observed in accounting figures and financial ratios. In this regard, the results of the study indicate that, the adoption of IFRS changes the magnitudes of the key accounting ratios of Finnish companies by considerably increasing the profitability ratios and gearing ratio moderately, and considerably decreasing the PE ratio and equity and quick ratios marginally. The results indicate that the increases in the profitability ratios and the decrease in the PE ratio can be explained by increases in the income statement profits.

In another study using financial ratios based on profitability, activity, liquidity and solvency, Padrtova and Vochozka (2011) compare the informative value of financial
statements of CEZ Inc drawn up under IFRS and Czech accounting standards for 2004 and 2005. The financial analysis results proved the impact of IFRS implementation on financial performance of the company. Financial statements prepared under Czech accounting standards showed the company healthier than financial statements drawn under IFRS.

Similarly, Beuren et al. (2008) in their study developed on economic-financial indicators of 37 English companies suggested divergence between IFRS and USGAAP, indicated significant correlation between differences of these indicators. However, in contrast, Ferrer et al. (2011) investigate how liquidity and leverage ratios exert significant effect on the degree of compliance with IFRS disclosures as measured by disclosure indexes constructed from Balance Sheets and Income Statements of 100 publicly listed companies in Philippines. Multiple regression analysis based findings suggest that none of the indices exert a significant effect on the financial variables based on computed t-statistics. The study accepts null hypotheses that liquidity and financial leverage have no effect with IFRS when expressed in terms of Balance Sheet and Income Statement indices.

Zhou et al. (2009) undertake a study in China, an emerging economy as sample country, investigated whether firms adopting IFRS have higher earning quality as compared to non-adopting firms in an emerging market. The results suggest some improvement in the quality of accounting information associated with the adoption of IFRS. The findings point to the need for a stricter enforcement mechanism of accounting standards in emerging markets. Enforcing the same sentiment, Liu et al. (2011) examine the impact of IFRS on accounting quality in China, a regulated market using a sample of 870 firms that were mandated to follow the new standards. Results of the data from 2005 to 2008 show that changes are less likely to result from changes in economic conditions but from changes in the market.

This study is important because it provides direct evidence on the question whether IFRS can be relevant to markets that are still disciplined mainly by regulators than by market mechanisms. In one of the only descriptive study using Indian banking industry, Firoz et al. (2011) critically analyse financial statements like business per employee, capital and reserves, investments and advances, net non-performing assets ratios and the impact thereon on relevant provisions of IFRS. The authors conclude that certain
issues need clarity from tax authorities as well as from Reserve Bank of India to ensure successful IFRS implementation by banking industry.

The idea that IFRS adoption enhances disclosure level and/or quality of corporate disclosures forms the basis of arguments in this thesis. The intuition is that a firm’s voluntary adoption of IFRS can be viewed as commitment to better disclosure, which may have various economic impacts on the firm.

There are different streams of IFRS literature. One stream investigates the impact of IFRS adoption on earnings quality and finds mixed results (Cuijpers & Buijink, 2005; Gassen & Sellhorn, 2006; Barth et al. 2008; Tendeloo & Vanstraelen, 2005). Another stream of research examines the value relevance of IFRS in comparison with local GAAP (Hung & Subramanyan, 2007; Bartov et al. 2005; Goodwin et al. 2008). The third stream of research examines the impact of IFRS adoption on cost of capital (Leuz & Verrecchia, 2000; Daske, 2006). There are also other streams of IFRS literature that examine factors influencing disclosure on transition to IFRS (Kent & Stewart, 2008; Palmer, 2008), relevance of accounting classification in the IFRS era (Nobes, 2008), impact of particular IFRS on harmonization (Morais & Fialho, 2008) and value relevance (Chalmers et al. 2008).

Proponents of IFRS often claim that IFRS adoption leads to greater and higher-quality disclosures. When compared with local accounting standards in most countries, IFRS is considered as being more fair-value-oriented, reducing accounting flexibility allowed for the issuers of financial statements, and incorporating the effects of economic events on firm performance into financial statements in a timely manner (Coopers & Lybrand 1993; Dumontier & Raffounier 1998; GAAP 2000).

Regulators and investors have commonly expressed the view that more the transparency and higher the quality in accounting, lower is the cost of capital for adopting companies (Levitt, 1998; IASB, 2002). The lower cost of capital is based on the theory that higher information quality lowers the estimation risk of future returns (Barry & Brown, 1985) and this lowers the information asymmetries between managers and investors that lower the choices of adverse selection, thus increasing liquidity and ultimately lowering the required rate of return (Diamond & Verrecchia, 1991).
It is generally accepted that under internationally recognized standards such as IFRS or USGAAP the quality of accounting is high, as shown by earlier studies. Amir, Harris and Venuti (1993) have shown that 20-F reconciliations of USGAAP are of value relevance and there are economic benefits for the investors. Using 20-F filings to reconcile from IFRS to USGAAP for financial years ending before November 15, 2007, Liu and O’Farrell (2011) study a sample of US-listed foreign companies using IASB- IFRS and their matched US-listed foreign companies using Regional-IFRS from the same industry and find that it is possible to directly measure the comparability between accounting measures prepared under IFRS and USGAAP.

Botoson (1997) has shown that higher disclosure levels tend to bring down cost of control. Leuz and Verrechhia (2000) have shown that adoption of USGAAP/IFRS reduces factors that affect information asymmetry like bid-ask spread and low volume, and thus help in reaping economic benefits for adopting companies.

Daske (2006) has found a relationship between cost of capital and disclosure policy for German companies but his results show that the risk for companies adopting USGAAP/IFRS has increased which is counter intuitive and no explanation can be given for the results, as the author has also expressed doubt on the method of estimating the cost of capital. While these studies focus on the impact of IFRS adoption on the disclosure quality, the other stream of research focuses on the association between the disclosure quantity or level and a firm’s voluntary adoption of IFRS. Ding et al. (2005) report that IFRS require more comprehensive disclosures than do most countries’ domestic standards.

The information asymmetry literature suggests that greater disclosure mitigates the adverse selection problem and enhances liquidity, thereby reducing the cost of equity through lower transaction costs and/or stronger demand for a firm’s securities (Amihud & Mendelson 1986). Diamond and Verrechhia (1991) also find that higher information quality lowers the information asymmetries between managers and investors, thus lowering the choices of adverse selection hence increasing liquidity and ultimately lowering the required rate of return. Tweedie (2006) argues that IFRS will “reduce the cost of capital and open new opportunities for diversification and investment return”.

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Auer (1996) in his study compares the Swiss GAAP and IFRS and finds that IFRS-based earnings announcements convey significantly higher information contents than local GAAP. Jermakowicz (2004) in his study examines the adoption of IFRS by BEL-20 companies in Belgium to analyse the application of IFRS in the consolidated financial statements of Belgian publicly traded companies. In Belgium, and several other European countries, a close link exists between accounting and taxation. The study has thrown some insight into IFRS implementation problems based on a survey sent to BEL-20 companies. The survey focused on the impact IFRS conversion had on companies, their internal organization and accounting and finance strategy.

In a similar study, Tendeloo and Vanstralen (2005) examine whether adoption of IFRS is associated with lower earnings management and the results indicate that, in general, adopters of IFRS cannot be associated with lower earnings management. The study uses a sample of German companies, because, in Germany, a relatively large number of companies chose to voluntarily adopt IFRS prior to 2005. Controlling for other differences in earnings management incentives and enforcement mechanisms, the study found that the German companies that have adopted IFRS engage significantly less in earnings management, as compared to German companies reporting under domestic GAAP.

Beckman et al. (2007) in their investigation of financial statements footnotes disclosures with a sample size of 22 German firms making 59 reconciliations of net income and stockholders’ equity as reported under Germany’s Commercial Code (HGB) to either IFRS or US, found German aggressiveness and conservatism in reporting and market valuation. Cordeiro et al. (2007) measure the impact of the application of IFRS to financial information of Portuguese public companies. The results show that the Balance Sheet and Income Statement structures of the firms studied suffered relevant accounting conversions in the process of compliance.

In one of the major work on studying economic consequences due to mandatory IFRS reporting Daske et al. (2008) with a sample of 26 countries for a period from 2001 to 2005 found that, on an average, market liquidity increases around the time of
introduction of IFRS. Capital market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong.

Capital market also affects most of the firms that voluntarily switch to IFRS, both in the year when they switch and again later, when IFRS become mandatory. Many adopting countries make concurrent efforts to improve enforcement and governance regimes.

In another major recent study by Aubert and Grudnitski (2011), by taking a sample across 13 countries and 20 industries, two-stage analysis was conducted on the impact and importance of mandatory adoption of IFRS on European Union. Results showed significant differences in return on assets for firms computed under IFRS and local Generally Accepted Accounting Principles. Specifically, there was no statistical support for any of the samples to show that, accounting information under IFRS was any more value relevant than the accounting information derived using local accounting principles. In another study taking European Union as sample, Byard et al. (2011) use control sample of firms that had already voluntarily adopted IFRS at least two years prior to the mandatory adoption date. They found that analysts’ absolute forecast errors and forecast dispersion decrease relative to this control sample only for those mandatory IFRS adopters domiciled in countries with both strong enforcement regimes and domestic accounting standards that differ significantly from IFRS.

Palmer (2008) with a sample size of 150 Australian listed firms found that extent and quality of disclosure is influenced by firm size, leverage and auditor firm size. Cormier et al. (2009) in their study investigated the impact of managerial incentives in influencing the decision to elect optional exemptions when first adopting IFRS by French firms. It also examines the value-relevance of the mandatory and optional equity adjustments that need to be recognized in connection with the first-time adoption of IFRS. The study found that, managerial incentives influence the decision to strategically elect one or more optional exemption choices at the transition date.

First-time adoption of IFRS by French firms is perceived as a signal of an increase in the quality of the financial statements. Major and Marques (2009) in their study assess the relationship between the application of IFRS, corporate governance and firm performance in Portugal with a sample of 240 observations, in 80 firms, over the period
of 2003-2005. Results show that Portuguese companies that follow Portuguese Securities Market Commission (CMVM) recommendations have a higher level of firm performance, which indicates an important link between financial and managerial accounting, however, the level of compliance with the recommendations is still low.

Lantto and Sahlstrom (2009) in their study examine the impact of IFRS adoption on key financial ratios using Finland as the sample country. The results clearly show that the adoption of IFRS changes the magnitude of the key accounting ratios. Moreover, it also found that adoption of fair value accounting rules and stricter requirements on certain accounting issues are the reasons for the changes observed in accounting figures and financial ratios. In this regard, the results of the present study indicate that the adoption of IFRS changes the magnitudes of the key accounting ratios of Finnish companies by considerably increasing the profitability ratios and gearing ratio moderately, and considerably decreasing the PE ratio and equity and quick ratios marginally. The results indicate that the increase in the profitability ratios and the decrease in the PE ratio can be explained by increase in the income statement profits.

In another study using financial ratios based on profitability, activity, liquidity and solvency, Padrtova and Vochozka (2011) compare the informative value of financial statements of CEZ Inc. drawn up under IFRS and Czech accounting standards for 2004 and 2005. The financial analysis results proved the impact of IFRS implementation on financial performance of the company. Financial statements prepared under Czech accounting standards showed the company healthier than financial statements drawn under IFRS.

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on computed t-statistics. The study accepts null hypotheses that liquidity and financial leverage have no effect on IFRS when expressed in terms of Balance Sheet and Income Statement indices.

Kabir et al. (2010) in their study find contrasting results using New Zealand firms from 2002 to 2009 that absolute discretionary accruals were significantly higher under IFRS than under pre-IFRS NZGAAP, suggesting lower earnings quality under IFRS than under pre-IFRS NZGAAP. In another work, Hellman (2011) studies the impact of IFRS on financial statements of 132 largest Swedish-listed companies as December 2005, and finds out the differences between Sweden’s voluntary adoptions of IFRS during 1991-2004. With regard to the EU’s international standards voluntary adoption before 2005, results indicate that firms on an average used the flexibility offered by the soft adoption regime to manage earnings and shareholders’ equity upwards. In another study on the impact of IRFS adoption in Europe and Australia on the relevance of book value and earnings for equity valuation, Clarkson et al. (2011) use a huge sample of 3,488 firms in 2004 and 2005 and control for non-linear effects, they find no change in price relevance for firms either in Code Law or Common Law countries after IFRS adoption, thus contradicting results from linear pricing models. Zhou et al. (2009) studied China-emerging economy as sample country-to investigate whether firms adopting IFRS have higher earnings quality as compared to non-adopting firms in an emerging market. The results suggest some improvement in the quality of accounting information associated with the adoption of IFRS.

The findings point to the need for a stricter enforcement mechanism of accounting standards in emerging markets. Enforcing the same sentiment, Liu et al. (2011) examine the impact of IFRS on accounting quality in China, a regulated market, using a sample of 870 firms that were mandated to follow the new standards. Results of the data from 2005 to 2008 show that changes are less likely to result from changes in economic conditions but from changes in market. This study is important because it provides direct evidence on the question whether IFRS can be relevant to markets that are still disciplined mainly by regulators than by market mechanisms. In the only descriptive study using Indian banking industry, Firoz et al. (2011) critically analyse financial statements like business per employee, capital and reserve, investments and advances, net non-performing assets ratios and the impact thereon on relevant provisions of IFRS.
The authors conclude that certain issues need clarity from tax authorities as well as from Reserve Bank of India to ensure successful IFRS implementation by banking industry.

From the above, it is important to observe that majority of the studies in IFRS are concentrated in the developed nations. It is because countries in European Union, Australia and New Zealand have mandated IFRS way back in 2005, there are various studies trying to understand the post-adoption scenarios. Since the USA and India are going to mandate IFRS, these studies are more futuristic in nature.

Studies using emerging countries as their samples are very rarely done. Except for one study on Indian banking industry and another two on China, none of them have focused on other issues pertaining to IFRS implementation in emerging economies. From the above literature review, it is apparent that none of the research has directly been able to relate the impact on economic activities like investments, financial risks, diversifications, mergers and acquisitions and other key financial functions by the adoption of International Financial Reporting Standards by Indian companies. The intuition is that adoption of IFRS is viewed as a commitment to better disclosure, which may have various impacts on Indian companies, which is required to be researched and thus check the impact on economic activities after adoption of IFRS by Indian companies.
2.3 Title of the Study

After going through the existing literature in the library and after deep discussion with the Guide, researcher has selected the topic. This topic has been selected after considering the availability of time, information, existing literature, tools and techniques and other related sources. The topic for this research has been selected as under:

“A STUDY OF IFRS AND ITS IMPACT ON SELECTED COMPANIES”

2.4 Objectives of the Study

1. To understand the impact of IFRS on selected companies.
2. To examine the implication of IFRS in the industries.
3. To outline detailed comparative statements of prevailing accounting system and IFRS based accounting system.
4. To understand the financial performance, financial efficiency, profitability and financial results in implementing the IFRS.
5. To understand the issues and significance in globalizing the accounting standards on various industries.
6. To understand the IFRS practices through practicing Chartered Accountants/Cost Accountant/ Company Secretaries.

2.5 Scope of the Study

This study is covered only Chartered Accountant of India they were randomly selected. So further generalization could not be possible but it would be limited only with 100 Chartered Accountant practitioner of India only.

2.6 Source of Data

This study will be based on primary data. The data will be collect from the chartered accountants of India. Other information related to Impact of IFRS implication will be collected from the secondary sources.
2.7 Sampling Design

The sample selected based on the universe of the study. The population of the study consists all chartered accountant in India but the number of chartered accountant is quite large and due to time as well as money constraint not possible to contact all. At this stage researcher has decided to take sample 100 selected chartered accountant of India and their perception regarding IFRS.

2.8 Hypothesis Testing

For the present study the researcher will be formulated two Hypotheses i.e. Null Hypothesis and Alternative Hypotheses. Both Hypotheses are tested with the help of statistical tools. The statements of Hypotheses are as under:

H0: There is no relation between gender and changes bring by IFRS in business process and operation after adoption.
H1: There is a relation between gender and changes bring by IFRS in business process and operation after adoption.

H0: There is no relationship between gender and ease of finance source after adopting IFRS.
H1: There is relationship between gender and ease of finance source after adopting IFRS.

H0: There is no relationship establish between gender and improvement in target setting abilities of executive under IFRS.
H1: There is relationship establish between gender and improvement in target setting abilities of executive under IFRS.

H0: There is no relation between gender and impact created after implementation of IFRS in Business Performance Management.
H1: There is relation between gender and impact created after implementation of IFRS in Business Performance Management

H0: There is no relation between gender and effect on FDI inflow after adopting IFRS
H1: There is relation between gender and effect on FDI inflow after adopting IFRS

H0: There is no relationship between gender and more efficiency under IFRS than GAAP
H1: There is relationship between gender and more efficiency under IFRS than GAAP

H0: There is no relationship between gender and better information provided for regulators in IFRS than GAAP
H1: There is relationship between gender and better information provided for regulators in IFRS than GAAP

H0: There is no relationship between gender and facilities provided like cross- borders mergers and acquisition in IFRS compared to GAAP
H1: There is relationship between gender and facilities provided like cross- borders mergers and acquisition in IFRS compared to GAAP

H0: There is no relationship between gender and Companies that operate or aims to operate in multiple foreign countries will be under pressure to comply with accounting standards under IFRS than GAAP.
H0: There is relationship between gender and Companies that operate or aims to operate in multiple foreign countries will be under pressure to comply with accounting standards under IFRS than GAAP.

H0: There is no relationship between gender and major opportunity for transformation in the finance function after adopting IFRS
H1: There is relationship between gender and major opportunity for transformation in the finance function after adopting IFRS

H0: Respondent do not adoption of IFRS changes business processes and operations.
H1: Respondent feel that adoption of IFRS changes business processes and operations.

H0: Respondent feel that executives will not invest heavily in planning, budgeting, forecasting and management reporting when IFRS is adopted.
H1: Respondent feel that executives will invest heavily in planning, budgeting, forecasting and management reporting when IFRS is adopted.

H0: Respondent feels that there is less efficiency and increase in cost of finance under IFRS than in GAAP
H1: Respondent feels that there is greater efficiency and decrease in cost of finance under IFRS than in GAAP

H0: According to respondent companies that operate or aim to operate in multiple foreign countries will not be under pressure to comply with accounting standards under IFRS than GAAP
H1: According to respondent companies that operate or aim to operate in multiple foreign countries will be under pressure to comply with accounting standards under IFRS than GAAP

H0: Respondent feels more accounting complexities under IFRS than GAAP
H1: Respondent feels less accounting complexities under IFRS than GAAP

2.9 Statistical Tools

Following Tools and Techniques would be used for conducting a research
Statistical technique:-

- Mean
- Average
- ANOVA
2.10 Significance of the Study

This research analysing the accounting and policy factors related to the potential adoption of IFRS by India as well as the other countries of the world. This study develops the conceptual framework for my analysis and discusses accounting factors driving the costs and benefits associated with IFRS adoption. I provide an analysis of the accounting factors related to the possible Indian adoption of IFRS, present several scenarios for the evolution of Indian accounting standards and outline opportunities for future research on global accounting standards and regulation. I start with a general discussion of the standard-setting process in accounting and how India switch to IFRS might affect worldwide competition among accounting standards and standard setters. Following are the different advantages based on the contribution provided by the IFRS.

- The research study will be done on various parameters of IFRS within practicing as well servicing Chartered Accountant. The parameter like their presentation requirement recording as well as implication requirements.
- The research gives the suggestion to other chartered accountant regarding the IFRS implication their fair treatment regarding the book of account and how to deal with converged IND-AS with reference to IFRS.
- Through the research work improve the analytical power of the researcher and knowledge regarding various tools and techniques.

2.11 Rationale of the Study

International Financial Reporting Standards (IFRS) is gaining momentum throughout the world as a single, consistent accounting framework and is positioned to become the predominant GAAP in the near future. More than 100 countries have moved to, or base their local standards on IFRS. Indian Accounting Standards have not kept pace with changes in IFRS. There are significant differences between IFRS and I-GAAP, because Indian standards remain sensitive to the legal and economic environment. Recognizing the significance of having full convergence with IFRS, the ICAI has decided to adopt “a big bang” approach and fully converge with IFRS issued by IASB, from accounting periods commencing on or after 1 April 2011 subject to regulatory approvals. The use
of different accounting frameworks in different of the same underlying economic transactions creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalization of capital markets call for a single set of high quality global accounting standards.

2.12 List of Companies Taken Under Study

The researcher has taken 50 around companies from leading countries of Asia where IFRS has been introduced, also these companies are taken from Financial, Non-Financial and Insurance Industry to analyse impact of IFRS by Industry and by Country, also Impact of IFRS has been analysed within Industry and within country.

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<th>COUNTRY</th>
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<td>Bahrain</td>
<td>Arab Banking Corporation</td>
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<td>Bahrain &amp; Kuwait Insurance Company</td>
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<td>Aluminium Bahrain B.S.C</td>
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<td>Bahrain Telecommunications Co.</td>
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<td>India</td>
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2.13 Outline of Chapter Plan

In the present research study, the researcher has prepared and presented the research mainly in four chapters. The highlights of each chapter are as follows:

**Chapter-1: Overview of IFRS**

This Chapter mainly includes Introduction to Accounting Standards, International Accounting Standards, and Applicability of Accounting Standards, comparative statement of AS and IAS, concept of IFRS in National and International context, Procedure of IFRS adoption in India, Emerging markets and IFRS and finally a specimen of Financial Statement prepared under IFRS.

**Chapter-2: Research Methodology**

This Chapter researcher represents Introduction, Review of literature, and Title of Study, Objectives of the Study, Scope of the Study, Source of Data, Sampling Design, Significance of the Study, Outline of the Chapter Plan, and Limitation of the study.

**Chapter-3: IFRS at a Global Level**

This chapter will deal with content analysis of IFRS components disclosure by companies, by year, by Industry and by country.

**Chapter-4: Evaluation of Chartered Accountants perception in India**

This chapter will deal with analysis of views of 100 chartered accountants on impact on IFRS on companies in area of performance management, benefit of IFRS compared to GAAP, complexities and on business functions.

**Chapter-5: Summary, Findings, Suggestions and Conclusion**

This chapter includes summary of each chapter and findings of the study, and last but not the least suggestions for smoother implementation of IFRS.

2.14 Limitation of the Study

1. In various practices of Accounting Reporting, this study is limited towards IFRS practice only.
2. Sample of experienced chartered accountants was taken only from India because of time and other resources constrains.

3. When collecting data through questionnaire from the experienced chartered accountants, it cannot be treated as totally free from errors. Every possible attempt was made to get the information as accurate as possible.

4. Questionnaire respondents can’t be considered totally unbiased

5. This research discusses the selected companies, so it is limited those companies only.

6. Research period consists limited time, so it cannot use for a longer period.

7. Only 50 companies from leading countries of Asia have been analysed to study the impact of IFRS on corporates