An Assessment of the Impact of Merger with IFRS: A Case Study of Infosys Ltd.

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Abstract

This study examines the effect of concurrence with IFRS on key financial ratios namely liquidity ratio, profitability ratio and leverage ratio. Secondary data has been collected for Infosys ltd for the financial period 2010-2011 to 2014-15.The results of wilcoxon rank sum test revealed significant differences in the values quick ratio, operating profit ratio, return on equity and earnings per share under both the standards. The study overall supports the confluence with IFRS.

Keywords: Indian generally accepted accounting principles, International financial reporting standards

1.Introduction

Accounting language is the "business dialect" through which businesses communicate its monetary endeavors to its proprietors, managers and partners. Financial reporting aims to suggest the financial position of the business to various stakeholders and empowers them to assess how efficiently resources have been utilized. In April 2001 International accounting standard board (IASB) replaced International accounting standard committee (IASC) in India. In progression of announcements IASB announced its standards namely International Financial reporting standards (IFRS). These standards are looked by administrative and government bodies to meet their reporting commitments. The era of globalization demands unity in accounting practices globally so that trade and business can be conducted satisfactorily. Many European countries like New Zealand, Russia etc. have officially accepted and implemented IFRS for preparing financial statements. Indian companies to prevent themselves from being sidelined from global platform must follow these internationally accepted principles. The body responsible for formulation of accounting standards in India, the Institute of Chartered Accountants of India (ICAI) attempts to unify with IFRS, in light of the laws, business practices and conditions existing in India. This will allow the investors to comprehend investment possibilities more easily as the financial statements will be framed under typical arrangement of accounting standards.

However, this confluence is likely to impact the financial statements due to contrasts in the Indian generally accepted accounting principles and IFRS. There are several areas of inconsistencies between IFRS and Indian generally accepted accounting principles like income acknowledgement, income articulations, depreciation, revenue recognition and inventory valuation etc. This has also posed a challenge for Indian corporate which will now have to bear huge monetary outlay for training of their accounting staff. The present study aims to analyze the impact of conjunction with IFRS on the liquidity ratio, profitability ratio and leverage ratio of Infosys Technologies ltd for the financial period 2010-2011 to 2014-015.

Infosys ltd. was founded in 1981.In 2014 in terms of revenue it was the third largest IT service company in India. The headquarters of the company are situated in Karnataka. The company is dealing in various kinds of products and services like enterprise mobility, big data, customer service and digital marketing etc (Bansal, 2015). Its operations are expanded in 45 countries. In 2017 it was included in winner circle of HfS Blueprint for its excellent service and operations (Infosys, n.d.)

2.Review of Literature

Aharony et al. (2010) The presented work assessed the impact of compulsory application of IFRS in 14 European countries on the significance of financial information for equity investors. The author studied the effect of valuation of goodwill, research and development expense, fixed expenses under IFRS on the prices and return of securities and on market to book values. The study revealed higher the level of agreement between local standards and IFRS greater is the relevance of information for equity investors.

Ghosh (2013) This paper illuminates the liquidity, risk and profit position of Ranbaxy laboratories for the financial period 2003-2012. The required financial information was collected from the financial statements of the company. The results showed that the average current ratio for the period of study was 1.42 this signifies unsatisfactory short term financial position of the company. The profitability position of the company was good in early years of study but large variations in profitability ratios was observed in the later period of the study, resulting in overall satisfactory profitability position**.** The study also revealed positive correlation between liquidity and risk of the firm and negative correlation between profitability and risk of the firm.

Ibiamke & Ateboh-Briggs (2014) The presented work aim to determine the influence of adoption of IFRS by the 60 listed Nigerian companies on profitability, leverage, activity and liquidity ratios .The relevant data was collected from the annual reports of the company. The author assessed the impact using Gray compatibility index. The author adopted "same firm year" research design which assumes that throughout the period of study the composition of the sample will not change. The results of paired t test revealed adoption of IFRS had a negative but not significant impact on the financial ratios of the selected companies**.**

Bansal (2015) The prime motive of this work was to compare the accounting and financial performance of Tata consultancy services, Wipro, Infosys and tech Mahindra for the period 2010-2014. The pertinent financial data was collected from balance sheet, statement of profit & loss and prowess and other database. The comparison among the selected companies on the basis of current ratio, return on equity, debt equity ratio, working capital turnover ratio, total asset turnover ratio, debtor turnover ratio and Du pont analysis revealed that Infosys and TCS were the most coveted firms among all the selected companies.

Gupta et al. (2017) This work attempted to measure the effect of adoption of IFRS on the financial position of Wipro Ltd. The author ascertained debt equity ratio, debt to total assets ratio, current ratio, net profit ratio, return on capital employed and return on equity ratio for the selected company for the financial period 2009-2010 to 2014-2015. The results of wilcoxon signed rank test showed significant affect of confluence with IFRS on debt to total assets ratio, net profit ratio, return on equity and return on capital employed.

3. Database and Methodology

3.1 Variables and Data collection

The study focuses on Infosys technology ltd, one of the leading IT service companies of India. The study period is the financial year 2010-2011 to 2014-2015. The said time period has been selected because Ministry of Corporate Affairs in 2015 has stipulated adoption of IND AS Rules 2015 in a phased manner beginning from accounting period on or after 1 April, 2015 (MCA, 2015). The IND AS are coordinated with IFRS. In order to draw clarity about the impact of unification with IFRS on the financial statements of a company it is desirable to compare the financial statements prepared as per Indian Generally Acceptable Accounting Principles (IGAAP) with the financial statements prepared as per IFRS. Data on selected financial measures have been collected from the annual reports of the company. These reports are vital records that portray the company to the general public (Maqbool & Zameer, 2018).

Ratio analysis

The financial health of the company can be ascertained by looking at some of the crucial ratios. This can help in identifying the origin of financial inconvenience at an organization. Ratio analysis involves investigation of the numerical relationship between two related figures. Each significant thing in the statement of profit & loss and balance sheet has an association with at least one thing in either of them or both that can be communicated through ratios. The three categories of ratio used in the analysis are:

1. Liquidity ratio
   - Current ratio
   - Quick ratio
2. Profitability ratio
   - Operating profit ratio
   - Net profit ratio
   - Return on Equity
   - EPS
3. Leverage ratio
   - Debt equity ratio
   - Debt to total asset ratio

4. Analysis and Results

Table 1 Financial ratios as per IFRS and IGAAP

RATIO	GAAP	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	Sig*(at 5%)
CR	**IGAAP**	4.71	4.38	4.36	3.58	3.05	**0.138**
	IFRS	6.51	6.35	5.62	4.71	4.15	
QR	**IGAAP**	4.70	4.38	4.35	3.57	3.04	**0.043***
	IFRS	6.49	6.34	5.61	4.70	4.14	
OPERATING PROFIT RATIO	**IGAAP**	0.34	0.33	0.30	0.25	0.26	**0.043***
	IFRS	0.29	0.29	0.26	0.24	0.26	
NET	**IGAAP**	0.25	0.23	0.22	0.20	0.22	**0.080**

PROFIT RATIO	**IFRS**	0.25	0.25	0.23	0.21	0.23	
RETURN ON EQUITY	**IGAAP**	0.26	0.27	0.25	0.24	0.24	**0.043***
	IFRS	0.25	0.25	0.24	0.22	0.23	
EPS	**IGAAP**	119.66	145.83	165.01	93.25	108.26	**0.043***
	IFRS	119.45	145.55	164.87	93.17	107.88	

The empirical analysis (Table 1) shows significant difference in the quick ratio, operating profit ratio, return on equity and earnings per share as per Indian generally accepted accounting principles (IGAAP) and international financial reporting standards (IFRS). It was not possible to ascertain leverage ratios since Infosys is a debt free company it generates ample cash internally to finance its investment, operational and financing needs.

Reasons for difference in Quick ratio

Reinforcement of liquid assets and diminished current liabilities under IFRS is the cause of strengthened liquidity position of the company. IFRS mandates prior approval of dividends before its payment thereby reducing provisions by significant amount. Moreover lease rentals and advances are treated as current assets under IFRS unlike IGAAP as per which they are treated as a part of property, plant and equipment (Kumar, 2015). This detailing distinction has resulted in superior liquidity position under IFRS.

Reasons for difference in Operating profit ratio

Financial statements prepared as per IGAAP and IFRS differ considerably in treatment of revenue. Payment of cash to customer as a sales promotion measure is considered as sales discount measure and subtracted from revenue under IFRS but under IGAAP it is treated as cost. In addition to this, different treatment of profit accruing on sale of investment, exchange rate fluctuations and treatment of excise duty leads to difference in revenue under both the standards (Gupta et al., 2017).

Reasons for difference in ROE

The principle of revenue recognition is different between IGAAP and IFRS. The values of depreciation, financial expenses, deferred taxes and some other expenses is different under both standards. The value of reserves & surplus is less as per IGAAP than its value as per IFRS predominantly due to inconsistency in the treatment of securities premium and share based payment reserves (Gupta et al., 2017).

Reasons for difference in EPS

Under IFRS the shares that are contingently returnable until such shares are not subject to recollection are not considered while calculating EPS. Moreover under IGAAP shares of which allotment has not been made but application money has been received or for which application money has been received in advance are included in calculation of diluted EPS (Daga, 2009).

5. Concluding Remarks

The study approves the existing literature on the favorable effect of adoption of IFRS on key financial ratios of the company as stated by Dunne et al. (2008); Goodwin & Ahmed (2006). The results of Wilcoxon rank sum test showed significant difference in the quick ratio, operating profit ratio, return on equity and EPS. Examination for the causes difference in ratios under both the standards uncovered that income acknowledgement standards, arrangement of liabilities and asset as current and noncurrent, reasonable value estimation were the major contributors in the contrast. In general the outcome demonstrates that adoption of IFRS will reinforce the financial position and will provide a true and transparent accounting picture to various stakeholders.

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