Determinants of voluntary adoption of IFRS by Indian Small Capitalisation companies

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Abstract:
Introduction
The long felt need for unification of accounting language across countries has lead to the propagation of IFRS including IAS. Convergence of the accounting language followed at local or regional level with that of the IFRS has many advantages such as increased access to global capital, harmonization of accounting practices across nations, reaching out to global investors, taking informed decision, mobilising global resources and professionalization of accounting education the world over. Leading economies of the world have volunteered to be the pioneer in embracing the IFRS either through adoption or through convergence. India is one among the pioneers in doing so with its large companies classified as those having a net worth of Rs. 1000 crore (i,e, $ 224.27 million USD) or more mandated to adopt IFRS with effect from April 1, 2011. This was to be followed by companies with net worth of Rs. 500 crore (i,e, $ 82.63 million USD) or more, from April 1, 2016 and the companies with Rs. 250 crore (i,e, $ 38.31 million USD) or more from April 1, 2017. The rest of the companies are to adopt IFRS voluntarily. Adoption of IFRS is beneficial to every kind of business, large, medium or small including the micro enterprises. The SMALL CAPs (Small Capitalisation companies) in India too are to benefit from IFRS.

This paper examines the nature and extent to which SMALL CAPs, i,e, companies with net worth between $ 15.4 million to $ 37.5 million have adopted the IFRS in India and to determine the factors which influence adoption of IFRS by the SMALL CAPs on a voluntary basis.

Research problem
The BSE listed SMALL CAP companies for being considered as companies having less resources may have constraints in adopting and implementing IFRS even though implementation of IFRS is advantageous to them. It is therefore considered prudent to ask questions as to

 1. The extent to which SMALL CAPs have accepted and implemented IFRS;
 2. The nature, extent and dimension of such implementation; and
 3. The factors which primarily drive SMALL CAPs to adopt and implement IFRS.

Aim of the study:
This paper
(1) Examines the nature and extent to which SMALL CAPs in India have adopted the IFRS; and
(2) Determines the factors which influence adoption of IFRS by the SMALL CAPs on voluntary basis.
Research and methodology:
 • Data Source and method of data collection: The study is based mainly on analysis of primary data collected through own developed questionnaire in a 5-point likert scale. The questionnaire consists of 30 statements distributed among 216 respondents of 80 selected SMALL CAPs. The respondents include chartered accountants, cost accountants, company secretaries, senior managers, and policy makers associated with SMALL CAPs, selected at random.
 • Data Analysis: Factor analysis has been conducted on the collected data by using SPSS 22.00 to identify the influencing factors for voluntary adoption of IFRS by SMALL CAPs.
Important findings
The study reveals that voluntary adoption of IFRS by SMALL CAPs in India is influenced by three major factors, namely, FDI inflows, FDI inflows, unification of reporting, Reporting durability and reporting cost.
Originality/Contribution
The study is original and empirical in nature. It is based on data collected through structured questionnaire. The perception of the preparers and analysts of accounting reports of selected SMALL Cap companies in India keeping in view the changing paradigm of the accounting principles has been analysed in the study.

Index Terms— Convergence, SMALL CAPs, IFRS, FDI

I.   INTRODUCTION

The national economy has got integrated into the international market and every business is trying for its

international existence. Harmonization of accounting aims at bringing the disparities down that exist in the financial reporting system being practiced in different countries owing to their own sets of socio-economic, political, cultural and legal systems. The purpose of harmonisation is to increase the comparability of accounting practices as followed by different nations across the globe. Standardization, often used as synonymous to harmonization, too aims at reducing disparities in accounting practices. In the year 2001, International Accounting Standard Board (IASB) put effort to prepare and implement a universal accounting language named International Financial Reporting Standards (IFRS) for harmonization. The use of IFRS as a universal financial reporting language has gained momentum across the globe. More than 130 countries have adopted IFRS as their updated accounting principle.

India is one among the pioneers in the context of harmonization and unification of accounting practice with IFRS. Large companies classified as those having a net worth of Rs. 1000 crore (i.e, $ 224.27 million USD) or more are mandated to adopt IFRS with effect from April 1, 2011. This was to be followed by companies with net worth of Rs. 500 crore (i.e, $ 82.63 million USD) or more, from April 1, 2016 and the companies with Rs. 250 crore (i.e, $ 38.31 million USD) or more from April 1, 2017. Ministry of Corporate Affairs (MCA) has also declared that any companies can adopt IFRS voluntarily from April 1, 2015. Presently in India two parallel set of accounting principles are existing in India, namely, existing Indian GAAP and Indian Accounting Standards (Ind AS). Ind AS is the Indian form of IFRS prepared by Institute of Chartered Accountant of India (ICAI) and notified by (MCA).

As per the IFRS implementation road map decided by the MCA, major high net worth companies comes under mandatory adoption phase. Moreover, out of total BSE listed companies 51% companies have remained to adopt IFRS (PwC Report, 2016). The voluntary adoption of IFRS is an option for SMALL CAPs to get aligns with IFRS.

Benefits of IFRS implementation by Indian SMALL CAP companies

A strong need was felt by legislation to bring about uniformity, rationalization, comparability, transparency and adaptability in financial statements. The better way for getting rid of problems faced by different methods of standards is to have a single set of global standards, of the highest quality, set in the interest of public. The convergence of financial reporting and accounting standards is a valuable process that contributes to the free flow of global investment and achieves substantial benefits for all capital market stakeholders. It improves the ability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment. It facilitates accounting and reporting for companies with global operations and eliminates costly requirements like restoration of financial statements. It has the potential to create a new standard of accountability and greater transparency, which are values of great significance to all market participants including regulators. It reduces operational challenges for accounting firms and focuses their value and expertise standard setters and other stakeholders to improve the reporting model.

In addition to the above benefits discussed following are the benefits of IFRS implementation in brief:

1. Enhances Investors comfort
2. Enhances credibility of domestic capital markets to foreign capital providers
3. Easy access to foreign capital markets
4. Enhanced comparability with international peers
5. Keep "one set of books"
6. Global education and training

LITERATURE REVIEW

Pratiwi, Shalihatulhayah and Mayasari (2013), conducted a study on 'The Influence of Political Factors on IFRS Adoption' to identify that colonialism, quality of local regulator and international power politics are the political factors which influence to adopt IFRS in 13 countries. Colonialism and the quality of local regulators have a positive influence on the adoption of IFRS in the country. While the international power politics is negatively influenced in the IFRS adoption process. The better quality of local regulator in the country indicates that the regulator of the country are able to formulate the policy and regulation regarding to the accounting standards that are used to support the development of financial reporting.

Archambault and Archambault (2013), in their study 'An Analysis of Social Factors Influencing the Adoption of International Financial Reporting Standards' empirically administrated a framework by using three models, namely, national culture, political system, economic system are the influencing factors for permitting IFRS in a country. The study concluded that literacy rate of a country and net import activities positively influence the decision to adopt IFRS. Economically developing countries were also shown to be more likely to adopt IFRS.

Djatej.A. et. al (2012) conducted a study on 'Critical factors of IFRS adoption in the US: an empirical study' to identify the behavioural attributes of accounting practitioners toward the possibility of early adoption of (IFRS). Using the Theory of Planned Behaviour (TPB) the current study empirically, investigates the attitude, subjective norms, and perceived control as the factors influencing the intention of early implementation of IFRS in the US.

Patil.M.D (2015) has conducted a study on 'Implementation of converged Indian Accounting Standards (Ind AS)' to study the IFRS convergence process and conversion on AS to Ind AS. To explain that IFRS is in infant stage in India needs accounts professionals to bridge in the changing paradigm.

Guggiola.G (2010) conducted a study on 'IFRS Adoption In The E.U.,Accounting Harmonization And Markets Efficiency: A Review' to explain the effects of IFRS adoption on international harmonization and the relationship among Coexisting local GAAP, fiscal rules and U.S. GAAP have been analyzed. Universal accounting language, Global financial comparability are the factors to improve market efficiency.

Sebtugt.Y (2014) in his study on 'Determinants of voluntary IFRS adoption in an emerging market: Evidence from Turkey' to identify the determinant factor for adopting IFRS voluntarily by listed firms in turkey. The authors have identified five determinant factors, namely, size, auditor, exports, industry, leverage. Size, international exposure, and type of auditor are important drivers of the voluntary IFRS adoption.

Okpala.k (2012) has conducted a study on 'Adoption of IFRS and Financial Statements Effects: The perceived implications on FDI and Nigeria Economy' to investigate the effect of IFRS adoption on Foreign Direct Investment in Nigerian economy. He found IFRS implementation has a significant impact on FDI inflows and helps to generate funds in the Nigerian economy. However, IFRS has much impact on making available timely and accurate financial reports.

RESEARCH PROBLEM

The BSE listed SMALL CAP companies for being considered as companies having less resources may have constraints in adopting and implementing IFRS even though implementation of IFRS is advantageous to them. It is therefore considered prudent to focus on the following areas as:

4. The extent to which SMALL CAPs have accepted and implemented IFRS;
5. The factors which primarily drive SMALL CAPs to adopt and implement IFRS.

OBJECTIVES OF THE STUDY

The study has been undertaken to examine the influence of IFRS upon BSE listed Indian SMALL CAP companies. The specific objectives of the study are as follows:

1. To examine the nature and extent to which SMALL CAPs in India have adopted the IFRS.
2. To study the factors influencing the adoption of IFRS by the SMALL CAPs on voluntary basis.

RESEARCH METHODOLOGY

• *Data Source and method of data collection:* The study is based mainly on primary data collected through own developed questionnaire in a 5-point likert scale. The questionnaire consists of 30 statements out of which 29 statements were considered for factor analysis. The questionnaire was distributed among 216 respondents of 80 selected SMALL CAPs. The respondents include chartered accountants, cost accountants, company secretaries, senior managers, and policy makers associated with SMALL CAPs, selected at random. The influencing factors derived from factor analysis has been taken as the independent variables and one statement, i.e. necessity of voluntary adoption IFRS for SMALL CAPs has been taken as dependent variable.

• *Sample Units:* Companies having net worth of less than Rs. 250 (crore) (i.e, $ 38.31 million USD) are treated as SMALL CAPs in this study.

• *Tools and techniques used:* Factor analysis has been conducted to identify the major influencing factors for voluntary adoption of IFRS by SMALL CAPs. Also Linear regression with ANOVA and model summary has also been conducted to find out the effect of the factors identified on the dependent variable. SPSS 22.0 package has been used for all the statistical calculations.

Data analysis and interpretation

Consistency of the data collected has been checked using cronbach's Alpha for reliability test which is shown in table 1.it is apparent that the alpha value is 0.883 for all the 30 items taken which indicates that the optimally reliable.

Table: 1 Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.883	.898	30

As stated before that the study intends to identify the influencing factors for voluntary adoption of IFRS, keeping this in view, a factor analysis has been conducted with KMO and Bartlett's test. To measure the sample adequacy of the data collected, KMO was conducted which has been depicted in Table 2.

Table: 2 KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.556
Bartlett's Test of Sphericity	Approx. Chi-Square	7071.533
	df	406
	Sig.	0.000

It is clear that Kaiser-Meyer-Olkin measure of sampling adequacy is 0.556, which is greater than the required 0.5 for a satisfactory factor analysis to proceed. The approximate chi-square value is 7071.533 with 406 degrees of freedom, which is also high. So it can concluded that factor analysis is appropriate as it fulfil the requirement to proceed. In the case of Bartlett's Test of Sphericity, the observed significance level is .000, which means the relationship among variables is strong. Hence, the data set complies with the requirements of the factor analysis and multivariate statistical analysis.

7 factors have been extracted from 29 variables through the exploratory factor analysis, which explain 78% variance (Cumulative percentage of rotation sum of square loading is 77.548) with varimax rotation and Kaiser normalisation. These factors with their variables are, namely, FDI inflows (7), international exemption (6), reporting flexibility (6), unification of reporting (3), minimising reporting cost (4), fulfil statutory requirement (2) and quality reporting (1)

To substantiate the linkage the factors identified through factors analysis with the dependent variable i.e, Necessity of voluntary adoption IFRS for SMALL CAPs, ANOVA and regression was also conducted.

Table: 3 Factors influences for the voluntary adoption of IFRS by Small Cap companies in India

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	114.473	7	16.353	48.356	.000[b]
	Residual	70.342	208	.338		
	Total	184.815	215			
a. Dependent Variable: voluntary adoption IFRS is essential for Small Caps in India						

b. Predictors: (Constant), FDI inflows, international expansion, unification of reporting, Reporting durability, reporting cost, fulfil statutory requirement, Quality reporting

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It is apparent from Table 3, that there is significant difference in the means of the predictors and the dependent variable as the significant P value is 0.000 which is less than 0.05.

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b. Dependent Variable: Necessity of voluntary adoption IFRS for SMALL CAPs

Table 4 indicates that the value of regression coefficient is adjusted R^2 is 0.607 revealing that the factors influencing IFRS adoption with 60.7% variation in voluntary adoption of IFRS.

MAJOR FINDINGS:

The study identifies the influencing factors i.e, FDI inflows, international expansion, unification of reporting, Reporting durability, reporting cost, fulfil statutory requirement, Quality reporting. Empirical evidence of the study supports that, the above factors influence 60.70 % as R^2=.607 for voluntary adoption of IFRS by SMALL CAPs. Leading factors, namely, FDI inflow, unification of reporting, minimising reporting cost indicate the positive influence as its standardised Beta coefficient vales are 0.676, 0.151, 0.188 respectively at 0.000 significant values.

CONCLUSION

In India, IFRS is at infant stage that needs time and adequate awareness of preparers and policymakers for its full phase adoption by every SMALL CAPs. Presently two set of accounting standards are prevailing in India i.e, existing accounting standard and Ind AS. The IFRS implementation roadmap decided by MCA, covers high net worth companies for mandatory adoption and companies having the net worth less than Rs.250 crore (i.e, $ 38.31 million USD) has to opt IFRS voluntarily. The transition from Indian GAAP to IFRS faces various difficulties and challenges but at the same time looking at the advantages of its adoption confers, the convergence of IFRS. Major factors, namely, FDI inflow, unification of reporting and minimising of reporting cost are the factors, which substantially influenced the SMALL CAPs for voluntary adoption of IFRS. Growth and expansion of an entity depend upon the wide range of capital inflow sources. In the present study, FDI inflow is found to be the most significant factor, which influences SMALL CAPs to adopt IFRS voluntarily. Increases in shareholders' trust, easy access in the global market, enhancing investor's confidence, corporate taxation benefit, trade alliance are the significant reasons for FDI inflow. IFRS adoption by a company minimises its reporting cost by preparing a single financial statement for worldwide communication, instead of preparing multiple financial statements as per different GAAP. Preparation of financial statements with IFRS reduces the reporting disparities and unify the statements, which is understandable and comparable by worldwide investors.

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