

A Paradigm Shift in Financial Reporting Format and Impact on Current Ratio

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ABSTRACT

As a step towards convergence of Indian accounting standards and IFRS, Indian companies need to present financial statements as per new format as specified in Schedule VI to Companies Act. The new format, popularly known as Revised Schedule VI is a principle based reporting format as against the old Schedule VI which was rule based reporting format. In the new format of Balance Sheet, there is change in sub grouping of assets and liabilities and so it affects the aggregate amount of current assets and current liabilities. As a result the current ratio of companies will also change, which will ultimately affect the decisions of the investors. Here arises a need to look into the impact of such change on the company's financial statement and their preparedness to accept it and getting competitive advantage in global competition.

This paper is an attempt to study the change in the result of liquidity analysis using current ratio for the companies included in Sensex from the Balance Sheet and notes appended to it as on the date of the year ended 31st March, 2011 for which reporting under old and new formats are available. The aim of the study is also to understand the preparedness of Indian Corporates to switch over to principle based classification of assets and liabilities into current and non-current. Applying paired t test the study finds out whether is there any significant difference in computed current ratio under old and revised format. This study concludes there is no significant difference between the current ratio calculated on the basis of data given as per old and new format.

Keywords: Schedule VI, Principle based Reporting, SENSEX, Current Ratio

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INTRODUCTION

The corporate financial reporting aims to present all its historical financial data along with all relevant qualitative data to its stake holders, on the basis of which decisions are taken. In this era of globalisation the stake holders are required to make the decisions in the presence of wide range of opportunities. In order to ensure they have invested their money in the best companies they need to make comparison between MNCs. But the difference in reporting format brings barriers in the way of comparison between companies. And also due to such differences, companies especially MNCs are also facing problems while reporting their cross border transactions. In order to remove all these regulatory differences and maintain uniformity, IFRS has been issued by IASB.

Worldwide some countries have already adopted and some are on the process either adopting or converging the new standards with their old standards. In India, as a step towards harmonisation of reporting practices, the Companies Act provides a common format for presentation of financial statements. With effect from the financial year beginning from 1st April, 2012 all companies require to present their financial statements as per the new format specified for Profit and Loss Statement and Balance Sheet as provided in the Schedule VI of Companies Act. The change in format resulted into change in the classification of items of Assets and Liabilities. The Assets and Liabilities in the new format are grouped under Non Current and Current and it is the role of Chief Financial Officer (CFO) to define and justify such classification at each reporting date. In the old format, once it was classified on the date of arising of the item, there is no need to review each year. Hence on analysis of the reporting in the old format and new format for a particular year can give a better insight into effect of change in format.

The ratio analysis, as a tool of financial statements analysis, gives a better understanding of the financial statements. However the ratios are subject to correctness of the figures and appropriateness of heading under which it is shown. Among various ratios the current ratio is most important measure for liquidity analysis, which establishes relationship between the current assets and current liabilities.

Due to the paradigm shift in classification of assets and liabilities into current and non-current on the revision of Schedule VI, the amount of current assets and current liabilities changes, so also the current ratio. So there is a need to analyse the change in current ratios and its impact on analysis of financial statements by the stakeholders.

In this paper it is attempted to study whether is there any significant differences in the current ratios of the selected companies included in SENSEX (except four companies namely HDFC Bank, Housing Development Finance Corporation Ltd., ICICI Bank and State Bank of India) for the year ended 31st March, 2011 as reported in old format in Annual Report, 2011 and in new format in Annual Report, 2012. This gives an idea about impact of revision of the Schedule VI in classifying the assets and liabilities into current and non-current.

OBJECTIVES

The objectives of the paper are: -

- a) To study how the principle based classification of the assets and liabilities into Current and Noncurrent has affected the value of computed current ratios
- b) To know the preparedness of Indian Corporate to converge to the International reporting practices

DATA AND METHODOLOGY

The methodology of the study involved:

- a) Calculation of Current Ratios

The ratios are calculated for the companies included in SENSEX excluding the four banking and housing finance companies for whom the reporting format of Companies Act are not applicable

The ratios are calculated for the financial year ending on 31st March, 2011 by taking values of Assets and Liabilities disclosed in Annual Reports published in 2011 and 2012 under old format and new format respectively.

- b) Hypothesis test has been done on basis of t test to find out whether is there any significant difference between the current ratio as per old and new reporting format.

HYPOTHESIS

Null Hypothesis (H₀): There is no significant differences in the current ratios computed taking the figures under old format and new format.

Alternate Hypothesis (H₁): There is significant differences in such current ratios.

ANALYSIS

For this study, the Annual Reports for the financial years 2010 -11 and 2011 -12 are studied. In their Annual Report for the year 2010 -11, the companies provided the financial figures for the year ending 31st March, 2011 and also of 2010 under the old reporting format. In Annual Report for 2011 -12, they provided the figures for the year ending on 31st March, 2012 and of 2011 in the revised format. As such the financial figures for the year ending 31st March, 2011 were available in the old format as well as new format. The value of current assets and current liabilities were taken from the balance sheets provided in annual reports of two periods under study. However due to non clarity in the old format, considering the disclosures in the schedules to balance sheet and notes, the figures of current assets and provisions are adjusted such that noncurrent figures are eliminated.

The following table shows the current ratios computed by taking the values of current assets and current liabilities as on 31st March, 2011 under Revised Schedule and Old Schedule.

(The total of current assets and current liabilities are provided in Appendix I)

Table: Current Ratios as on 31st March, 2011 of Companies included in Sensex under Revised Schedule and Old Schedule

SL.NO.	NAME OF COMPANIES [#]	CURRENT RATIOS AS ON 31.3.2011	
		REVISED SCHEDULE	OLD SCHEDULE
1	BAJAJ AUTO LIMITED	0.79	0.78
2	BHARAT HEAVY ELECTRICALS LTD.	1.74	1.49
3	BHARTI AIRTEL LTD.	0.28	0.39
4	CIPLA LTD.,	2.84	3.98
5	COAL INDIA LIMITED	2.56	1.46
6	DR. REDDY'S LABORATORIES LTD.,	1.40	2.12
7	GAIL (INDIA) LTD.	1.06	1.30
8	HERO MOTOCORP LIMITED	0.96	1.02
9	HINDALCO INDUSTRIES LTD.	1.62	1.98
10	HINDUSTAN UNILEVER LTD.,	1.05	0.82
11	INFOSYS LTD	4.59	4.35
12	ITC LTD	1.54	1.64
13	JINDAL STEEL & POWER LTD	0.78	1.48
14	LARSEN & TOUBRO LIMITED	1.36	1.05
15	MAHINDRA & MAHINDRA LTD.	1.08	1.00

16	MARUTI SUZUKI INDIA LTD.	2.37	1.75
17	NTPC LIMITED	2.57	2.77
18	ONGC LTD	1.35	1.48
19	RELIANCE INDUSTRIES LTD	1.36	1.73
20	STERLITE INDUSTRIES (INDIA) LTD	3.63	7.28
21	SUN PHARMA LTD.	5.97	4.01
22	TATA CONSULTANCY SERVICES LTD.	1.32	1.75
23	TATA MOTORS LTD.	0.58	0.76
24	TATA POWER CO. LTD	0.89	1.64
25	TATA STEEL LIMITED	1.38	1.96
26	WIPRO LTD.	2.10	2.48

#source: www.bseindia.com

On applying the 'paired t -test' using the Statistical software the following result was obtained:

Paired Samples Test

	Paired Differences					T	Df	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower	Upper			
Pair 1 CR_ Revised - CR_Old	-.20385	.93657	.18368	-.58213	.17444	-1.110	25	.278

Interpretation

As the Critical value 2.06 is more than the above computed value 0.278, so null hypothesis is accepted and it is concluded that there is no significant difference between the reporting under revised schedule and old schedule formats for the analysis by the stakeholders. Though individually some company has significant change in their current ratio and it can affect the decision of their stake holders. But as a whole there is no significant impact of the change in reporting format on company's current ratio. So there are no much difficulties for companies while adopting the new regulations.

CONCLUSION

In this globalised economy the stake holders of a company are not limited within a country. But due to difference in accounting practices, many a times stake holders are facing problem when it arises to analyse a foreign financial statement. In order to attract more foreign investors, domestic companies need to prepare their financial statement as understandable to such investors. The financial reporting, satisfying all the stakeholders is gigantic task for the reporting entity. Also there cannot be multiple reporting formats for providing the information to stakeholders considering the cost and benefit analysis of reporting.

For the Indian companies, the reporting in old format was inadequate and inconsistent when compared to the International reporting practices and hence they were also preparing the financial statements under IFRS. The dual reporting was costly. It is a welcome step by Ministry of Corporate Affairs by issuing the new reporting format to converge to international reporting practice. The new format requires classifying the assets, liabilities, incomes and expenses by considering the appropriate accounting principles at the end of each financial year. As it is a principle based reporting format, it will be a challenge for Chief Financial Officer (CFO) and his team for correct disclosure. This study by computing the current ratios under old and new format for a particular year and statistically testing the difference in the ratios, found that the Indian corporate and their CFOs are ready to accept the challenge of principle based reporting replacing the rule based reporting.

References

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http://www.mca.gov.in/XBRL/pdf/Guidance_Note_Rev_ScheduleVI.pdf
 - c)websites of the 26 companies under study
 - d) “Supplement on Revised Schedule VI.pdf”

APPENDIX

Total of Current Assets and Current Liabilities with Current Ratios of the 26 Companies.

(The figures of current assets and current liabilities are in ` crore except of BHEL and WIPRO which are in ` millions.)

Sl.No.			Current Assets	Current Liabilities	Current ratios
1	Bajaj Auto Ltd.	Revised	3030.95	3855.47	0.79
		Old	3004.75	3830.74	0.78
2	BHEL	Revised	43277.86	24938.68	1.74
		Old	50612.13	34020.14	1.49
3	Bharati Airtel	Revised	53105	191647	0.28
		Old	59753	153237	0.39
4	CIPLA	Revised	4544.4	1598.51	2.84
		Old	4521.29	1137.15	3.98
5	Coal India Ltd.	Revised	68318.26	26665.85	2.56
		Old	65459.7105	44872.53	1.46
6	DRL	Revised	36527	26037	1.40
		Old	35963	16976	2.12
7	GAIL	Revised	9420.19	8847.68	1.06
		Old	11088.5	8506.06	1.30
8	Hero MotorCorp	Revised	5771.84	6017.31	0.96

		Old	6223.9	6109.44	1.02
9	Hindalco	Revised	15929.2	9842.64	1.62
		Old	15543.86	7838.78	1.98
10	HUL	Revised	6974.25	6620.07	1.05
		Old	6059.83	7399.85	0.82
11	INFOSYS	Revised	24003	5224	4.59
		Old	23153	5317	4.35
12	ITC	Revised	13045.54	8477.48	1.54
		Old	14075.84	8562.78	1.64
13	JSPL	Revised	7234.74	9310.97	0.78
		Old	6935.01	4698.46	1.48
14	L&T	Revised	39972.77	29300.38	1.36
		Old	28867.05	27616	1.05
15	M & M	Revised	7960.14	7360.17	1.08
		Old	6324.59	6353.84	1.00
16	MARUTI SUZUKI	Revised	97464	41047	2.37
		Old	69833	40008	1.75
17	NTPC	Revised	36114.34	14041.04	2.57
		Old	35524.74	12817.51	2.77
18	ONGC	Revised	259235.55	191566.12	1.35
		Old	302525.58	203739.16	1.48
19	RIL	Revised	95877	70484	1.36
		Old	93814.68	54220.6	1.73
20	STERLITE	Revised	27159.61	7483.17	3.63
		Old	27973.4	3844.36	7.28
21	SUN PHARMA	Revised	46938.9	7866.9	5.97
		Old	29481.3	7352.4	4.01
22	TATA CHEMICALS	Revised	2500.99	1891.82	1.32
		Old	2648.58	1514.52	1.75
23	TATA MOTORS	Revised	10971.66	19000.27	0.58
		Old	11508.42	15068.18	0.76
24	TATA POWER	Revised	2767.6	3105.33	0.89
		Old	3927.17	2394.96	1.64
25	TATA STEEL	Revised	18113.02	13095.89	1.38
		Old	18448.73	9394.06	1.96
26	WIPRO	Revised	217122	103276	2.10
		Old	199595	80548	2.48