“Value relevance of financial information: A comparative study of pre- and post-implementation of Indian accounting standards”

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VALUE RELEVANCE OF FINANCIAL INFORMATION: A COMPARATIVE STUDY OF PRE- AND POST-IMPLEMENTATION OF INDIAN ACCOUNTING STANDARDS

Abstract

In 2016, India implemented new accounting standards, Ind AS, aligning with IFRS to increase transparency in the financial reporting of Indian companies. This study examines the value relevance of financial information in India before and after the adoption of Indian accounting standards (Ind AS) by comparing the published financial statements in pre- and post-Ind AS periods and determines the influence of financial information on the market price of shares. The study period is for twelve years, from 2011 to 2022, divided into 2011–2016 (pre-Ind AS period) and 2017–2022 (post-Ind AS period). To evaluate the value relevance of financial information, the Ohlson pricing model is employed on the panel data of the blue-chip companies listed in the Nifty 50 Index. The results from the Least Squares regression reveal that the net cash from investing activities, profit-after-tax, and book-value-per-share were relevant for investment decisions prior to the adoption of the Ind AS. In contrast, the profit-after-tax had no explanatory power during the post-Ind AS period. However, the net cash from investing activities and the book-value-per-share significantly influenced the market price of equity since the implementation of Ind AS. The value relevance of the accounting statements was superior in the pre-Ind AS period compared to the post-Ind AS.

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INTRODUCTION

The debacle of the US capital markets in 1929 triggered the need to introduce accounting standards based on principles of materiality, conciseness, reliability, and consistency. Whereas experts criticize the approach of conservatism and materiality in accrual accounting as it obscures the true and fair view of the business's financial position (Hung, 2000), and questions have been raised on the relevance of the information in these financial statements.

The GAAP of every nation is influenced by political and social factors designed to cater to the local conditions (Gerhard Mueller & Kelly, 1991; Ray Ball, 2006). Some nations follow rule-based accounting, while others may adopt principle-based accounting leading to divergence in reporting among countries.

Financial statements are the report cards of business organizations, which provide valuable information to stakeholders, assisting them in assessing an organization's functioning. As a firm's financial needs grow, organizations resort to raising funds from various external sources. Published financial statements are an excellent medium for

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reaching out to interested investors and decision-making can be smooth if relevant, comprehensive quantitative and qualitative information are embedded in the documents (Francis & Schipper, 1999). It remains a primary and essential document in discovering the price of financial assets (Oyerinde, 2009, Omokhudu & Ibadin, 2015; Hossain et al., 2004).

To bring uniformity, transparency, and comparability to accounting standards, the International Accounting Standards Board (IASB) initiated developing superior accounting standards, the International Financial Reporting Standards (IFRS), in April 2001. The initial financial statements prepared as per IFRS were published in June 2003. As of March 2018, reporting as per the IFRS was done by 27,000 companies listed on 88 major stock exchanges across the globe. IFRS was meant to bring higher quality to financial reporting, making financial statements relevant to the, reducing the asymmetry in information and curtailing earnings management (Barth et al., 2012; Ewert & Wagenhofer, 2005; Ball & Brown, 1968; Oyerinde, 2009).

India is the fastest growing economy, occupying the fifth place in terms of the size of the economies worldwide, and attracts several foreign investors. Indian Accounting Standards (Ind AS) were introduced in 2016 to enhance the transparency of published financial statements of Indian companies. Studies of market behavior to accounting information have focused on developed economies (Negash, 2008), specifically revolving around earnings and book value, whereas adoption of these findings in other economies exhibited an epistemological bias. This research paper attempts to study the value relevance of the accounting information for the equity market participants in India both prior to and post the introduction of the Indian Accounting Standards (Ind AS) aligning with IFRS.

1. LITERATURE REVIEW

Statements are considered value-relevant when the reported financial statements have a significant association with the share prices and their returns and can relate to and predict a firm's value and potential growth (Ohlson, 1995). Studies show that markets draw information from financial statements to discover the prices of financial assets, and the prices converge toward the asset's intrinsic value in the long run (Penman et al., 2007). The interest of investors in the sectors and ticket size has changed to suit the changing economies. From the first industrial revolution of mechanization to the present ecosystem of technology-driven businesses, financial reporting also underwent a change to cater to investor needs. Collins et al. (1997) observed a reduction in the value relevance of financial statements as the economies moved from a labor-intensive to a technology-driven ecosystem. The findings of Core et al. (2003) corroborated the above findings. They revealed a decline in the value relevance of accounting information such as cash flows, income, and balance sheet items in the new economy period, post-1990, where the valuation of firms was valued differently than the way it was before 1977. The US markets indicated that financial statements carried little value and were losing relevance during the study period (Francis & Schipper, 1999). Similar results were found in the study on the book value of equity and earnings of German firms with the market price of the shares on adopting IFRS compared to the reporting based on International Accounting Standards (Paananen & Lin, 2007). Abayadeera (2010) examined 91 companies across various sectors in Australia on the value relevance of accounting information in modern industries; the study revealed a significant influence of book value, whereas the value relevance of reported earnings declined during the period. A study by Lev and Zarowin (1999) on 1,300 firms in the US for the period 1977–1996 revealed that reported earnings and cash flows were relevant, whereas the relevance of the book value diminished during this period. Sharma et al. (2012), in their study on Indian markets for the period 2000–2008, reported that the value relevance of financial statements was insignificant; it was found that the value relevance of accounting information in the post-Ind AS period had reduced (Venugopala Rao et al., 2022). The information from the cash flow statement in India had little value addition (Vishnani & Shah, 2008). The study on the impact of reforms in financial reporting in the UAE for the period 2001–2008 suggested that the value relevance of accounting information decreased post the reforms in the GAAP, in convergence with IFRS, in the year 2003 (Jamal Barzegari Khanagha, 2011). Ahmed et al. (2013) studied the accounting quality of reporting on adopting International Financial Reporting Standards (IFRS) compared to benchmark firms and found no significant difference in the accounting quality between firms adopting the IFRS and their domestic GAAP.

Contrary to the findings mentioned above, some research studies revealed the value relevancy of financial statements in determining the market price.

The study on listed companies in Nigeria from 2002 to 2008 revealed the association between dividends, earnings, and share prices; the accounting information on dividends was a widely used parameter in determining the share price (Oyerinde, 2009). The discretion in presenting the accruals in statements makes room for earnings management. The companies listed on the Australian exchange suggest that the earnings management had a differential impact on the value relevance of financial information based on the duration of the accruals (Whelan & McNamara, 2004). The public sector banking stocks listed on BSE from 2007 to 2012 revealed a positive relationship of the earnings per share with share price, while book value per share was found to be statistically insignificant with the share prices (Mulenga, 2015). It was noted that IFRS increased the quality of information in three European countries, i.e., Austria, Germany, and Switzerland, and it worked in the favor of investors' decision-making (Daske & Gebhardt, 2006). Study results on the influence of adopting IFRS in the UK by (Latridis & Rouvolis, 2010) revealed a healthy transition into the new reporting environment. It also suggested that there was less scope for earnings management, making the statements more value relevant. Findings in the empirical study on the financial reports of the US firms in the 1980s revealed the incremental value relevance of most of the fundamental information; it explained 70% variability of earnings to excess returns (Lev & Thiagarajan, 1993). The study of listed firms in the Chinese markets during 1999–2003 confirms the relevance of accounting information in the share markets, and the strength in the B- and H-share markets were higher than that of the A-share market (Liu, J. & Liu, C., 2007). The study on the accounting reforms in Tunisia revealed that a firm's cash flow and book value had a significant association with the market price of the shares (Ben & Nachi, 2007). Results of the study to determine the effect of the financial performance of the stock price of non-banking companies in Indonesia suggested a significant association between them (Zarah Puspitaningtyas, 2017). The results of the study of the relationship between the accounting information and the market price of the firms listed on the Malaysian stock exchange during 2012–2016 post-adoption of IFRS suggested that the earnings, book value of equity and cash flow from operations significantly explained the variation in the share price of firms (Abo Baker Mirza et al., 2019). A study on the explanatory power of accounting variables on the market prices of shares in Germany and the UK by Elbakry et al. (2017) suggested long-run Granger-causality of the accounting variables on the share prices in the UK, unlike the German markets due to the evolution of the standards in a highly politicized environment in the country. The earnings and book value has value relevance during the IFRS enforcement period in the Indian market, with a slight weakness in the book value compared to the earnings with the share price (Srivastava & Muharam, 2021). The findings of the study on the value relevance of book values and earnings in Indonesia and India revealed that it increased during the period when IFRS was enforced. It was also found that the scope for earnings management reduced in this period, which otherwise prevailed (Srivastava & Muharam, 2022).

Several studies conducted on financial information and its relevance in measuring the influence in determining the price of listed financial assets' produced contradicting results; some supported the statements' relevance, while others opposed it.

The literature indicates a gap in the studies on the market behavior of the shares price to the financial statements post the introduction of Indian Accounting Standards (Ind AS) in India. This paper attempts to unravel the impact of the Indian Accounting Standards (Ind AS) converging to IFRS on the behavior of the market price of equity.

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1.1. Accounting Standards in India

The accounting principles put statement users in a dilemma regarding the application of the financial statements in discovering the price of the shares traded. The debate between reliability and relevance is ever continuing. The accounting concept of records inked on historical cost provides reliability in the information with a certain amount of dilution in its relevance in the accounting period, whereas presenting the accounting information as per fair value adds relevancy but with a compromise on reliability, as valuations are subjective (Kothari, 2001). The Institute of Chartered Accountants of India (ICAI) has prescribed Indian Accounting Standards (Ind AS). The new accounting standards attempt to converge with IFRS, accepted as Global Financial Reporting Standards, making financial information comprehensive and investor-friendly globally (ICAI, 2018). From the accounting year 2016, all Indian companies barring banks and NBFCs should present their financial statements in schedule III as per Sec 129 of the Companies Act, 2013, in compliance with Indian Accounting Standards (Ind AS).

The quality of published financial statements and their influence on share prices in India is evaluated by analyzing the financial statements presented before and after the adoption of Ind AS. The study aims to achieve the following:

a. To study the effect of the accounting standards in India on the market price of shares.

b. To investigate the value relevance of financial statements for pre- and post-Ind AS periods.

2. METHODOLOGY

From 2016–2017, the Government of India made it mandatory for all Indian companies except banks and NBFCs to report their financial statements adopting Ind AS. The study is for twelve years, from 2011 to 2022, divided into 2011–2016 (pre-Ind AS period) and 2017–2022 (post-Ind AS period). National Stock Exchange (NSE) Nifty 50 Index is a broad-based stock market index benchmark for the Indian equity market. Out of 50 companies, banking and financial companies are excluded as they have not adopted the Ind AS. The 23 companies selected for the study were consistently listed on the index for all twelve years, considering that they were a good representation of the industry hence were included for analysis. The balanced panel data are examined to evaluate the predictive ability of the accounting variables in the Indian markets. Data were collected from secondary sources; websites of NSE, SEBI, Ministry of Corporate Affairs, individual companies, publication houses, and statistical data provided on the websites of the Government of India.

Financial statements consist of a statement of profit and loss indicating the firm's overall performance, a balance sheet revealing the financial position, and a statement of cash flow for the period followed by notes to accounts for detailed analysis. The accounting variables defining the profitability and a firm's net worth have been included to capture the overall financial performance and position for the study period. The variables from the cash flow statement captured the accounting information represented on a cash basis. The share price quoted on the NSE is considered as a dependent variable, and the independent accounting variables are the book-value-per-share (BVPS), the profit-after-tax (PAT), and the net cash from the investing activities (NCFIA).

Accounting variables have a contemporaneous impact on market returns in the short run, which is visible during the announcement of the results by the corporates; within a few days, this new information gets factored into the share price (Fama, et al., 1969). For this study, the market price of shares at the end of the 5th day of the trading session, post the announcement of a company's financial results, is considered.

To determine the association of accounting variables with the stock returns, the Ohlson model is widely adopted (Penman et al., 2007). The authors framed the regression equations on the panel data for the pre-Ind AS period (2011–2016) and the post-Ind AS period (2017–2022) on the basis of this model.

2.1. Variables in the study

The variables (dependent and Independent) considered for the study are discussed below.

2.1.1. Dependent variable

MPS (Market-price-per share): Market price is the price discovered in the secondary markets by various market participants who depend on the supply of information from several sources in the marketplace. It has been assumed that financial information from the accounting information released by a company also influences the market price. This model considers the 5th day share price at the market close (5DMP) post a company's financial results announcement as the dependent variable.

2.1.2. Independent variables

To capture a summarized view of the performance of a firm and its yearly financial position both on an accrual and cash basis, the independent variables employed in this model are described below.

BVPS (Book-value-per-share): Book-value-per-share is derived from a firm's financial position. The data provided in the balance sheet (a statement of the liabilities and assets valued at historical and fair values) are the outcome of the accounting principles applied in presenting the books of accounts. The literature suggests that BVPS is expected to affect share prices.

PAT (Profit-after-tax): A firm's performance is determined by the bottom line, which is an outcome of certain assumptions in accounting methods. The reported profits of firms can conveniently be termed as estimated, given the accounting assumptions that vary among the firms in the industry. This metric is widely discussed and used.

NCFIA (Net cash from investing activities): NCFIA is forward-looking; it provides a firm's future course of action. It indicates the strategies and direction of the firm's plans. A cash flow statement, an accompanying document, is prepared on a cash basis; this complements information of the financial statements that are presented on an accrual basis.

Model Specification:

$$MPS_{cy} = \beta_0 + \beta_1 LOGBVPS_{cy} + \\ + \beta_2 LOGPAT_{cy} + \beta_3 NCFIA_{cy} + \varepsilon_y, \quad (1)$$

where MPS_{cy}: Market price of company c on the 5th day post announcement of results in year y; $LOGBVPS_{cy}$: Log of the book-value-per-share, of company c in year y; $LOGPAT_{cy}$: Log of profit-after-tax of company c in year y; $NCFIA_{cy}$: Net cash from investing activities of company c in year y; ε_y: Error term; β_1, β_2, and β_3 reflect the direction and the response of the book-value-per-share, profit-after-tax, and net cash from investing activities on the market price, respectively. The stationarity of all the variables was checked, since it is a primary requirement to have stationary time-series to avoid erroneous results. It was found that the book-value-per-share and profit-after-tax were not stationary, and hence it was transformed into its log values to convert it into stationarity series, henceforth mentioned as *LOGBVPS* and *LOGPAT* in the model. The results of the data are discussed below.

3. RESULTS AND DISCUSSION

The descriptive statistics of variables employed in the model given in Table 1 and Table 2 reveal interesting facts about the firms. Of the total 138 observations of pre-Ind AS (2011-16) and post-Ind AS (2017-22), the mean market price of shares exhibited an upward growth in the post-Ind AS period compared to pre-Ind AS. Market prices have risen over this period, indicating that market participants have evinced interest in investing in the shares. This increase can also be attributed to the aforementioned variables and other unobserved market factors. However, the median of the share price in pre- and post-Ind AS periods below the mean indicates that only a few market companies command a higher share price.

Table 1. Descriptive statistics, pre-Ind AS (2011–2016)

Descriptive Statistics	5DMP	BVPS	PAT	NCFIA
Mean	971.1732	276.5243	6756.846	–9719.493
Median	615.7500	202.5600	4497.620	–3923.510
Maximum	3819.950	1014.250	29625.00	14225.70
Minimum	100.8500	12.73000	–7362.390	–73070.00
Std. Dev.	868.2787	209.1719	6574.694	14218.34
Skewness	1.312841	0.988057	1.515355	–2.224785
Kurtosis	4.136227	3.412364	5.155385	8.424100
Jarque-Bera	47.06499	23.43166	79.52764	283.0124
Probability	0.000000	0.000008	0.000000	0.000000
Sum	134021.9	38160.35	932444.8	–1341290.
Sum Sq. Dev.	1.03E+08	5994147.	5.92E+09	2.77E+10
Observations	138	138	138	138

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Table 2. Descriptive statistics, post-Ind AS (2017–2022)

Descriptive Statistics	5DMP	BVPS	PAT	NCFIA
Mean	1364.575	399.4018	10021.94	–13412.49
Median	676.8500	229.4200	7930.725	–5727.370
Maximum	8743.700	1832.240	67565.00	8565.000
Minimum	81.95000	31.32000	–31316.60	–142409.0
Std. Dev.	1608.754	375.0668	12934.77	22004.61
Skewness	2.157288	1.742865	1.098346	–2.984463
Kurtosis	8.082039	5.881464	7.301491	14.27529
Jarque-Bera	255.5455	117.6056	134.1376	935.8708
Probability	0.000000	0.000000	0.000000	0.000000
Sum	188311.3	55117.45	1383028.	–1850923.
Sum Sq. Dev.	3.55E+08	19272486	2.29E+10	6.63E+10
Observations	138	138	138	138

When compared to both periods, the book-value-per-share and profit-after-tax show almost the same averages, slightly leaning on the higher side during post-Ind AS. However, the minimum PAT during post-Ind AS numbers reveal that companies have reported deep losses in this period compared to the past; this may be due to the economic slowdown, which was prevalent in the auto sector.

Net cash flow from investing activities is a forward-looking indicator. A higher mean spending post-Ind AS, compared to pre-Ind AS, indicates that the companies have higher spending in the assets, and a better outlook, which is corroborated by the maximum spending, which has gone up by 38%.

The Jarque-Bera statistics indicate that barring the book value of the shares, which are normally distributed, the others do not confirm; this is a common feature in financial time series.

Table 3. Pearson correlation, pre-Ind AS (2011–2016)

	5DMP	BVPS	PAT	NCFIA
5DMP	1.000000	0.664800	–0.036374	0.306563
BVPS	0.664800	1.000000	0.115227	–0.059553
PAT	–0.036374	0.115227	1.000000	–0.615206
NCFIA	0.306563	–0.059553	–0.615206	1.000000

Table 4. Pearson correlation, post-Ind AS (2017–2022)

	5DMP	BVPS	PAT	NCFIA
5DMP	1.000000	0.815368	0.027148	0.159884
BVPS	0.815368	1.000000	0.111321	–0.121672
PAT	0.027148	0.111321	1.000000	–0.501303
NCFIA	0.159884	–0.121672	–0.501303	1.000000

The correlation matrix given in Table 3 and Table 4 revealed that all the variables in the model are correlated, indicating an association between them. The PAT was negatively correlated with the market price in the pre-Ind AS period. However, it turned positive in the post-Ind AS period. The net cash from investing activities exhibited a positive relationship with the 5th day market price during the study period; however, its strength weakened in the post-Ind AS compared to the period of pre-Ind AS. The relation of the PAT and the BVPS was also negative with the NCFIA in both the periods.

Table 5. Regression, pre-Ind AS (2011–2016)

Dep Variable: 5DMP
Panel Least Squares
Sample: 2011–2016
Periods: 6
Cross-sections: 23
Total observations: 138

	Coefficient	Standard Error	t-statistics	p-value
LOGBVPS	564.8709	57.64715	9.798764	0.0000
LOGPAT	142.8013	62.04898	2.301429	0.0229
NCFIA	0.023754	0.003928	6.048019	0.0000
C	–3120.814	663.6148	–4.702749	0.0000
R-squared	0.480197			

Table 6. Regression, post-Ind AS (2017–2022)

Dep Variable: 5DMP
Panel Least Squares
Sample: 2017–2022
Periods: 6
Cross-sections: 23
Total observations: 138

	Coefficient	Standard Error	t-statistics	p-value
LOGBVPS	1214.696	110.8286	10.96014	0.0000
LOG PAT	51.62600	102.9773	0.501334	0.6170
NCFIA	0.018311	0.004562	4.014162	0.0001
C	–5736.179	1220.707	–4.699063	0.0000
R-squared	0.488306			

Table 5 and Table 6 show mixed results on the influence of regressors on the regressand. The R-squared of 0.48 for both the periods (pre- and post-Ind AS) indicates the model fits fairly and explains the variance in the 5th day market price after the announcement of the financial results through the accounting variables of PAT, BVPS, and NCFIA. The R-squared in both periods revealed similar strengths in explaining the variability.

The Accounting Standards that were applied before the introduction of Ind AS in 2016 revealed that all the independent variables were significant at 5% and influenced the market price of listed shares. The model for the post-Ind AS period revealed that the PAT is positive but insignificant.

The NCFIA has been significant in both periods and negatively influenced the 5th day share price in the market. It appears that the Indian Accounting Standards (Ind AS), which embraces the IFRS, has diminished the value relevance of the accounting variable of profit-after-tax. The results indicate that the financial reporting as per pre-Ind AS had better predictive power of the market price when compared to the financial reporting as per Ind AS.

CONCLUSION

The quality and timeliness of the information bring value to financial statements. The implementation of Ind AS converging to IFRS was considered a step towards enhancing the value relevance of the financial statement information. On the premise that investors rely on published financial statements for their strategic investment decisions, a study of the published financial statements of listed blue-chip companies in India before and after the implementation of the Ind AS is undertaken to determine its value relevance. Panel data were studied to measure the statistical effects of firm-specific factors, minimizing the estimation biases efficiently. The OLS regression on the Ohlson pricing model revealed that published financial statements were value relevant both in the pre-Ind AS and post-Ind AS period. However, it is interesting to note that the performance metric (profit-after-tax) was found to be insignificant during post-Ind AS and could not assist the investors' decision-making. Hence, the value relevance of financial statements during the pre-Ind AS was superior to the post-Ind AS. The limitation of the study is that only the blue-chip companies listed on the NIFTY 50 were studied, excluding banks and non-banking financial companies as they have not yet adopted the Ind AS for their financial reporting.

Further research can be done by including macroeconomic factors and published financial information, to determine their influence on the market price of shares during pre-Ind AS and post-Ind AS. As the above study indicates the association of the accounting variables, such as book-value-per-share and net cash flow, with the market price of the shares, further research on the causality of the market price of shares can be done. A similar study can be done on the midcap and small cap companies listed on Indian exchanges.

AUTHOR CONTRIBUTIONS

Conceptualization: K. P. Venugopala Rao.
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