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Earning Power Capabilities under GAAP & IFRS

A Case Study of Satyam & Infosys

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ABSTRACT

India is going for the adoption of the IFRS from 01-04-2011 but a common conjecture is that after adopting the international financial reporting standards may revolutionize the profitability analysis and may also change the earning power of the companies. In the study an empirical research on the effects of the IFRS-adoption on the earning power of the company by selecting Satyam Computer Services Ltd and Infosys Technologies Ltd, two giants of Information technology and both are listed in the BSE, NSE NYSE. The study also discussed the causes of the change in the earning power under the IFRS and Indian GAAP.

1. INTRODUCTION

Companies are increasingly raising capital and attracting major investors from outside their home countries. A handful of firms in India are participating in this trend, raising capital in North American and European markets and attracting foreign institutional investors to India. But India has by no means realized its full potential with respect to attracting foreign capital. The country's low-cost, high-quality human resources afford Indian companies a unique competitive advantage. But to fully leverage this advantage they need to attract more foreign capital from the global financial markets.

For this purpose not only integration of capital markets, foreign capital flows, FDI's and international mergers but also global economic crises and possible losses of investors which forces practitioners to question the reliability of financial statements. A worldwide accounting environment, which ensures data that, is correct, complete and up-to-date and a dependable investment climate is needed. Different of similar business activities in different countries' financial statements causes hard-to-explain and various results in an international manner.

Financial Reporting serves as an important mechanism to facilitate decision-making and to "control" the behavior of stakeholders. The accounting profession has long been concerned with how to prepare financial information that is relevant and reliable. Almost every country has promulgated its financial accounting standards and reporting regulations to ensure that similar transactions are treated in a same manner. National GAAP attempts to ensure comparability of financial information across various companies under a jurisdiction like a Indian GAAP. For insuring this object the ICAI has issued different accounting standards and regulations to ensure that similar transaction are treated in a same manner. The accounting standards issued by the ICAI are known by the name of "Accounting Standard". Till now the ICAI has issued the 32 accounting standards. These accounting standards ensure that different transactions which are relevance to the different decision making will be recognition, measurement, presentation and disclosure requirements treated in a same manner of the same transaction by the different companies in India.

Accounting Regulation in India

With the rapid development of global markets, capital markets in particular, the comparability issue has started to reach across boarders. Now the new era is the

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globalizations era. Today MNC is not working in the one country or depend on the one country for the financial requirement other then this now the investors also not depend on the one country's company for the portfolio management. The investors have need the reliable relevance transparent uniform and high quality financial information for the portfolio management. At least two approaches have been proposed to solve this international accounting comparability problem-

(i) Political approach- Under which allowing co-existence of different sets of GAAP and letting them compete with each other and this approach has been adopted by the Infosys Technologies Ltd. The Infosys Technologies Ltd provides financial statements according to the different accounting standards like Indian GAAP, US GAAP, UK IFRS, DUTCH IFRS, and the IFRS. In this approach investor considerer the relevant financial statement for example if investor belong to the UK and want to invest in the Infosys then he will consider the only those financial statement which are according to UK IFRS. This approach has one disadvantage that if the investor belongs to different country then company will have to prepare different financial statement according to the different national GAAP.

(ii) Economic approach-onsidering convergence toward the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). IFRS is an accounting framework that establishes recognition, measurement, presentation and disclosure requirements relating to transactions and events that are reflected in the financial statements. IFRS are being developed by the International Accounting Standards Board (IASB) in the public interest to provide a single set of high quality, understandable and uniform accounting standards and increasingly recognized as Global Reporting Standards. Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). IAS was issued between 1973 and 2001 by the board of the International Accounting Standards Committee (IASC). In April 2001 the IASB adopted all IAS and continued their development, calling the new standards IFRS.

For attending this approach the Council of the Institute of Chartered Accountants of India, has decided to fully converge with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board from the accounting periods commencing on or after 1st April, 2011.

In this study an empirical research on the effects of the IFRS-adoption on the earning power of the company has been conducted and thus, effects are made to close the existing research gap. We analyze the earning power of a sample of Satyam and Infosys Technologies Ltd, which are listed in the BSE, NSE NYSE and also prepared financial statement in accordance with IFRS. So in this research we have analyzed the earning power of the company under IFRS and Indian GAAP and the causes of the change in the earning power under the IFRS and Indian GAAP.

2. BRIEF PROFILE OF THE SATYAM COMPUTERS

Satyam Computers was founded in June 1987 as a private limited company by Ramalinga Raju along with one of his brothers-in-law, DVS Raju. Satyam is a leading global business and information technology services company, delivering consulting, systems integration, and outsourcing solutions to clients in 20 industries and more than 65 countries. The company's 52,865 Associates excel in engineering and product development, supply chain management, client relationship management, business process quality, business intelligence, enterprise integration,

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and infrastructure management, among other key capabilities. Satyam development and delivery centers in the US, Canada, Brazil, the UK, Hungary, Egypt, UAE, India, China, Malaysia, Singapore, and Australia serve 690 clients, including 185 Fortune 500.

3. BRIEF PROFILE OF INFOSYS TECHNOLOGIES LTD.

Infosys Technologies Ltd. was started in 1981 by seven people with US$ 250. Today, it is a global leader in the "next generation" of IT and consulting with revenues of over US$ 4 billion. Infosys defines designs and delivers technology-enabled business solutions that help Global 2000 companies win in a Flat World. Infosys also provides a complete range of services by leveraging our domain and business expertise and strategic alliances with leading technology providers. Infosys pioneered the Global Delivery Model (GDM). The GDM is based on the principle of taking work to the location where the best talent is available, where it makes the best economic sense, with the least amount of acceptable risk. Infosys has a global footprint with over 40 offices and development centers in India, China, Australia, the Czech Republic, Poland, the UK, Canada and Japan. Infosys has over 91,000 employees. Infosys takes pride in building strategic long-term client relationships. Over 97% of its revenues come from existing customers.

4. FINDING OF THE RESEARCH

- Table 1st show the turnover ratio under the Indian GAAP and IFRS in the Satyam computer services ltd. is not differs but in the Infosys technologies ltd. it is vary and under the IFRS it is less or negative. The reason is that the Satyam computer services ltd applies the IFRS first time. When a company adopts the IFRS first time then company avails some exceptions for some transaction not fully converge to the IFRS so in this company turnover ratio is not differ. But the Infosys technologies ltd is providing the consolidated financial statement from the long time so it has fulfilled the entire requirement for applying the IFRS. So there might be some change in the turn over ratio of Satyam computer services ltd. in the future when it will adopt full IFRS.

- Table 2nd show the gross margin ratio under the Indian GAAP and IFRS in the Satyam computer services ltd. and in the Infosys technologies ltd are vary and under the IFRS it is less. The reason of less gross margin under the IFRS is that some revenue has considered under the Indian GAAP but the same did not consider under the IFRS. The gross margin ratio in the Satyam computer services ltd is more vary as compare to the Infosys technologies ltd. The reason are same as above finding that Satyam computer services ltd is the newly adopted IFRS Company as compare to the Infosys technologies ltd. so it may be seen some variation in the future in this ratio in the Satyam computer services ltd. and the second thing which is more important that this variation is the negative influence in the adoption of the IFRS.

TABLE-1

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	INDIAN GAAP	IFRS	INDIAN GAAP	IFRS
TURN OVER (SALES/NET ASSETS) (time)	1.14	1.15	1.21	1.07

TABLE-2

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	INDIAN GAAP	IFRS	INDIAN GAAP	IFRS
GROSS MARGIN (GP/SALES) (%)	37.90	36.52	44.84	41.27

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- Table 3rd show the operating leverage ratio under the Indian GAAP and IFRS in the Satyam computer services ltd. and in the Infosys technologies ltd are vary and under the IFRS it is less. The reason of less operating leverage under the IFRS is that in the IFRS we do not consider the financial revenue in the calculation of the EBIT (earning before interest and tax) so EBIT is less in the IFRS as compare to the Indian GAAP. The variation of the operating leverage in the Satyam computer services ltd. is more as compare to the Infosys technologies ltd.. The reason is that the financial revenue is more in the Satyam computer services ltd. as compare to the Infosys technologies ltd. The general finding is that if any company has the financial income then the operating leverage will vary according to the amount of the financial income.

- Table 4th show the return on net assets ratio under the Indian GAAP and IFRS in the Satyam computer services ltd. and in the Infosys technologies ltd are vary and under the IFRS it is less. The reason of less operating leverage under the IFRS is that in the IFRS the financial income is not considered in the calculation of the EBIT (earning before interest and tax) . Here the return on net assets is more vary in the Infosys technologies ltd. as compare to Satyam computer services ltd. the reason of this high variation in the Infosys technologies ltd. is that according to the Indian GAAP there is not any non current liabilities it has the only the current liabilities but according to the IFRS it disclosed the non current liabilities also so non current liabilities reduces the current liabilities due to this adjustment the net assets increased and the return on net assets also reduced

- Table 5th show the financial leverage ratio under the Indian GAAP and IFRS in the Satyam computer services ltd. and in the Infosys technologies ltd are vary and under the IFRS it is high. The reason is that in the Indian GAAP the PAT (profit after the tax) is less as compare to the EBIT but in the IFRS the PAT (profit after the tax) is more as compare to the EBIT. The reason behind the PAT (profit after the tax) is more as compare to the EBIT in the IFRS is that in the IFRS financial revenue do not considered in the EBIT but include in the calculation of the PAT (profit after the tax).the variation of the financial leverage in both the companies is slightly same but in the operating leverage the variation under the IFRS more as compare to the Indian GAAP in the Satyam computer services ltd. The reason was the above said finding that financial revenue is more in the Satyam computer services ltd. But here the difference should be in the Satyam computer services ltd. however here the difference is that in the Satyam computer services ltd. has the more financial revenue but it also has the financial expenditure (interest) however the Infosys technologies ltd has financial revenue but it has not the financial expenditure so its PAT (profit after the tax) has increased more as compare to the Satyam computer services ltd. Therefore the variation has got equal in both the companies.

- Table 6th show the financial leverage ratio according to the balance sheet under the Indian GAPP and IFRS in the Satyam computer services ltd. is equal but in the Infosys technologies ltd there is a variation. The reason is that in the Infosys technologies ltd it has created a non current liabilities under the IFRS however it has not any non current liabilities under the Indian GAAP therefore its ratio has increased in the IFRS because due to the occurring the non current liabilities in the IFRS that non current liabilities occurring from the current liabilities so it transaction has reduce the current liabilities and this transaction has increased the net assets so this ratio has been increased. Other reason is that the Satyam computer services ltd is newly IFRS adopted company and availing some exemption from some IFRS for evaluation the assets. However the Infosys technologies ltd has been giving there financial

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statement since long time so it has adopted the entire IFRS so these changes have been made in the Infosys technologies ltd.

- Table 7th show the rate of return ratio or earning power of the company under the Indian GAAP and IFRS in the Satyam computer services ltd. is slightly equal and has increased under the IFRS. But in the Infosys technologies ltd there is a variation and giving the negative sign under the IFRS as compare to the Indian GAAP. the reason is that the Infosys technologies ltd has been giving there financial statement since long time but the Satyam computer services ltd is newly IFRS adopted company and availing some exemption from some IFRS for evaluation the income and expenditure, assets and liabilities.

(A) <u>Some Optional Exemption</u>: (a)- business combination: an entity may choose not to retrospectively account for business combination in accordance with IFRS- 3. An entity may keep the original previous GAAP accounting (b)- fair value or revaluation as deemed cost of property, plant, and equipment intangible assets and investment property (c)-employee benefits: actuarial gain and losses (d)-accumulated transactional reserve (e) - assets and liabilities of subsidiaries associates and joint venture

TABLE-3

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	**INDIAN GAAP**	**IFRS**	**INDIAN GAAP**	**IFRS**
OPERATING LEVERAGE (EBIT/GP) (%)	60.36	53.00	71.40	66.93

TABLE-4

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	**INDIAN GAAP**	**IFRS**	**INDIAN GAAP**	**IFRS**
RETURN OF NET ASSETS (EBIT/NA) (%)	25.99	22.34	38.74	29.40

TABLE-5

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	**INDIAN GAAP**	**IFRS**	**INDIAN GAAP**	**IFRS**
FINANCIAL LEVERAGE (PAT/EBIT) (%)	87.07	101.93	87.18	100.17

TABLE-6

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	**INDIAN GAAP**	**IFRS**	**INDIAN GAAP**	**IFRS**
FINANCIAL LEVERAGE (NA/NW) (time)	1.03	1.03	1	1.03

TABLE-7

	Satyam computer services ltd		Infosys technologies ltd.	
(YEAR 2007-08)	**INDIAN GAAP**	**IFRS**	**INDIAN GAAP**	**IFRS**
RATE OF EARNING (PAT/NW) (%)	23.31	23.43	33.77	29.53

(B) <u>Mandatory Exemption:</u> (a) - derecongnition financial instrument (b) -hedge accounting (c) - estimates

- So in this case the Satyam computer services ltd might be obliged to all these written exemption therefore there is not huge variation under the IFRS and the Indian GAAP but when it will adopt the entire IFRS then the earning power will vary under The IFRS and the Indian GAAP. However we can not predict which way it will vary because the reason is that Satyam computer services ltd is the newly adopted IFRS company and the Infosys technologies ltd has providing the financial statement since long time but it has one limitation that is its consolidated financial statement according to the IFRS is not the audited financial statement so it can be said that the earning power may be negative in the IFRS.

5. CONCLUSION

The India one of the country which is going for the adoption of the IFRS from 01-04-2011 but before this date the few Indian companies have adopted the IFRS. The main problem before adoption of the IFRS is that a common conjecture is in the mind of the accounting information users that after adopting the international financial reporting standards may revolutionize the profitability analysis and may also change the earning power of the companies. The reason behind is that after adoption of IFRS of the companies will have to change there incomes, expenditures, assets, and liabilities therefore these changes can also change the earning power of the companies. It can be concluded that earning power under the IFRS and the Indian GAAP is different but the variation in the both companies selected for study is also different. It is very much clear from the study that after adopting IFRS the companies earning power will also change.

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