UNIVERSITY GRANTS COMMISSION

EXECUTIVE SUMMARY

OF MINOR RESEARCH PROJECT ON –

"A STUDY OF COMPLIANCE OF ACCOUNTING STANDARDS BY THE LISTED COMPANIES IN KARNATAKA"

BY

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INTRODUCTION

Accounting is a language of business and is also a service activity which can be used as a tool for mustering various economic problems. It is not only a language but an information system. According to AICPA (1953) “The function of the accounting is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be used in making economic decisions, in making reasoned choices among alternative courses of action.”A fundamental concern in accounting regulation is that financial statements are informative; that is, they reflect the underlying economic condition of the reporting firm [O Bohren, et.al. 2004].The need for accounting is to provide an effective measurement and reporting system for decision-making. The quality of information available to the users helps in efficient distribution of resources in the economy of a country.

The information-provisioning objective of accounting will go a long way in fulfilling the social obligation of the business, which helps for better allocation of limited resources mainly, capital or public money. In this regard, Samuels [1993:*19*] holds that “Financial reports that reflect the commercial reality of a company’s situation assist financial community in channeling the scarce financial resources of a company into the most productive investment opportunities”. The extent of better allocations of society’s scarce resources like capital, in relation to optimum utilization of resources for productive purposes mainly depends on the information provided by the corporate bodies in a country for its overall development. Further, the communicated results are valuable for interested parties in decision-making when they are considered facts [Tamboli, 2004:*109*]. Financial reporting is not only important for optimum allocation of economic resources, it is also important for effective and resourceful decision making because the major objective of the financial reporting is to supply information for resourceful decision making [Ubha, 2001:*5*].

ACCOUNTING STANDARDS

As accounting is the language of business, which is used for effective communication of the financial data from suppliers to the users. Hence this language should be supported by sound grammar called ‘Accounting Standards’. Accounting standards are norms of written statement concerned with accounting rules and guidelines for preparation and publication of financial statements.

The problem of bringing uniformity and transparency has been viewed as a challenge for the accounting profession around the world. This challenge has been accepted by the accounting professionals and academicians through consistent and continuous efforts which are commendable. In recent times, their efforts center on the promulgation of “standards” in place of “principles”. Gone are the days in which the trade was shielded by an artificial veil of super secrecy. The ‘era’ of ‘no information’ philosophy is over. As capital becomes dearer in the market, competition stiffens and socio-economic compulsions cast their shadow over the industrial focus of every nation, there is, truly speaking, little time to waste in pandering over the sagacity of additional disclosures.

STATEMENT OF THE PROBLEM

The accountings standards in India have been issued by ICAI from 1979 some of the standards were mandatory and some of the standards were voluntary in the initial periods but, now all the standards are compulsory because the adoption of IFRS at International level has been made compulsory from 1-1-2005. The ICAI has issued totally 31 standards (except AS-8, which had been withdrawn). This study focuses on whether the companies registered in Karnataka are following all the standards promulgated in preparing their financial statements because all the standards are not dealt with recognition and measurement criteria but concentrates on disclosure aspects. Hence, the companies may not observe the disclosure standards while preparing annual reports. Hence, the financial reporting in India is in a diverse situation. The attempt has been made in this research to analyze the problems associated with the companies for not observing the requirements of all the standards issued by the accounting regulatory body. There is a general feeling amongst the investors and other stakeholders that the financial statements prepared and submitted by the companies lack the disclosure contents which is otherwise mandatory in nature.

REVIEW OF LITERATURE

A literature review is a description of the literature relevant to a particular field of study or topic. It is a process of reading, analyzing, evaluating and summarizing scholarly materials about the specific topic. A review of theoretical and empirical literature pertaining to the topic of the study is an integral part of any research work. Hence, an attempt has been made in this study to present a review of various studies relating to “Compliance of accounting standards”, as reported by experts, professionals and researchers at national and international level. The literature review is the choice of research designs and means used to collect data.

It is not only the analytical or empirical research but also the non-empirical and narrative evidences which were equally contributed for the development of financial reporting system.

The review of the empirical studies selection for this research reveals that, no recent study has been conducted in India to examine the level of compliance of accounting standards while preparing financial reporting by corporates. Majority of the studies have focused on effectiveness of reporting, corporate reporting practices and disclosure practices. The accounting standards arerespective to bring uniformity in financial reporting and to ensure consistency and comparability of the information published by the corporates in this regard only the regulatory pressure can bring compliance of national standards. It is observed that, regulatory agencies have played a pivotal role in improving the financial reporting system keeping in view the investor ;d protection and capital market discipline as India is moving towards converged IFRS disclosing more and more information than required by the law is an urgent necessity. The foreign studies have observed the increased disclosure of International accounting standards in the financial statements there by accounting flaws and manipulations have been reduced considerably. As per as Indian studies are concerned few studies have concentrated on disclosure practices but the level of compliance has not deeply touched upon.

Compliance refers to the degree of adoption of accounting standards in financial reporting. The various studies on compliance revealed that no vivid results and firms have the tendency to deviate from accounting standards to present a rosy picture.

The studies conducted abroad by Aledo et al. (2009),Fernley and Hines (2005), Zehri and Abdelbaki (2003) ,Street and Bryant (2000) , Street et al. (1999) etc.

In addition the studies carried out in India byRamanna and sletten (2009),Perera and Thrikawala (2010), Blanchette and Desfleurs (2011) etc.have been reviewed systematically.

NEED FOR THE STUDY

Various studies conducted earlier on accounting standards and financial reporting has focused only on financial reporting challenges and effectiveness. Some of the studies have also focused on pre and post mandatory comparisons in preparing financial reports. Majority of the empirical studies were relating to the financial reporting practices and measurement issues. But, no study on the compliance of accounting standards by corporates has been made in the post mandatory period of the accounting standards. Since there is a divergence of opinions amongst the stakeholders about the total adoption of accounting standards in India. The present study attempted to fill the gap in this area.

OBJECTIVES OF THE STUDY

The purpose of this research is to report on empirical study of the compliance of accounting standards by the sample listed corporate undertakings in Karnataka. However, this study has been taken up with the following objectives:

I. To analyze the Compliance Level of accounting standards during the post-mandatory period of accounting standards in India;
II. To evaluate the objective measurement changes in the financial reporting;
III. To analyze the changes in reporting system after mandatory of the accounting standards i.e., from quantitative to qualitative;
IV. To understand the financial reporting system prevailing in the listed companies in Karnataka;
V. To make relevant suggestions to improve the quality of financial reporting in India.

HYPOTHESES FOR THE STUDY

In carrying out the present study, the following hypotheses have been identified:

I. Accounting standards lack theoretical base which is a sine-quo-non for financial reporting;

II. The objective measurement of financial reporting has considerably increased after the accounting standards became mandatory;

III. The mandatory accounting standards influences more on usefulness level, quantum information dissemination and adequacy level of qualitative information;

IV. The mandatory accounting standards focus mainly on naïve investors than on sophisticated investors and also more on voluntary additional disclosure;

V. The compliance level is positively related to the performance level.

SIGNIFICANCE OF THE STUDY

Since the companies are adopting not only local standards and also moving towards global standards it is useful for the standard setters, corporate sectors, professional accountants, investors, creditors and other stakeholders. Because this study will provide information how the companies are adapting themselves to the changed accounting environment. This study helps to understand the harmonization of accounting standards by observing the level of compliance in India there by predicting the India's position to move towards the global standards.

The development of Indian stock exchanges in the recent time demands disclosure of more information by all the companies to have fair and transparent accounting system so that the bad feelings of the stakeholders about the corporate camouflage can be removed. The suggestions and recommendations made in this study will help the government agencies like NACAS, NFRA, and others namely, Standard setters to make appropriate modifications in setting accounting norms.

SCOPE OF THE STUDY

This empirical research is mainly concerned with adoption of the accounting standards or compliance of accounting standards by companies in India and particularly in Karnataka. This study is confined to theoretical concepts of accounting, accounting standards and financial reporting. This study confines only to the analysis of the annual reports of the selected companies the basis of analysis is the level of compliance of accounting standards by companies.

RESEARCH METHODOLOGY

The present study covers the compliance of accounting standards by the corporate undertakings in Karnataka. This study has been carried out based on the comprehensive survey of theoretical foundations of accounting standards and financial reporting with considerable review of literature as a precursor to the empirical analysis. It was estimated that more than 500 companies were based in Karnataka in the year 2009-10 but after going through the records from the concerned authority namely register of companies Bangalore there were only 240 companies based in Karnataka. Out of 240 companies 66 companies representing 27.5% of the universe have been selected for the purpose of this research. The basic approach of this research stems from the facts that the companies are not adhere to the requirements of the regulatory authority because even the SEBI or registrar of companies are not taking any stringent action against the companies failing to observe the requirements. Hence, there is a tendency among the companies that accounting standards though mandatory or not constant and total observations by the regulators hence, slow progress could be seen in adoption. The financial statements of the companies which are listed in the recognized stock exchanges and are based in Karnataka have been examined and financial and other data have been gathered from annual reports, auditor's report and the foot notes and schedules to accounts to enquire into the compliance level of accounting standards. The result of the information obtained by direct consultation or enquiry with the management of the corporate undertakings has also been analyzed with regard to the response towards the compliance of accounting standards. The abundant use of statistical tools and packages has been made and analysis has been made considering the empirical evidences.

LOCALE OF THE STUDY

The present study has been carried out by taking 66 companies representing 27.5% of the companies registered in Karnataka in the period of study. The Karnataka has been selected as a locale of the study because the corporate management of these companies is operative with an admixture of rural, semi-urban and cosmopolitan culture. These companies were listed on the recognized stock exchanges in India and some of the companies were also listed in Bangalore stock exchange. The study mainly concentrated on compliance level of accounting standards by corporate enterprises.

FINDINGS OF THE STUDY

In view of the identified hypotheses and objectives nearly, 66 companies' annual reports have been analyzed for a period of 3 year 2009-10 to 2011-12. The findings of the study have been presented under general findings and empirical findings.

GENERAL FINDINGS

1. Accounting standards helps the companies to overcome the problems of alternatives, thereby understandability and comparability of the financial statements are enhanced.
2. Though the accounting standards are mandatory the company managements have delineated the adoption of some of the standards.
3. Since, some of the standards are disclosure in nature, there is no effect on the position and performance statement.
4. Despite shortcomings the accounting standards have been improved quality, understandability and reliability.
5. Few studies in India have suggested the adoption of global standards to increase fairness and international credibility
6. The financial scandals or manipulations cannot be prevented or reduced by the implementation of standards alone. Hence, accounting ethics should be of paramount importance.

EMPIRICAL FINDINGS

- AS- 1 Disclosure of Accounting policies have been followed by all the Companies chosen for the study as it is an essential factor for the company to disclose its method of preparation of its financial statements.
- AS- 2 Valuation of Inventories have been followed by all the companies with FIFO 27%, lower of cost or net realizable value 64% and specific cost 9% of the companies

- AS- 3 Cash Flow Statement has been followed by all the companies because it is necessary for all the companies to show the inflow and outflow of cash in the business.
- AS- 4 Contingencies and Events Occurring after the balance sheet Date has been followed by all the companies with regard to disclosure and 17% of the companies with respect to recognition measurement.
- AS- 5 Net Profit or Loss for the period, Prior Period items and Changes in accounting policies. 48% of the companies have given effect to the prior period items and changes in accounting policies.
- AS- 6 Deprecation Accounting has been followed by all the companies to know the real value of the asset 33% of the companies have followed WDV method and 67% of the companies followed SLM method.
- AS- 7 Construction Contract has been followed by only 3% of the companies have been involved in construction work.
- AS- 8 has been withdrawn with AS- 26 Intangible Asset.
- AS- 9 Revenue Recognition has been followed by all the companies.
- AS- 10 Accounting for Fixed asset has been followed by all the companies as every company is having Fixed Assets.
- AS- 11The Effects of Changes in Foreign Exchange Rates has been followed by 83% of the companies as they are dealing with Foreign Exchange Transaction.
- AS- 12 Accounting for Government Grants has been followed by 24% of the companies. Even the Recognition, Measurement and Disclosure have been made by these companies.
- AS- 13 Accounting for Investments has been followed by 64% of the companies as they engage in investment activities.
- AS- 14 Accounting for Amalgamation has been followed by 17% of the companies.
- AS- 15 Employees Benefits has been followed by all the companies because it’s an essential factor to provide benefits to employees.
- AS- 16 Borrowing Cost has been followed by 60% of the companies.
- AS- 17 Segment Reporting has been followed by 70% of the companies.

- AS- 18 Related Party disclosure has followed by most of the companies because these companies hold many branches under it.
- AS- 19 Lease agreement has been followed by 64% of the companies who have entered into the lease contract.
- AS- 20 Earnings Per share has been followed by all the companies.79% of the companies have shown basic EPS, 45% of the companies have shown both Basic and Diluted EPS.
- AS- 21 consolidated financial Statements have been prepared by 68% of the companies.
- AS- 22 Accounting for Tax on Income has been followed by some companies with DTA 61% and DTL 39%.
- AS- 23 accounting for Investments in Associates in Consolidated financial Statement has been followed by 32% of the companies.
- AS- 24 Discontinuing Operation has been followed by 24% of the companies.
- AS- 25 Interim Financial Reporting is followed by all the companies with discrete policy.
- AS- 26 Accounting for Intangible assets has been followed by 80% of the companies.
- AS- 27 Financial Reporting of Interest in Joint Ventures has been followed by 39% of the companies.
- AS-28 Impairment of Assets has been followed by 68% of the companies.
- AS-29 Provisions, Contingent Liability and Contingent Assets are followed by all the companies.
- AS-30, 31 and 32 deals with Financial Instruments: Recognition and Measurement, Presentation and disclosures have been followed by30% of the companies.

LIMITATIONS OF THE STUDY

Incarrying out this research the following limitations were noticed.

1. The selection of companies is limited to 66 which are considered as substantially low because there are more thanat all India level.
2. Locale of the study is limited to Karnataka only and opinions cannot be fully generalized.
3. The study was based on only secondary data hence, opinions have been ignored.
4. The periods selected were a crucial time where in India was making effort to move towards converged International financial reporting standards (IFRS).

CHAPTERIZATION

This empirical study is organized in six chapters. The first chapter which is Introduction mainly focuses on the problem and the research methodology. The second chapter discusses the accounting standards from the various perspectives. The third chapter deals with corporate financial reporting. The fourth chapter contains review of literature .The fifth chapter focuses on the empirical study based on the research methodology i.e. analysis and interpretation of data. The sixth chapter summarizes the conclusions and presents a broad framework of relevant suggestions.