

# A Comparative Study on Effect of IFRS on Profitability of Selected Companies in Developed and Developing Countries

\* Pooja Sharma  
\*\* Sushant Gupta

## Abstract

The new accounting standards aim to provide a worldwide framework for preparing and presenting the financial statements for the stakeholders of business, faithful presentation, objectivity, and relevance for users. These new reporting standards may or may not give the effect on profitability of the concerns. Therefore, the present study was conducted to examine the effect of IFRS on profitability position of IFRS adopted companies with special reference to developed and developing countries. The sample for the purpose of the present study consisted of a total of 29 companies of selected developed countries and 27 companies of selected developing countries. The collected data were time series as well as cross section. Consequently, the study applied panel data technique for the purpose of analysis. Further, the findings showed that IFRS had a significant impact on profitability of the concerns, but there was no significant difference in the profits of IFRS adopted companies of developed countries and developing countries.

**Key words :** IFRS, return on equity, developing countries, developed countries

**JEL Classification :** M480, M40, M410

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International Financial Reporting Standards (IFRS) are the new accounting norms which are developed by International Accounting Standards Board (IASB). It provides a common set of worldwide language for the businesses so the books of accounts can be compared globally. These standards aim to provide a global framework for presentation as well as preparation of financial statements for the stakeholders of business, faithful presentation, objectivity, and relevance for users. The framework of IFRS is mostly “principle based” rather than rule based ; mostly, the focus of IFRS is on presentation rather than on preparation. Due to the adoption of IFRS, it has become easier for the investors to access the financial data, which is now standardized, consistent, and comparable. IFRS enactment will contribute towards economic growth ; all shareholders should attempt to have application to secure advantages of the worldwide GAAP and principle based standards (Okpala, 2012). IFRS is projected to reduce the cost of raising the funds, lower the accountant's fees, and allow quicker access to the capital markets, it also enables companies to set targets based on an international business environment (Rakesh & Shilpa, 2013). IFRS was adopted in most of Europe and Australia from 2005 (Kulkarni & Aanand, 2016). Gupta, Kumar, and Gupta (2012) and Kaur (2011) discussed that the introduction of IFRS would give a major impact on the key industries. It is a roadmap for India to bring investment in the nation.

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\*Assistant Professor, Lovely Professional University, Jalandhar, Punjab. E-mail : pooja.16767@lpu.co.in

\*\*Assistant Professor, Lovely Professional University, Jalandhar, Punjab. E-mail : sushant.18281@lpu.co.in

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The adoption of IFRS has an effect on some aspects of financial reporting. With the adoption of IFRS, profitability of the concerns might get affected. There are extensive literatures available, which have determined the relationship of IFRS with financial performance, economic growth, macro-economic variables, FDI, and corporate governance, but these studies are mainly conducted in specific countries only. The relationship of IFRS and profitability position of various companies in developed and developing countries is rarely studied. Therefore, this study is an attempt to fill this gap. The main objective of the study is to explore the effect of IFRS on profitability of companies with regard to developed and developing countries.

## Review of Literature

Oyebisi, Olubukola, Olugbenga, David, and Chukwu (2017) observed that due to introduction of IFRS, the quality of reporting information of the banks in Nigeria improved as compared to that with local GAAP. The study also found that there was no considerable relation between the financial ratio as measured under IFRS and local GAAP. It was also stated that the information under IFRS was more difficult to read and understand. This might be due to the fact that the standards were new and not much training had been carried out.

Nengzih (2015) explored the impact of IFRS in pre and post era of adoption on the profitability rate. The study considered the sample of 43 listed companies in Indonesia considering return on equity (ROE), return on assets (ROA), and corporate income tax as the study variables. Hypotheses were tested by using simple descriptive analysis and paired sample *t* - test. The results proved that the company's profitability increased after the adoption of IFRS.

Abdul - Baki, Uthman, and Sannia (2014) analyzed the effect of IFRS adoption/convergence on the Nigerian companies' performance after making comparison of 24 financial ratios calculated by using financial statements keeping in view IFRS and Nigerian GAAP. Mann - Whitney *U* test was used for statistically testing whether the difference lies within the ratios. The results of the study proved that the disclosure of financial statements of Nigerian firms was not attributed to their performance evaluation.

Istrate (2014) measured the impact of IFRS on Romanian listed companies. The study compared accounting figures of 68 companies of Bucharest Stock Exchange for the years 2011 and 2012 published in financial statements that were drawn in compliance with the IFRS for seven indicators (total assets, equity, liabilities, net income, ROE, solvability, and leverage). The results of the Gray index concluded that there was increase in equities and decrease in income.

Istrate (2013) focused on the Gray index of conservatism also known as index of comparability to measure the impact of IFRS adoption in Europe for the year 2005. This study focused on the sample size of 600 companies listed on Euronext markets. Data related to equity, income, leverage, ROE, and ROA for the sample companies were collected from the position statement of the selected companies. The author concluded that IFRS numbers increased in the case of equity, including increase in returns (on capital and assets).

Iatridis and Dalla (2011) examined the effect of IFRS adoption/convergence on the financial performance and performance of listed companies. It mainly focused on the Greek industrial sector and stock market indices. The data of 200 companies and three stock market indices (FTSE 20, FTSE 40, and Small Cap 80) for the years 2004 and 2005 were examined. The results of binary logistic regression revealed that IFRS execution had a great impact on the profitability of industries.

Stent, Bradbury, and Hooks (2010) studied the impact on the position statements of the companies adopting NZ IFRS during 2005 to the year 2008. The sample considered 56 listed companies out of which 16 listed companies were early adopters and 40 listed companies adopted only when IFRS became mandatory. Hypotheses were tested by using simple descriptive analysis. The results of the study showed that 87% of the selected firms were affected

by adoption/convergence of IFRS. For most firms, the impact of IFRS was small, which also affected their financial ratios.

## Research Objectives

(1) To examine the effect of convergence/adoption of IFRS on the profitability of selected domestic listed companies of various countries.

(2) To compare economy-wise profitability of selected companies which had adopted IFRS.

## Research Methodology

The study is based on secondary data. The data regarding developing countries and developed countries were collected from *World Economic Situation and Prospects (2017) Report*, United Nations. The countries were categorized in two groups where one group consisted of IFRS adopters excluding those countries which adopted it after 2011 - 12, and the other group consisted of IFRS non - adopted countries. The study used random sampling technique and applied lottery method to select 10 sample countries (which are IFRS adopters on or before 2011 - 12) out of which five countries are developed, five countries are developing, and then 10 sample countries were also selected, which are IFRS non-adopters for the purpose of analysis. Furthermore, the study considered top three companies of each selected country on the basis of its market capitalization. The availability of data were checked for each company and further excluded those companies whose data were missing. Thus, the sample for the purpose of the present study consisted of a total of 29 companies of selected developed countries and 27 companies of selected developing countries. IFRS data were collected from IASB website for the period of 2017 and the data of companies were collected from their annual reports for the period of 2011 - 12 to 2015 - 16.

In order to explore the effect of International Financial Reporting Standards (IFRS) on the profitability position, the following hypotheses were formulated for the purpose of analysis :

↪ **H01** : There is no significant effect of IFRS convergence/adoption on profitability position of selected domestic listed companies of various countries.

↪ **H02** : There is no significant difference between profitability of selected IFRS adopted companies of developed countries and developing countries.

The study considers IFRS as a dummy variable, where 1 is allocated to those countries who are the adopters of IFRS and 0 to those countries who are not the adopters of IFRS. For the purpose of the study, the meaning of adoption here includes IFRS convergence or IFRS required by domestic listed companies, whether mandatorily or voluntarily. Furthermore, to analyze the profitability position of the companies, the study considered return on equity (ROE) as a proxy variable. It reveals how competently the companies were using their own capital to create profits (Al - Behadili, 2013). According to Gul, Irshad, and Zaman (2011), the return on equity depicts the percentage of profit earned over the equity. According to DuPont analysis, ROE covers all the aspects of corporate performance. It is influenced by three things : operating efficiency, resource utilization, and financial leverage. As per the thumb rule, higher the ROE, better the performance of the companies. Consequently, the profitability of the companies is judged through ROE in the present study. Further, the study uses panel data technique to analyze pooled cross section and time-series data.

## Data and Measures

The hypothesis of the study is to analyze the effect of IFRS on profitability of various companies and to test this hypothesis, random effect model has been applied. Based on the hypothesis posed, the estimated model is as follows :

$$ROE = f(IFRS)$$

The above equation was changed into mathematical form using the linear model :

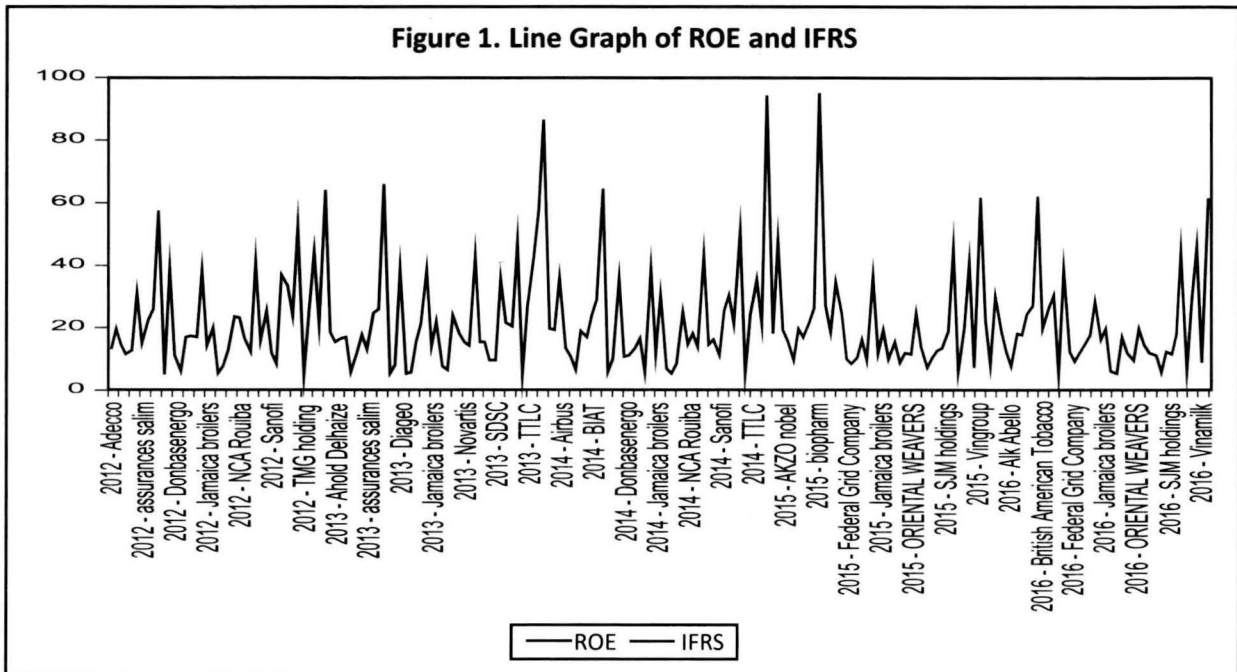
$$ROE = \alpha + \beta_1 IFRS + e$$

where, *ROE* = Return on equity, *IFRS* = International Financial Reporting Standards,  $\alpha$  is constant, and *e* is the error term.

**(1) Effect of International Financial Reporting Standards on Profitability of Selected Companies :** The random effect model has been chosen after taking into consideration the assumption of stationarity and normality. Further, the panel unit root test was applied to check the stationarity.

**(i) Panel Unit Root Test :** The line graph depicted in the Figure 1 has been drawn for the selection of the appropriate equation. For ROE, individual intercept option and for IFRS series, none option is selected while performing the panel unit root test. The results of the panel unit root test are shown in the Table 1.

The Table 1 shows the result that all the series are stationary in level form. It means that the null hypothesis is rejected at the 1% significance level for the variables.



**Table 1. Results of Panel Unit Root Test**

Variables	Individual Unit Root test	
	ADF- Level Difference	
	Statistics	p - value
IFRS	8.20361	0.0165*
ROE	68.5192	0.2107*

Null Hypothesis: Unit Root, \* Significant at 0.01 level

**Table 2. Test of Normality**

	IFRS	Kolmogorov-Smirnov <sup>a</sup>		
		Statistics	df	p-value
ROE	0	.086	57	.200*
	1	.055	150	.200*

*Note.* <sup>a</sup> Lilliefors Significance Correction

**(ii) Test of Normality :** Further, the assumption of normality was checked through the Kolmogorov - Smirnov test using SPSS software.

The Table 2 depicts the results that the data is normal as the  $p$  - value is more than 0.05 resulting into acceptance of the null hypothesis that the data is normally distributed. Further, the panel data is analyzed using the random effect model. Firstly, the Hausman test is applied to select the appropriate model amongst fixed and random effect model. The following are the assumptions of the Hausman test :

☞  $H_0$ : Random effect model is appropriate.

☞  $H_1$ : Fixed effect model is appropriate.

The Table 3 reflects the result that the random effect model is appropriate as null hypothesis is accepted because the  $p$  - value is more than the 0.05 level. Consequently, the random effect model is further applied to examine the effect of IFRS on the dependent variable ROE.

The Table 4 presents the results of the random effect model. The value of  $R^2$  shown in the Table 4 is 0.63, which indicates that approximately 63% of the variance is explained by IFRS and the remaining 37% of the variance is explained by the other factors. As the pooled data is time series data, therefore, there can be problem of auto correlation. In the present study, there is no auto correlation as the Durbin - Watson value is near to 2 (value = 1.93 ; see Table 4). The results also reveal that IFRS has significant effect on ROE which is also supported by the findings of Chandrasekar and Kumar (2017) in their study done in India. As the  $p$  - value is less than 0.05, therefore, our null hypothesis  $H_0$  is rejected. Therefore, it can be implied that the profitability of the concern is

**Table 3. Results of Hausman Test**

		Chi-Square Statistics	Degree of Freedom	p-value
Cross-section random		0.142100	1	0.7062
Variable	Fixed	Random	Var (Diff.)	p-value
IFRS	0.420961	2.214157	22.628725	0.7062

**Table 4. Results of Random Effect Model**

Dependent Variable: ROE				
Method: Panel EGLS (Random Effect Model)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
IFRS	3.035763	0.669071	4.537278	0.0000
C	15.86224	1.121244	14.14701	0.0000
			<b>S.D.</b>	<b>Rho</b>
Period Random			14.56123	0.8037
Idiosyncratic Random			7.195767	0.1963
Weighted Statistics				
R-squared	0.633189	Mean dependent var		4.149337
Adjusted R-squared	0.628473	S.D. dependent var		7.211617
S.E. of Regression	7.145555	Sum squared resid		10467.08
F-statistic	7.037253	Durbin-Watson stat		1.936276
Prob (F-statistic)	0.008608			

affected by new international accounting standards. The results of our study are also supported by the findings of Alsaqqa (2012), who found that there was a great impact of adopting IFRS on profitability and stock performances in Nigeria. The findings are also in line with the study results obtained by Tanko (2012), where IFRS firms tend to exhibit higher values on a number of profitability measures. Therefore, it can be concluded that the countries should adopt IFRS as these new reporting standards improve the quality of accounting information regarding profitability as compared to domestic accounting standards.

**(2) Economy - Wise Profitability Comparison of IFRS Adopters :** Independent samples *t* - test technique was applied to compare profitability of developed countries with developing countries who have adopted IFRS.

Levene's test, which is considered for equality of variance, is presented in the Table 6. It indicates that the test is not significant at the 5% level of significance. Consequently, the *p*-value of equal variances assumed is considered for the analysis. Furthermore, *p* - value of equal variances is also not significant as it is more than the 5% level of significance (*p* - value : 0.697) and in this case, the null hypothesis H02 is accepted. It can be implied that there is no significant difference in the profitability of companies of developed countries and developing countries which have adopted IFRS. Though IFRS adoption has an effect on profitability of the IFRS adopted companies, but there is no difference in the profitability of IFRS adopters in developed and developing economies. The results of our study are supported by the findings obtained by Abhimantra, Maulina, and Agustianingsih (2018), where it was found that there was no significant difference of IFRS implementation between developed countries and developing countries. It can be concluded that with the introduction of new reporting standards, the reported net profit gets affected in a positive way.

**Table 5. Group Statistics**

	Developed/Developing	N	Mean	Std. Deviation	Std. Error Mean
Profit	1	81	19.6561	16.23466	1.80385
	0	87	18.6592	16.81466	1.80272

**Table 6. Independent Samples t-Test**

		Levene's Test for Equality of Variances		t-test for Equality of Means				
		F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference
FDI	Equal variances assumed	.189	.665	.390	166	.697	.99684	2.55345
	Equal variances not assumed			.391	165.776	.696	.99684	2.55023

## Research Implications and Recommendations

The target of the study is to look at the connection amongst IFRS and profitability of selected companies in different nations. The results reveal that there is a significant relationship between IFRS and profitability of various countries. It implies that IFRS adoption will ultimately improve the reporting standards of the companies. High reported net profit will attract more domestic as well as international investments. Therefore, it is recommended that the countries should adopt IFRS, so that the inflows of foreign investments in their respective economies get increased. Moreover, the government and accounting educators should make certain arrangements to spread the knowledge regarding IFRS among the students, investors, and researchers. There is also great need of introducing professional development activities for the educators to enrich their learning experience from rules based accounting to principles based set of accounting standards.

## Conclusion

The main aim behind introduction of IFRS is to provide uniform accounting information to its users. IFRS is mainly principle based, which has a major effect on reporting of profitability. Therefore, the present study was conducted to look at the impact of IFRS adopted organizations on their profitability and also to examine economy wise comparison of those companies which have adopted IFRS. The findings show that IFRS has a significant impact on profitability, but there is no difference in profitability of IFRS adopters in developed and developing countries. From the results, it can be concluded that the countries should adopt IFRS as it provides common standards for the preparation of financial statements. Adopting IFRS will ultimately improve the reporting standards of the companies. High reported net profit will attract more domestic as well as international investments. Therefore, it is recommended that the countries should adopt IFRS, which will further improve the inflow of investments in their respective economies.

## Limitations of the Study and Scope for Further Research

The study considered the data of only 20 sample countries for analyzing the relationship of profitability with IFRS due to time & cost constraints and further for profitability, the study considered 46 companies only from selected countries. The data regarding return on equity was not easily available in the annual reports of the companies, but still, an honest attempt has been made to explore the information and make an analysis using the available information.

In the present study, an attempt has been made to examine the effect of IFRS on profitability. Further research can be conducted to analyze the effect on foreign direct investment as the basic purpose of IFRS is to promote investment. Moreover, effect of IFRS on various social and economic factors can also be examined.

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## About the Authors

**Pooja Sharma is working as an Assistant Professor in Lovely Professional University, Jalandhar, Punjab. She has done M.Phil and is currently pursuing Ph.D in management. She has a research experience of approximately 10 years.**

**Sushant Gupta is working as an Assistant Professor in Lovely Professional University, Jalandhar, Punjab. He has done MBA and is currently pursuing Ph.D in management. He is specialized in accounting and finance.**