

Effect of Ind AS on Earnings Management in Selected FMCG Companies in India

OPEN ACCESS

Manuscript ID:
COM-2021-09044320

Volume: 9

Issue: 4

Month: October

Year: 2021

E-ISSN: 2582-6190

Received: 28.07.2021

Accepted: 18.09.2021

Published: 01.10.2021

Citation:

Nandini, G., and TA Tamilselvi. "Effect of Ind AS on Earnings Management in Selected FMCG Companies in India." *ComFin Research*, vol. 9, no. 4, 2021, pp. 24–26.

DOI:

<https://doi.org/10.34293/commerce.v9i4.4320>



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Abstract

Corporate frauds have increased drastically which has been witnessed in the last decade in India and around the world. Managers use their judgement in analysing the financials and modification of statements which is the origination for earnings management. This paper discusses earnings management evaluation after the adoption of Ind AS for the first time by leading fast-moving consumer goods companies in India. Random sampling is used to select three companies and analyse them for a period of 6 years (2014-2020)

The Jones Model (1991) is used to evaluate earnings management and tested using the regression model to arrive at the findings. The Jones model of non-discretionary accruals is used for evaluation of accounting manipulation. The Jones model has non-discretionary and discretionary accruals estimated in the model. The R square is 14.3% and the F-test significance value is greater than 0.05; therefore null hypothesis is accepted, concluding there is no change in earnings management after the new standards.

Keywords: Ind AS, Earnings management, Jones model, Corporate frauds

Introduction

The financial statements are prepared to keep in mind to reflect true and fair views to the investors. To achieve financial reporting objective's, the regulators and accounting group are interested to know how accounting standards should be formulated or altered. The high-quality standards have a positive effect on reporting and are of greater use to the users of information. (Zicke and Kiy, 2017). It is important to examine the risk of possible manipulation in Indian companies after the adoption of Ind AS. Accounting frauds and creative accounting have gained attention since many companies have manipulated the books of accounts like Enron, WorldCom, Satyam, Lehman Brothers. (Drabkova, 2018)

There are many financial indicators, rating and default models the results conflict with one another. The managers adjust the amount of reported profit to maximum or to loss, thereby reaching profits in subsequent accounting periods (Drabkova, 2015). Nobel research report stated 50 sound market cap firms are practising creative accounting and investors need to carefully study the books of accounts.

Literature Review

The reporting quality differs after the adoption of international standards like IFRS and now Indian companies are required to prepare under Ind AS (converged IFRS). Earlier studies suggested strong enforcement countries show higher accounting quality than weak enforcement countries. There are many studies conducted on IFRS on various issues and many authors have proved that IFRS adoption enhances transparency in financial reporting and accounting quality is improved (Daske et al., 2008).

Alareeni and Aljuaidi (2014) compared the two models of Modified Jones and Yoon model for detecting earnings management effectively in Palestine. The results showed Yoon model was better than the Modified Jones model. Beslic et al. (2015) also tried to find the best model for the Serbian environment. The authors compared using multiple linear regression Jones model, Dechow model and Kasznik model and findings proved Kasznik model to be statistically significant.

Objectives

The study analyses the following objective to evaluate the earnings management after the adoption of Ind AS in selected FMCG companies.

Methodology

The data is collected from secondary sources like annual reports of the companies selected under study. The paper evaluates manipulation in earnings management after Ind AS adoption in the FMCG sector. The companies selected are ITC Ltd, Emami Ltd, and Tata consumer products Ltd based on the performance under the FMCG sector in India. The Jones model of non-discretionary accruals is used for evaluation of accounting manipulation. The Jones model has non-discretionary and discretionary accruals estimated in the model. The analysis is carried from 2014-15 to 2019-20.

Non-discretionary accruals use change in revenues and Property, plant and equipment. These

variables are assumed to control for the change in the economic development of the firm (Jones 1991). The accrual model helps in finding the inconsistency of non-discretionary accruals for two different periods. If the non-discretionary accruals compared to total assets are lower from one period to another, discretionary expenditures of the subsequent periods are higher. The model used suggests if non-discretionary accruals decrease, discretionary accruals increase and vice-versa. The model used in the study is similar to (Drabkova, 2015) which is defined as follows:

$$(1/\text{Total Assets}) + \text{Revenue current year} - \text{Revenue prior-year} / \text{Total assets current year} + (\text{property, plant and equipment gross current year} / \text{total assets prior year})$$

Results and Discussion

The calculation of data using the formula is

	X1	X2	X3
2014-15	2.17435E-05	0.076487705	0.543629245
2015-16	2E-05	0.011552	0.504942
2016-17	1.8E-05	0.345073	0.339304
2017-18	1.6E-05	-0.17177	0.3421
2018-19	1.4E-05	0.030273	0.28972
2019-20	1.3E-05	0.019787	0.715802
2014-15	0.000596543	0.236514614	0.452243209
2015-16	0.000375	0.152574	0.407755
2016-17	0.00038275	-0.0348985	0.35206673
2017-18	0.000357	0.002934	0.344197
2018-19	0.0003543	0.0538945	0.2674292
2019-20	0.000373	-0.01421	0.376634
2014-15	0.000105	0.02689	0.067252
2015-16	0.000104	0.012178	0.076891
2016-17	0.000104	-0.13886	0.072592
2017-18	9.44E-05	0.00338	0.077175
2018-19	9.14E-05	0.039872124	0.076358003
2019-20	5.4E-05	0.128951	0.110388

The regression model is used here to statistically evaluate the model.

Table 1: Summary Statistics for Jones Model

Model	R	R square	Adjusted R square	Std, Error of the estimate	Sig. F change	Durbin Watson
1	.378	.143	.029	2.97333	.315	.969

Source: Author’s Computation

Table 2: Anova

	Model	Sum of squares	df	Mean square	F	Sig.
1	Regression	22.109	2	11.055	1.250	.315
	Residual	132.610	15	8.841		
	Total	154.719	17			

Source: Author's Computation

The R² for the Jones model shows 14.3% variability of the dependent variable. The Adjusted R² is 2.9% and the Durbin-Watson test is 0.969 which indicates positive autocorrelation. The ANOVA results prove there is no statistically significant change after the adoption of Ind AS in earnings management.

Most of the previous studies in this model have been carried out in developed countries like the USA and UK and very few researches in emerging markets. This paper mainly focuses on finding whether any manipulation in financial reports after adopting Ind AS.

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