

Effectiveness of OCI in Channelizing the Impact of Fair Valuation

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Abstract

Ind AS (Indian Accounting Standards) is the customized version of IFRS (International Financial Reporting Standards). Indian companies, listed and unlisted; whose net worth is more than 500 crore, have converged to Ind AS reporting from the financial year 2016-17. The major change that Ind AS has brought to the framework of financial reporting was the introduction of fair value concept as a method of valuing assets and liabilities. This paper tries to address the facets of fair valuation and how the other comprehensive income (OCI) in the statement of profit and loss plays a role to reduce the volatility of fair valuation in the financial statements. The sample consists of selected companies following Ind AS and those are listed in BSE 100 index. The researcher has tried to analyze the components of OCI in them and the effectiveness of OCI in channelizing the impact of fair valuation.

Keywords: Ind AS, Other comprehensive income, fair valuation, volatility

1.1 Introduction

India converged to International Financial Reporting Standards from the financial year 2016-17. The decision has paved way to a series of changes in various aspects. ICAI has come up with a new frame work for those companies adopting Ind AS. The major change included in the frame work is the introduction of fair value concept as a method of valuation of assets and liabilities. Ind AS has allowed the companies to channelize the impact of fair valuation either through other comprehensive income (OCI) or profit and loss account. Fair valuation has raised a stir among the professionals and academicians. The role of OCI in reducing the impact of fair valuation is still a valid question. And to what extend OCI acts as a cushion in covering the volatility posed in the financial statements. The paper tries to address the above mentioned issues. The paper is divided into four parts. Section 1 includes the framework of the study, section II analyses the data of Indian companies, section III interprets the results and concludes the same.

1.2 Objectives

- To study the effectiveness of OCI component in reducing the impact of fair valuation.
- To make a comparative analysis of Indian scenario across industries.

1.3 Statement of Problem

Does fair value affect the true and fair view of total comprehensive income?

1.4 Definitions:

- **Fair value:** Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date

under current market conditions (ie an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

- **True and fair view:** Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework.
- **Total comprehensive income:** The change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.
- **Other comprehensive income:** It sets aside income-relevant items that possessed low reliability from contaminating (polluting) the earnings number.

1.5 Scope of the study

Ind AS has been implemented and it's the right time to know its impact in various aspects of financial reporting as well as across the industries. Fair valuation is being raised a major concern since the implementation of Ind AS. This paper addresses the chaos related to fair valuation and the effectiveness of OCI in channelizing the impact of fair valuation without contaminating the revenue figure. Also it is relevant to know the future prospects of the OCI and fair valuation.

1.6 Methodology

- Annual reports of companies listed in BSE 100 index are downloaded and data relating to OCI are collected from them.
- 20 companies are selected on the basis of availability of data on purely convenience basis.
- The components of OCI are summarized, tabulated and presented as a percentage of Total comprehensive income.
- Further the data is analyzed to know the impact of OCI.

2.1 Indian Scenario

The study has been conducted on selected 20 companies on the basis of availability of data. Table 2.1 represents the corresponding sample comprises companies from ten industries. The sample is selected on purely convenience basis and it may not be representative.

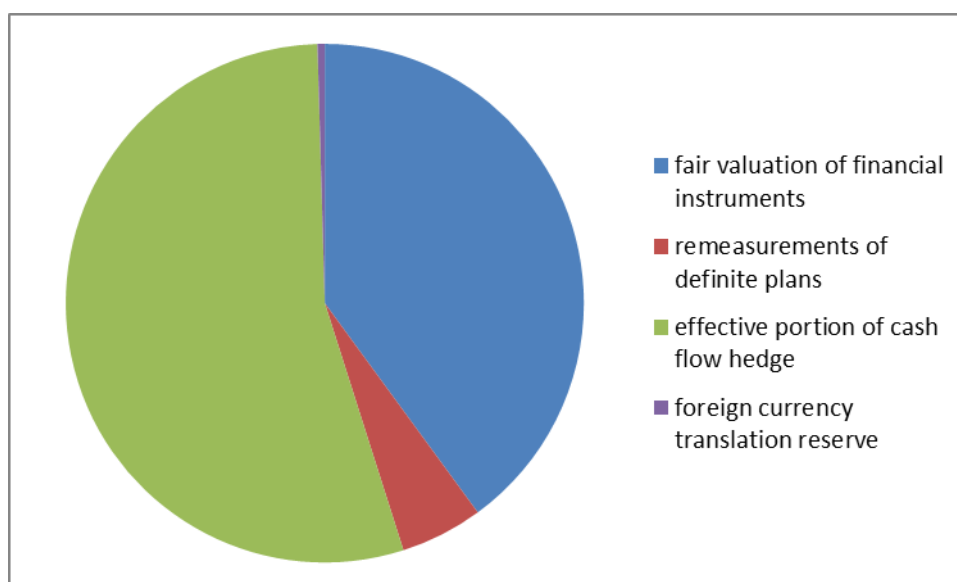
Table 2.1: Samples and their industries

Industry	No. of firms
Healthcare	1
Automobile	3
Pharmaceuticals	3
Luxury goods	1
Manufacturing	3
IT	2
Consumer goods	2
Oil & gas	2
Construction	1
Energy	2

The sample has more number companies from manufacturing sector and automobile sector. The uneven selection of companies could affect the credibility of data analysis.

The components of OCI are summarized and can be presented in the figure 2.1

Figure 2.1: The components of OCI



Source: computed by the researcher

From figure 2.1 it is evident that above 50 percent of the OCI amount is comprised of effective portion of cash flow hedge and fair valuation of both equity and debt instruments. Re-measurement of employee benefit plans and foreign currency translation reserve hardly comes to 10 percent. OCI accounts for approximately 8 percent of the total comprehensive income. This means hedge accounting and derivative accounting has affected the OCI more than any other component. Foreign translation reserve represents the least percent against comprehensive income. The sample selection might also affect the percentage analysis, still in a general sense, it is stated that Ind AS 107 and Ind AS 109 has affected the OCI and the impact of the fair valuation is effectively channelized through OCI without showing its directly in the statement of profit and loss as a charge against net income.

Industry wise analysis of OCI is tabulated as follows. The table 2.2 shows the percentage break down of OCI. It is seen that oil and natural gas and energy industry have bigger share of COI in their total comprehensive income.

Table 2.2: Samples and their industries.

Industry	OCI	Industry	OCI
Healthcare	0.14	IT	2.30
Automobile	0.35	consumer goods	0.51
Pharmaceuticals	0.12	oil & gas	32.90
luxury goods	0.16	Construction	1.67
Manufacturing	0.53	Energy	23.27

In the present Indian scenario, from table 2.2, on an average, OCI represents only 8 percent of the comprehensive income. It is evident that fair valuation does not have a major impact on the income of the firm, and OCI to an extent is helpful in channelizing the volatility of fair valuation.

3.1 Interpretations and Conclusion

Researcher has also done some content analysis of some foreign firms to know the impact of fair valuation in the true and fair view of the financial statements. It is evident that OCI is more volatile under IFRS. But it

should be noted that there are some carve outs between Ind AS and IFRS. The main points that could make an impact on the value of OCI are described below:

- In the case of employee benefits, the discount rate applied for determining actuarial liabilities are the government bond rate while under IFRS, it is the corporate bond rate. This could increase the vulnerability of the figures under IFRS when compared to Ind AS.
- Contradictory to IFRS, Ind AS 21 (published by the MCA in February 2011) provided an option for unrealized exchange differences arising on certain long-term monetary assets and long-term monetary liabilities denominated in a foreign currency to be recognised directly in equity.
- Foreign currency convertible bonds are carried at fair value under IFRS, while Ind AS allows recognizing the same as equity.

Due to these carve outs, it is not feasible to draw a parallel comparison between foreign companies and Indian companies.

The data collected from Indian companies does not reveal any major impact of fair valuation in comprehensive income and thereby we can assume that OCI has been an effective tool in channelizing the impacts of fair valuation. There are some other aspects of Indian economy that we should consider while concluding. Fair valuation affects derivative instruments and other financial instruments. India is having an infant derivative market and the capital market is also at a developing stage. Hence, at this point of time it is not appropriate to judge the effectiveness of OCI in managing the fair value volatility. For a hypothetical comparison researcher has some foreign firms and also studied the share of OCI in them. It is revealed that the total comprehensive income of some companies account for more than 50 percent OCI in them. This is alarming as these figures could hamper the concept of true and fair view of the financial statements. As a conclusion researcher thinks that India is on its way expand its capital market and once it flourishes fair valuation could be a threat to the true and fair view of the financial statements.

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