IFRS ADOPTION AND KEY ACCOUNTING RATIOS: AN EVIDENCE FROM COLOMBO STOCK EXCHANGE

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ABSTRACT

The purpose of this study is to investigate the impact of International Financial Reporting Standards (IFRS) adoption on key accounting ratios of firms listed in the Colombo Stock Exchange (CSE). The study also sought to test if the entity's sector discriminates the impact that the IFRS adoption has on accounting ratios being evaluated. Descriptive statistics and non-parametric univariate analysis (Mann Whitney U test) were used to compare pre and post IFRS convergence ratios. The researchers tested eleven accounting ratios falling under profitability, liquidity, leverage, and market performance. We randomly sampled 40 firms listed in CSE, 20 each from the service and manufacturing sectors. The study period was ten years from 2007 through 2016, whereby the periods corresponding to pre-IFRS convergence were from 2007 through 2011, and post-IFRS convergence was captured from 2012 through 2016.. We showed that all profitability measures we tested were significantly impacted by IFRS adoption. We infer that the direct comparability of the profitability measures across pre and post-IFRS periods is no longer useful for decision making. In contrast, all liquidity ratios investigated were significantly indifferent between the pre and post-IFRS adoption. We have argued that liquidity measures have not changed considerably due to IFRS adoption and may thus still be comparable across pre and post-IFRS periods. Leverage and market ratios returned mixed results. We also document that the IFRS convergence's impact on profitability and leverage ratios tends to be influenced by the sector in which firms operate, while its impact is not evidenced in relation to liquidity measures and market ratios. The limitation of this paper is that the effects of firm-specific variables and macro-economic factors on accounting ratios were not controlled. The results are useful for those interested in analyzing the long-term trends of accounting ratios. Our findings will also help the policymakers, standards setters, financial analysts, and future researchers about the behaviors of accounting ratios and quality financial reporting due to convergence to IFRS-based accounting regimes. This study is one of very few works on this topic in Sri Lanka, an IFRS jurisdiction with a developing economy.

Keywords: Accounting Standards, International Accounting, IFRS Adoption, Accounting Ratios, Financial Ratios.

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1. INTRODUCTION

Accounting ratios have long been used for predicting financial characteristics (Bao et al., 2010). Changes in accounting standards potentially disturb the consistency of the meaning implied by financial ratios. It happens primarily due to variation in recognition and measurement rules in different accounting regimes. For example, IFRS is more inclined towards exist price system of measurement, which leads to fair value adjustment in balance sheet figures and income statement and recognition of unrealized gains and losses to other comprehensive income. These tend to influence key accounting ratios like liquidity, leverage, and coverage ratios (Blanchette et al., 2011). The convergence of local accounting standards with the IFRS regime has thus implications on behavior of accounting ratios, thereby comparability, prediction, and interpretation of financial information concerned.

Zeller et al. (2019) identified four major categories in the body of IFRS literature. Accordingly, the first stream of research compares amounts and ratios of IFRS-based financial reports computed under domestic or non-IFRS standards (e.g., Bao et al., 2010; Barth et al., 2012). The second strand of literature investigates how cultural, legal, and accounting systems of countries adopting IFRS affect the implementation of IFRS standards (e.g., Nobes, 2013). The third section of the research is to measure the intended and unintended consequences due to IFRS. The fourth category of literature focuses on how IFRS impacts issues such as earnings management and accounting quality etc. (e.g., Evans et al., 2015). The present research falls into the first stream of IFRS literature mentioned above as this study seeks to examine the effects on accounting ratios of the differences between Sri Lanka accounting standards in pre and post IFRS convergence. The question of "what are the effects of the differences between IFRS and Generally Accepted Accounting Standards (GAAP) on financial reports?" is a matter of concern for corporate firms, and investors (Bao et al., 2010). An accurate answer to the above question is crucial as it inextricably connects to firms' ability to make their financial reports appealing to the investor community (Fajardo, 2007) and interpret the financial reports accurately (Tie, 2007). This knowledge is also essential to investors and financial analysts as it connects to the assessment of investment risk and returns and the decision to diversify portfolios into international markets (Bao et al., 2010).

Further, accounting ratios under different accounting systems behave differently. For example, the mean and spread of a given financial ratio calculated in space and time may significantly vary between different accounting standards regimes. This will also signal the quality of financial reporting and the reliability and validity of the underlying financial reporting standards. Therefore, addressing the above question presented by Bao et al. (2010) will be instrumental in the standards-setting and revision process.

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Thus, despite numerous studies have investigated the effects of IFRS convergence on accounting ratios, conclusions significantly vary across jurisdictions due to the diversity of the economies, market, sector, and characteristics of the firms under evaluation. Lanto and Sahlstrom (2009) revealed that IFRS adoption significantly changed the value of prominent accounting ratios of Finnish companies. However, the financial ratio changes are minimal in South Africa (Ames, 2013). Lantto and Sahlstrom (2009) document that the core profitability and gearing ratios of Finish listed firms are significantly higher under IFRS adoption. Punda (2011), following Lantto and Sahlstrom (2009), reports a significant change in the key performance indicators of listed firms in the UK following the introduction of IFRS. Blanchette et al. (2011) found increased volatility in most of the accounting ratios corresponding to the IFRS regime compared to Canadian standards. Jones and Finley (2011) report that IFRS adoption led to a significant decline in post-IFRS ratios' volatility. Barth et al. (2012) report, although IFRS adoption led to an enhancement in the comparability of financial reporting of US firms, significant differences remain. These variations in IFRS research findings validate the claim that IFRS would create differences in different contexts and jurisdictions. According to Blanchette et al. (2011, p.8), the unclear and unresolved question on the source of increased volatility in accounting ratios under IFRS regime is still open for future research.

This study thus seeks to investigate the impact of IFRS adoption on key accounting ratios of companies listed in CSE. We particularly observe eleven accounting ratios falling into four evaluation categories: profitability ratios, liquidity ratios, leverage ratios, and market ratios. The majority of research on the IFRS impact on accounting ratios has focused on developing economies and reported different findings. Addressing this gap in the IFRS literature, this paper seeks to provide evidence from a developing economy. This article also seeks to test the sector anomalies that IFRS adoption has on the above stated vital accounting ratios.

The primary motivation for this research is that Sri Lanka, an IFRS jurisdiction, has been little focused on in the IFRS literature. Addressing the void in IFRS literature, this paper makes three significant contributions. First, it contributes to the extant IFRS literature with empirical evidence from an emerging market. Second, it is the first to offer an analysis of IFRS impact on key accounting ratios in Sri Lanka. This contribution may thus be helpful to national and international standard setters, regulators, and policymakers in reviewing the application, effects, and potential decision usefulness of IFRS for emerging economies. Third, the present study reports the anomalies in IFRS impact across different sectors (manufacturing vs. service sector), which has drawn little attention in previous IFRS literature.

The paper proceeds as follows. The following section provides a review the recent literature on the impact of IFRS on accounting ratios. It also discusses the theoretical framework and includes a subsection providing a comparison of Sri Lanka Accounting Standards, pre, and posts IFRS adoption. Section 3 contains the research methodology,

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where we describe the sample, test selection, and accounting ratios under evaluation. Section 4 describes and discusses the results and the final section, Section 5, offers the study's conclusion.

2. LITERATURE REVIEW

2.1. Accounting regime change and accounting ratios

Literature on the implications of IFRS adoption in the Sri Lankan context is little documented (Bandara, 2020; Nijam, 2016; Nijam and Jahfer, 2018). Nijam (2016) reported the early evidence of the pros and cons of IFRS adoption in the Sri Lankan context (Bandara, 2020) and stated that IFRS adoption *inter alia* increased the firms' financial reporting quality, evidenced by many positive impacts on qualitative characteristics of financial statements. Nijam and Jahfer (2018), in their assessment of the impact of IFRS adoption on the value relevance of accounting information, reported that the volatility of Book value of equity per share (BVEPS) was relatively high during the IFRS period compared to that prevailed in the years that preceded the IFRS adoption. Bandara and Falta (2021) recently reported that the new IFRS reporting environment was perceived to have improved the financial reporting quality compared to that under the previous Sri Lanka Accounting Standards regime.

Among that Sri Lankan literature on IFRS adoption, little has been discussed on the comparability of pre and post IFRS convergence accounting information. However, studies from other IFRS jurisdictions document evidence of how the IFRS adoption influenced the accounting ratios. Blanchette et al. (2011), based on the sample of 22 full sets of audited financial statements corresponding to 9 Canadian companies early adopting IFRS, found that the effects of IFRS on means and medians of ratios relating to the financial condition are not statistically significant. Blanchette et al. (2011 p.8), however, confirmed an increased volatility of leverage and profitability ratios prepared under IFRS. Blanchette et al. (2011) also reported a significant difference in the distribution of values of profitability ratios such as ROA, comprehensive-ROA and price-earnings related ratios, and liquidity ratios such as current and quick ratios. Differences were also confirmed in debt, alternative-debt and equity ratios, interest coverage, fixed-charge and cash-flow coverage. These differences were primarily due to differences in the application of fair value accounting and consolidation. They also observed that mining companies in the sample had more incentive for early adoption. They report a significant industry effect on six profitability and coverage ratios of the companies mining industry. McConnel1(2012) studied a sample of 50 Canadian mining firms and observed the impact of IFRS over 2010-2011. They used the accounting ratios used in Blanchette et al. (2011) and performed Wilcoxon signed-rank tests. The research reveals no statistically significant difference in the ratios' dispersion despite the finding that the central tendency of three ratios, such as quick ratio, ROA, and comprehensive ROA, were significantly different.

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Bao et al. (2010) showed evidence of the effect of the differences of essential line items in the financial statement prepared under IFRS and US- GAAP. They employed both univariate tests (t-tests) and multivariate analysis (ANOVA, probit, and logit analyses). They showed that IFRS-country firms experience a significantly higher current ratio, a significantly lower asset turnover ratio, and a significantly lower debt-to-asset ratio.

Lueg et al. (2014) document that important accounting ratios under IFRS are significantly different from UK GAAP. They report that the increase in profitability and liquidity ratios is significant and substantial, while the decline in the P/E-ratio is small due to the stock price's stability despite the increase in net income. They state that these differences in the UK reflect the situation in a creditor-oriented code law regime. Cordazzo (2013) aimed to report empirical evidence of nature and the size of the differences between Italian GAAP and IFRS by comparing the net income and equity of companies listed on Borsa Italiana. They report that the total impact on net income is relatively more than that on equity. They found a more significant inconsistency between Italian GAAP and IFRS in the accounting treatments impacting net income and equity.

Hung and Subramanyam (2007) examined the effects of IAS adoption during 1998-2002. They compared financial statements prepared under IAS and German GAAP and found that the total assets and the book value of equity under IAS were significant than those under HBG. They also report significantly higher variations in book value and net income of the firms investigated. They recommend adopting a country-specific approach will be more advantageous in inferring the impact of IFRS adoption as it will control the bias driven by different institutional arrangements and time-series differences. Stent et al. (2010) examined the impact of IFRS adoption on the financial statement of 56 listed companies in New Zealand from 2005 through 2008. The sample comprised of 16 early adopters and 40 firms waiting for NZ IFRS to became mandatory. They primarily investigated NZ IFRS's impact on the financial statements and ratios of first-time adopters of NZ IFRS. Results revealed that NZ IFRS affected 87 percent of firms though the magnitude of the impact was small for most firms while it was large for some entities. Stent et al. (2010) document that NZ IFRS has significant effects on common accounting ratios. Lantto and Sahlstrom (2009) evaluated the effects of IFRS adoption in Finland. They calculated various commonly used accounting ratios of 91 firms sampled from the Helsinki Stock Exchange during 2004-2005. They employed univariate analysis and Wilcoxon test. They showed that IFRS adoption substantially increased many profitability ratios (OPM, ROE, ROCE, GR), while the gearing ratio was moderately inflated. They also found a considerable decrease in PE ratio while equity and quick ratios marginally declined.

Terzi et al. (2013) examined 140 manufacturing firms listed in the Istanbul Stock Exchange during 2004-2006 years to evaluate the impact of IFRS adoption. They

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employed the Wilcoxon signed-ranks test and logistic regression models for empirical analysis. Terzi et al. (2013) document that accounts of shareholder's equity, fixed assets, inventories, and long-term liabilities were significantly affected by IFRS adoption. They also found that financial leverage ratios, current ratios, and asset turnover ratios were subject to significant changes under the IFRS regime. The findings of Terzi et al. (2013) thus observed the IFRS impacts on various accounting ratios though Agca and Aktas (2007) could find significant impact only with current ratio and net asset turnover ratios. Punda (2011) studies a sample of 101 firms trading in the London Stock Exchange in 2005. The study focused on five accounting ratios OPM, ROE, ROIC, CR, and PE. Employing Wilcoxon Signed-Rank, it was found that accounting numbers significantly differed between UK GAAP and IFRS. Punda (2011) states that under IFRS regime all profitability ratios recorded substantial increase compared to pre transition period. However, increase in liquidity ratios was not significant. Further, the PE ratio (market-based Price to Earnings ratio) declined slightly after the transition. Silva et al. (2009) examined the impact of IFRS in Portugal. They analyzed the selected ratios (Gearing Ratio, PER, and EPS) of 39 firms listed in the Lisbon Stock Exchange using K-Means Cluster Analysis. They report that such balance sheet measures as investments, equity, intangible assets, fixed assets, and liabilities recorded significant chnages. Iatridis and Dalla (2011) investigated the effects of IFRS adoption on the financial statements of Greek listed companies. It focuses on the financial position and performance of 200 sample firms listed on the Athens Stock Exchange in major industrial sectors and stock market indices from 2004 and 2005. They employed a binary logistic regression model and showed that IFRS adoption had a positive impact on the profitability of firms in the industrial sectors whist IFRS adoption caused negative impact on the liquidity ratio of many firms.

2.2. Theoretical Framework

This paper is situated within decision usefulness theory. The theory of decision usefulness holds that information reported in financial statements must be useful to make economic decisions (Scott, 2012). Adopting this normative theoretical foundation, IASB's conceptual framework for financial reporting (p.19) provides that the "objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful for existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity." Comparability of financial information is a cornerstone qualitative characteristic that enhances the decision usefulness of financial statements (IASB, 2018). Changes in accounting standards or accounting standards regimes generally modify the underlying recognition and measurement rules, impacting the comparability of financial information reported in the financial statements prepared under different accounting regimes. The investigation of the nature and magnitude of such changes in the comparability of financial statements due to the changes in the accounting regime will help infer the usefulness of the accounting standards newly

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adopted. However, it is context-driven, resulting in varying conclusions when repeated in different times and spaces. Sri Lanka's accounting regime change is thus a unique case that will help improve the understanding of the usefulness of IFRS convergence. This study thus examines the effect of IFRS convergence on the comparability of accounting information reported in pre and post-IFRS regime in Sri Lankan context.

2.3. Sri Lanka Accounting Standards: An Account of Pre and Post IFRS Adoption

With the establishment of the Chartered Accountants of Ceylon[1] in 1959, accounting was officially recognized as a profession in Sri Lanka (Asian Development Bank,2002). Sri Lanka, as a common law country, had a significant affiliation with the accounting systems and traditions of the British. The present institutional framework pertaining to the accounting and financial reporting system in Si Lanka is mainly regulated by the Institute of Chartered Accountants of Sri Lanka (ICASL), Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB), the Central Bank of Sri Lanka (CBSL), the Securities and the Exchange Commission of Sri Lanka (SEC), and the Inland Revenue Department (IRD) (ADB, 2002: Bandara and Falta, 2021: World Bank, 2004). These institutions primarily operate within the regulatory framework governed by the Finance Companies Act No. 78 of 1988, the Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, the Banking Act No 30 of 1995, the Inland Revenue Act No 10 of of 2006, and the Companies Act No 07 of 2007 (ADB, 2002: Bandara and Falta, 2021: World Bank, 2004).

The early accounting sector in Sri Lanka was governed by the prescription of Companies' Ordinance of Ceylon, contemporary UK legislation, and the recommendations of ICAEW (ADB, 2002). It continued until the Institute of Chartered Accountants of Sri Lanka (ICASL) adopted the first Sri Lanka Accounting Standard (SLAS)[2] in 1970. Later, the Accounting Standards Committee (ASC) that was established under the Accounting and Auditing Standards Act No. 15 of 1995 issued the first set of Sri Lanka Accounting Standards (SLASs) in 1996. Codifying the SLASs issued from time to time since 1996, ICASL released its first bound volume of standards which contained twenty-eight SLASs (ADB, 2002). These standards were effective till 30 June 2001 (ADB, 2002). Adhering to the recommendations of the Presidential Commission on Finance and Banking and the condition of ICASL's IFAC membership, the accounting standards issued by ASC of ICASL since 1996 had to be and, in fact, were in compliance with corresponding International Accounting Standards (IAS) (ADB, 2002).

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[1] *The Institute of Chartered Accountants Act (No.23) 1959*

[2] *SLAS 1: The treatment of dividends duly grossed in the balance sheets and appropriation statements of companies*

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The "Diagnostic Study of Accounting and Auditing in Sri Lanka," published by the Asian Development Bank (ADB) in 2002, confirmed that financial reporting by private sector was largely comparable with financial reports of those in other countries: both developing and developed (p.3). However, this report observed that SLASs that were in force were to some extent incompliant with corresponding IASs (ADB, 2002) (See Table 01 for a summary of divergences between SLASs and IASs as identified in ADB's report in 2002).

Table 01: Summary of Divergences Between SLASs and IASs as Identified in ADB's Report in 2002

Non-adoption	Sri Lanka did not adopt the I the following IASs: IAS 15, IAS 26, IAS 29, IAS 32, IAS 35, IAS 36, IAS 38, IAS 39, IAS 40 and IAS 41
Adopted but not enforced	Though Sri Lanka had drafted or adopted IAS 10, IAS 34 and IAS 37 through corresponding local SLASs respectively SLAS 12, SLAS 35, and SLAS 36 they were not issued or enforced.
Implemented but withdrawn	Sri Lankan standards based upon IASs that have been withdrawn: SLAS 8, SLAS 11, SLAS 15 and SLAS 22
Localized standards	Country-specific national standards that have been developed: SLAS 32 and SLAS 33
Non-comparable standards	Non-comparable SLASs (due to significant differences): IAS 12 and IAS 19
Content differences with IASs	IAS 16, IAS 31

Source: Prepared by author based on the report of Diagnostic Study of Accounting and Auditing in Sri Lanka," published by the Asian Development Bank (ADB) in 2002.

Further, World Bank (2004, p. 11), in its Report on the Observance of Standards and Codes (ROSC), observed that despite Sri Lanka's compliance with IAS, there still existed certain gaps arising from non-adoption of some IAS and allowance of alternative treatment that was not in par with IAS.

ROSC, similar to the Report on Diagnostic Study of Accounting and Auditing in Sri Lanka conducted by ADB (2002), offered a detailed account of incompliance/ divergence between SLAS and IAS and recommended that Sri Lanka *inter alia* should necessitate the adoption of IAS/IFRS without modification for specified business enterprises in a manner that all SLASs adheres to corresponding IAS/IFRS and their amendments adopted by the International Accounting Standards Committee till that

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date. These standards should be legally mandatory for all specified business enterprises.'' (p.14). These advocacies from prominent multilateral bodies mainly pushed Sri Lanka for a full-scale convergence towards the IFRS regime from January 2012. Sri Lanka Accounting Standards that correspond to IFRS are commonly referred to as SLFRS, while LKAS refers to the Sri Lanka Accounting Standards that correspond to IAS (Institute of Charted Accountants of Sri Lanka [ICASL], 2012) Australian Accounting Standards Board [AASB 10], 2020, para. 8 ICASL, 2012). ROSC of World Bank (2015) confirmed that SLASs, after the adoption of IFRSs, were in line with the corresponding IFRS and IAS that IASB had issued. As a policy of IFRS adoption, the Accounting Standards Committee of ICASL reviews IFRSs prior to their adoption, and they are not localized. Sri Lanka was among the first countries that adopt IFRS in the South Asia region (World Bank, 2015).

3. METHODOLOGY

Comparisons of financial information across different accounting regimes, pre and post IFRS adoption, were made across eleven accounting ratios falling into four evaluation categories: profitability ratios, liquidity ratios, leverage ratios, and market ratios. Table 02 summarizes the ratios employed under each of the above-stated groups and equations used for the computation of the ratios concerned. Manufacturing companies were randomly drawn. The final sample thus represented the firms from clothing and textiles, petroleum, chemicals and plastics, electronic computers, and transportation, while service-sector firms represented hospitality, travel, transportation, healthcare, media, and sports. Data for the computation of ratios were collected using publicly published annual reports of sampled firms for the periods covered by the study. The sample data so gathered were tested with normality procedures where it was found that data failed to meet the normality assumption affirmed by Kolmogorov-Smirnov test statistics (p-value of all ratios were above 0.05 significant level). The distribution of many ratios was leptokurtic and positively skewed. Log transformation also failed to achieve the normality of the data set. Not surprisingly, previous studies on a similar topic e.g., Stent et al. (2010) also confronted the same issues and had the recourse to non-parametric tests. Therefore, we adopted the Mann-Whitney test, non-parametric test procedures equivalent to independent sample t-test to analyses statistical differences in our sample data.

In this study, each ratio has two independent groups of ratios, that is, ratios corresponding to pre and post IFRS adoption. Both groups are compared to infer the differences in accounting standards. The Mann-Whitney test is based on the comparison of each observation from the first group with each observation from the second group. According to Mann-Whitney test procedures, the data are sorted in ascending order, and then the data falling in each group are individually compared together. The highest number of possible paired comparisons is thus: (nx* ny), where nx is the number of observations in the first group and ny the number of observations in the second (Nachar, 2008). If both groups being evaluated arise from

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the same population, as held by the test's null hypothesis, each datum of the first group will have an equal chance of being larger or smaller than each datum of the second group (Nachar, 2008). If the null hypothesis is rejected, we infer that both groups (accounting ratios of pre and post accounting regime) belong to different population and thereby directly incomparable and *vice versa*.

Table 02: Ratios and Measurement

Variables	Description	Measurement
Panel A: Profitability Ratios		
Earnings per Share (EPS)	EPS describes company's profit per outstanding share of calculated annual basis	$\frac{\text{Net Income} - \text{Preferred dividends}}{\text{Weighted average share outstanding}}$
Return on Assets (ROA)	ROA indicates profitability of total assets in generating the company's revenue.	$\frac{\text{Net income} + \text{Interest expenses}}{\text{Average total assets}} * 100$
Return on Equity (ROE)	ROE measures of the profitability of a business in relation to the equity.	$\frac{Net\ income}{\text{Average shareholder equity}} * 100$
Panel B: Liquidity Ratios		
Current Ratio (CR)	CR measures a company's ability to pay short-term obligations.	$\frac{Current\ assets}{Current\ liabilities}$
Quick Ratio (QR)	QR measures how quickly a firm's current assets can settle its current liabilities.	$\frac{Current\ assets - Inventory}{Current\ liabilities}$
Acid Test Ratios (ATR)	ATR is an indicator of how quickly a firm's most short-term assets can settle its current liabilities.	$\frac{Cash\ \ cash\ equivalent + Accounts\ receivable + Marketable\ securities}{Current\ liabilities}$
Panel C: Leverage Ratios		
Total Debt to Equity (DE)	DE is the ratio between a company's equity and liabilities.	$\frac{Total\ liabilities}{Shareholders\ equity}$
Long term Debt to Equity (LDE)	LDE is used to determine the leverage that a business has taken on.	$\frac{Long\ term\ Liabilities}{Shareholders\ Equity}$
Time Interest Earned (TIE)	TIE measures company's ability to honor its debt payments.	$\frac{Income\ before\ income\ tax\ and\ interest}{Interest\ expenses}$

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Panel D: Market Ratios		
Price to Earning (PE)	PE is company that measure its current share price relative to its per-share earnings	$\frac{Market\ price\ per\ share}{Earning\ per\ share}$
Earning Yield (EY)	EY refers to the earning per share for the most recent 12-month period.	$\frac{Earning\ per\ share}{Market\ price\ per\ share} * 100$

Source: Prepared by the authors

As of the period of this study, there were 290 companies listed in CSE under 20 GICS industry groups as of 20th January 2020, with a market capitalization of Rs. 2,748.10 Bn. For the purpose of this research, we randomly sampled 40 companies, 20 each from service and manufacturing broader sector categories. The sample firms were observed for ten years from 2007 through 2016, resulting in 400 firm-year observations. Pre IFRS period was from 2007 through 2011, while the period from 2012 through 2016 represented the post-IFRS regime.

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics

Panel A in Table 03 shows that the profitability ratio with the highest spread (standard deviation) during the pre-IFRS period is ROE while it is also the only profitability ratio of which spread tends to have significantly declined (by 33%) during the post-IFRS adoption. The profitability of sample firms measured by EPS and ROA has grown in size and spread from pre to post IFRS regime. Spread measured by the standard deviation of EPS of the sample firms has more than doubled (129%) during post-IFRS adoption compared to that of pre IFRS convergence period. Meanwhile, ROA, compared to EPS, records less inflation in size (43%) and volatility (30%). Thus, EPS remains to be the most volatile profitability measure in the periods followed by IFRS adoption.

Table 03: Descriptive Statistics

Ratios	Accounting Regime	MIN	MAX	SUM	μ	σ
Panel A: Descriptive Statistics on Profitability Ratios						
EPS	Pre IFRS	-39.82	48.95	600	3.00	7.33
	Post IFRS	-57.85	97.5	1473.51	7.37	16.77
ROA	Pre IFRS	-26.86	96.45	2822.20	14.11	18.77
	Post IFRS	-24.04	98.96	4049.47	20.25	24.43
ROE	Pre IFRS	-48.58	204.78	2862.55	14.31	27.29
	Post IFRS	-52.77	100.5	3015.55	15.08	18.31
Panel B: Descriptive Statistics on Liquidity Ratios						

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CR	Pre IFRS	0	19.53	394.75	1.98	2.11
	Post IFRS	-1.85	22.76	398.70	1.99	2.44
QR	Pre IFRS	-1.05	18.5	357.36	1.79	2.31
	Post IFRS	0.03	28.35	416.21	2.08	3.31
ATR	Pre IFRS	-8.9	18.05	304.34	1.52	2.48
	Post IFRS	-1.5	20.1	333.55	1.67	2.57
Panel C: Descriptive Statistics on Leverage Ratios						
DE	Pre IFRS	0	42.8	772.41	3.86	6.29
	Post IFRS	-3.5	53.5	926.24	4.63	9.70
LDE	Pre IFRS	0	56.8	809.17	4.05	9.01
	Post IFRS	0	36	613.79	3.07	6.38
TIE	Pre IFRS	-13.64	90	1107.93	5.54	11.80
	Post IFRS	-4.9	82.49	1306.24	6.53	9.83
Panel D: Descriptive Statistics on Market Ratios						
PE	Pre IFRS	-68.7	125	2531.53	12.66	21.22
	Post IFRS	-54.8	97.32	2322.25	11.61	15.04
EY	Pre IFRS	-21	21.92	566.38	2.83	4.97
	Post IFRS	-11.01	20.25	1125.7	5.63	5.14

Source: Authors' own findings

Note: N=400, N(pre IFRS)=200, N(post IFRS)=200

All liquidity ratios investigated recorded a slight increase in magnitude and volatility during the post- IFRS periods compared to pre-adoption. Statistics in Panel B of Table 03 describe that as moving from pre to post IFRS adoption periods, current ratio (CR) grows by 1% and 15% respectively in size and standard deviation while QR ratio increased respectively in size and volatility 16% and 43%. The magnitude and standard deviation of ATR after the convergence to IFRS inflated by 10% and 3%, respectively. Though the said increase in the size of liquidity ratios is relatively far less than that of profitability ratios, the QR ratio records higher volatility among all liquidity measures evaluated. ATR has been the most consistent measure of liquidity amidst the accounting system changes as it records relatively minimal (3%) changes in standard deviation.

On the other hand, in terms of growth in size and spread, leverage measures produced mixed results. Shifting from pre to post IFRS regime, DE grew by 20% and 54% respectively in size and standard deviation while the LDE ratio declined respectively in size and volatility by 24% and 29%. Meanwhile, the volatility of TIE has declined by 17%, although its size grew by 18% from pre to post IFRS convergence. Thus, DE measured by total liability divided by equity tends to be the most volatile leverage measure during the period following the IFRS convergence, thereby recording higher growth in standard deviation.

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Out of two market ratios tested (namely PE and EY), PE of the post-IFRS period as compared to pre-IFRS adoption declined in size (8%) and spread (29%) while, in contrast, the size and spread of EY grew respectively at 99% and 3%.

4.2. Univariate Analysis

Table 04: Results of Univariate Analysis

Panel A: Profitability Ratios

		EPS	ROA	ROE
Pre IFRS	MR & SR	177.10 [35419]	188.34 [37667.5]	189.64 [37928]
Post IFRS	MR & SR	223.91 [44781]	212.66 [42532.5]	211.36 [42272]
	MWU	15319	17567.5	17828
	W	35419	37667.5	37928
	Z	-4.049	-2.104	-1.879
	Sig	0.000***	0.035**	0.06*

Panel B: Liquidity Ratios

		CR	QR	ATR
Pre IFRS	MR & SR	204.76 [40952.5]	200.15 [40029.5]	199.03 [39806]
Post IFRS	MR & SR	196.24 [39247.5]	200.85 [40170.5]	201.97 [40394]
	MWU	19147.5	19929.5	19706
	W	39247.5	40029.5	39806
	Z	-0.737	-0.061	-0.254
	Sig	0.461	0.951	0.799

Panel C: Leverage Ratios

		DE	LDE	TIE
Pre IFRS	MR & SR	207.07 [41413]	213.77 [42754.5]	190.43 [38085]
Post IFRS	MR & SR	193.94 [38787]	187.23 [37445.5]	210.58 [42115]
	MWU	18687	17345.5	17985
	W	38787	37445.5	38085
	Z	-1.136	-2.296	-1.743
	Sig	0.256	0.022**	0.081*

Panel D: Market Ratios

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		PE	EY
Pre IFRS	MR & SR	196.56 [39312]	168.69 [33737]
Post IFRS	MR & SR	204.44 [40888]	232.32 [46463]
	MWU	19212	13637
	W	39312	33737
	Z	-0.682	-5.504
	Sig	0.496	0.000***

Source: Authors' own findings
Notes: MR - Mean Rank; SR- Sum of Ranks; MWU-Mann-Whitney U; W-Wilcoxon W; Sig- Asymp. Sig. (2-tailed)
*** significant at 0.01, ** significant at 0.05, and * significant at 0.1

Table 04 presents the summary of Mann-Whitney U test results. The mean rank in relation to all profitability ratios pertinent to post- IFRS adoption is larger than that of the pre-IFRS period. Univariate analysis based on the pooled sample reveals that all profitability ratios under investigation differed significantly between pre and post-IFRS periods. The evidence tends to suggest that profitability measures have significantly changed to the extent the figures no longer belong to the same population. This implies that the direct comparability of profitability measures that belong to different accounting regimes tender no useful information. Fair value intensive measurement rules introduced in the IFRS regimes might have significant bearings over the measurement of income, expenditures, and profits, thereby making them incomparable.

Further, all liquidity ratios, namely CR, QR, and ATR, tested significantly the same throughout the periods surveyed despite the changes in the accounting regime. This finding tends to suggest that the liquidity measures have not been significantly impacted due to IFRS convergence. The figures thus share the characteristics of the same population, implying that the comparability of liquidity measures pertaining to pre and post-IFRS may still be possible despite the accounting regime change. This result might be attributed to the commonality between relevant accounting standards corresponding to pre and post IFRS regimes. For example, researchers observed notable similarities in accounting standards for inventory between pre and post-IFRS convergence.

Further, leverage and market ratios produced mixed evidence. Leverage ratios such as LDE (of which the mean rank declined by 12%) and TIE (of which the mean rank increased by 11%) are significantly different, respectively, at the alpha value of 0.5 and 0.1, thereby possibly being sensitive to IFRS convergence. Thus, the said leverage measures calculated in pre and post IFRS periods are no more directly

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comparable. Surprisingly, the debt to equity (DE) ratios pertaining to pre and post IFRS adoption periods still share similar characteristics. Similarly, in market ratios, PE was tested indifferent between different accounting regimes while EY significantly varied across. We recognize the limitation of this study that the real cause for mixed evidence with respect to leverage and market measures could not undoubtfully be established with the data used for this research.

4.3. Sectoral Anomalies in IFRS Impacts on Accounting Ratios

How the IFRS convergence affects the accounting ratios of companies in the different sectors is another question that this study sought to address. Table 05 presents the descriptive statistics sector wise. Accordingly, the mean and the spread of EPS in the manufacturing sector during the pre-IFRS period has more than doubled during post-IFRS convergence. Though the mean EPS and its spread of service sector firms during post-IFRS periods have grown respective by 132% and 148% as compared to those figures during the post-IFRS period, service sector firms record comparatively far less inflation in volatility as compared to pre and post IFRS convergence. Thus, the EPS of service sector firms has been less volatile during post-IFRS periods than manufacturing counterparts.

Table 05: Descriptive Statistics Sector wise

Accounting Regime 0-Pre IFRS 1-Post IFRS	**Ratios**	**MIN**	**MAX**	**μ**	**σ**
Panel A: Descriptive Statistics on Profitability Ratios					
0	EPS_m	-1.6300	48.9500	5.408619	8.5718340
1	EPS_m	-.4400	97.5000	12.780512	21.2621688
0	*EPSs*	-39.8200	9.7800	0.591370	4.7696451
1	*EPSs*	-57.8500	14.4000	1.954600	7.3590515
0	ROA_m	.1100	96.4500	18.754420	20.8381455
1	ROA_m	.0500	98.9600	23.736020	27.4981975
0	*ROAs*	-26.8600	58.1200	9.467626	15.1762760
1	*ROAs*	-24.0400	66.4400	16.758700	20.4651626
0	ROE_m	-39.3600	59.1700	11.813972	13.8052223
1	ROE_m	-1.0600	70.4900	13.256041	12.5527274
0	*ROEs*	-48.5800	204.7800	16.811490	35.9598499
1	*ROEs*	-52.7700	100.5000	16.899390	22.5685919
Panel B: Descriptive Statistics on Liquidity Ratios					

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0	CR_m	.1300	5.9700	1.815540	1.0856186
1	CR_m	-.7969	4.4500	1.569713	.9516836
0	*CRs*	0.0000	19.5300	2.132000	2.7807186
1	*CRs*	-1.8500	22.7600	2.417300	3.2645228
0	QR_m	-1.0500	5.1600	1.172230	1.0042956
1	QR_m	.0500	9.6000	1.335869	1.4746785
0	*QRs*	.0900	18.5000	2.401400	2.9987324
1	*QRs*	.0300	28.3500	2.826300	4.3276521
0	ATR_m	-8.9000	5.2000	.843111	1.7662907
1	ATR_m	-1.2000	6.7000	1.048020	1.1621919
0	*ATRs*	-1.5000	18.0500	2.200310	2.8745492
1	*ATRs*	-1.5000	20.1000	2.287300	3.3208691
Panel C: Descriptive Statistics on Leverage Ratios					
0	DE_m	0.0000	19.0300	2.598450	3.3054194
1	DE_m	0.0000	51.1300	3.121765	7.9113211
0	*DEs*	0.0000	42.8000	5.125610	8.0818588
1	*DEs*	-3.5000	53.5000	6.140360	11.0306469
0	LDE_m	.0010	56.8000	3.530850	10.3484122
1	LDE_m	0.0000	24.7000	1.917805	5.0780600
0	*LDEs*	0.0000	39.8400	4.560780	7.4445789
1	*LDEs*	.0030	36.0000	4.220030	7.3069483
0	TIE_m	-3.1000	21.3200	3.859360	4.4003145
1	TIE_m	-4.2600	46.8400	6.506860	8.2178674
0	*TIEs*	-13.6400	90.0000	7.220000	15.9647714
1	*TIEs*	-4.9000	82.4900	6.555500	11.2547750
Panel D: Descriptive Statistics on Market Ratios					
0	PE_m	-4.8500	43.3300	11.471700	9.6435255
1	PE_m	-4.4400	97.3200	13.103800	15.9901428
0	PE*s*	-68.7000	125.0000	13.843600	28.4532528
1	PE*s*	-54.8000	48.8800	10.118700	13.9502201
0	EY_m	-2.0700	21.9200	4.462570	4.2580928
1	EY_m	-.3800	20.2500	5.699430	4.9578640
0	EY*s*	-21.0000	16.3000	1.201210	5.1049277
1	EY*s*	-11.0100	20.2100	5.557500	5.3377365

Source: Authors' own findings

Note: Subscripts $(_m)$ and $(_s)$ respectively represent the ratios obtained for manufacturing and service sector firms.

Despite that the mean EPS and its spread in service sector firms during post-IFRS periods have grown respective by 132% and 148% as compared to those figures

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during the pre-IFRS period, service sector firms record comparatively far less inflation in volatility as compared to pre and post IFRS convergence. Thus, the EPS of service sector firms has been less volatile during post-IFRS periods than manufacturing counterparts despite the fact that the growth of the mean of manufacturing firms supersedes that of manufacturing firms. The mean and volatility of LDE in both the manufacturing and service sectors have declined in the post-IFRS period compared to the years prior to IFRS adoption. However, the standard deviation, that is, the volatility of LDE in the manufacturing sector during the post-IFRS period, is more than five times (527%) smaller than that of the pre-IFRS period. TIE in the manufacturing sector has grown in size (265%) and volatility (382%) in the period following IFRS convergence compared to the years before it.

Table 06: Highlighting the Sector Anomalies of IFRS Convergence on Accounting ratios

Panel A: Profitability Ratios			
	EPS	**ROA**	**ROE**
Pooled Sample	Rejected	Rejected	Rejected
Manufacturing Sector Firms	Rejected	Retained*	Retained*
Service Sector Firms	Rejected	Rejected	Retained*
Panel B: Liquidity Ratios			
	CR	**QR**	**ATR**
Pooled Sample	Retained	Retained	Retained
Manufacturing Sector Firms	Retained	Retained	Retained
Service Sector Firms	Retained	Retained	Retained
Panel C: Leverage Ratios			
	DE	**LDE**	**TIE**
Pooled Sample	Retained	Rejected	Rejected
Manufacturing Sector Firms	Retained	Rejected	Rejected
Service Sector Firms	Retained	Retained*	Retained*
Panel D: Market Ratios			
	PE	**EY**	
Pooled Sample	Retained	Rejected	
Manufacturing Sector Firms	Retained	Rejected	

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Service Sector Firms	Retained	Rejected

Source: Authors' own findings

Table 06 compares the outcomes on null hypotheses for univariate tests with for pooled and sector wise data (See Appendix 01 for detailed univariate analysis results for sector wise data). Accordingly, the evidence on IFRS impact for liquidity (CR, QR, and ATR) and market ratios (PE and EY) calculated on pooled sample reproduced even in sector wise data. However, we found some incidence of sector anomalies for IFRS impacts on profitability and leverage measures. Service sector firms coincide with the findings we obtained with pooled sample for profitability measures. It suggests that the rejection of the null hypothesis for univariate tests for a pooled sample has been dominated by the data of service sector firms. In the manufacturing sector, the profitability measures of ROA and ROE were not significantly affected by the IFRS convergence though it is otherwise for EPS. ROA and ROE of manufacturing firms between pre and post-IFRS convergence shared the characteristics of the same population, and thus their comparison may be meaningful.

In contrast, manufacturing firms corroborated the pooled sample-based result for leverage measures. In the service sector, the leverage measures of LDE and TIE were not significantly affected by the IFRS convergence though it is otherwise for the DE ratio. LDE and TIE of service sector companies between pre and post-IFRS convergence periods tend to represent the same population, which may make their comparison meaningful. Overall, our findings suggest that the IFRS convergence's impact on profitability and leverage ratios tends to be influenced by the sector in which firms operate, while its impact is not evidenced in relation to liquidity measures and market ratios. We, however, recognize the limitation that our data was not meant to infer the cause for the existence of such anomalies statistically. We, however, opine that it is a more cautious approach for future IFRS impact studies to take into account the sector diversities.

5. CONCLUSION

This paper sought to empirically examine selected key accounting ratios of listed companies in CSE to evaluate the impact they sustain due to Sri Lanka's convergence into IFRS. For this purpose, eleven commonly used accounting ratios measuring profitability (EPS, ROA and ROE), liquidity (CR, QR, and ATR), leverage (DE, LDE, and TIE), and market performance (PE and EY) were observed for ten years where five years each before and after the convergence. Descriptive statistics revealed that all accounting ratios evaluated except LDE (measured by long term liabilities to equity) and PE (measured by the market price per share to earnings per share) grew in size during the post-IFRS period compared to that of pre-IFRS adoption. The volatility (standard deviation) of all accounting ratios except ROE, TIE, and the above stated two such ratios as LDE and PE inflated. Univariate analysis

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assisted by Mann Whitney U test revealed that, as compared to the ratios corresponding to pre and post IFRS adoption periods, all profitability ratios tested (EPS, ROA and ROE) are significantly different while all liquidity ratios under investigation (CR, QR, and ATR) were significantly indifferent. Leverage and market ratios returned mixed results, whereas such leverage measures as LDE and TIE and the market ratio were significantly different. In contrast, DE (a leverage ratio) and EY (a market ratio) were significantly indifferent between pre and post-IFRS values. Our findings concerning profitability ratios tend to agree with that of Blanchette et al. (2011) and Bao et al. (2010) while contradicting with McConnell(2012). In contrast, our findings in relation to key liquidity ratios tend to tally with that of McConnell(2012) than Blanchette et al. (2011). Our findings regarding prominent leverage measures largely reflect the position of Blanchette et al. (2011) though it slightly disagrees with McConnell(2012). In contrast, the findings of McConnell(2012) connected to price-to-earning measures agree with that of the present paper. In short, finding tends to be context driven.

Significant statistical differences in accounting ratios may be attributed to the differences in underlying accounting treatments and freedom to choose accounting policy alternatives prescribed in the accounting standards that prevailed before and after the IFRS adoption. In summary, we document that the liquidity measures have not changed considerably due to IFRS adoption and may thus still be comparable across pre and post-IFRS periods. Leverage and market ratios returned mixed results. It is however noteworthy that the differences between accounting ratios of ore and post IFRS periods, as concluded by Bao et al. (2010), maybe caused by the changes in other factors as firms age, size, changes in corporate governance, management style, and the industrial and macro-economic conditions that have not been addressed in this research. We also investigated the sample firms partitioned into manufacturing and service sector firms to uncover the sectoral anomalies, if any, concerning the IFRS impacts on accounting ratios. Findings we had with the pooled sample were not altered in the cases of liquidity and market ratios. Thus, the IFRS effects on liquidity and market ratios of manufacturing firms tend to be indifferent to that of service sector firms. However, in contrast, IFRS effects on profitability and leverage ratios tend to differ across the firms depending on the sector (manufacturing or service) in which firms operate. Though in the pooled sample, all profitability measures were significantly different between pre and post-IFRS period, ROA of manufacturing firms and ROA and ROE of both manufacturing and service sector firms are, for some reasons, not significantly different between pre and post IFRS periods. Further, leverage ratios that were significant in the pooled sample are not significant in the service sector. The debt to equity (DE) ratio remains significantly indifferent in manufacturing and service sector firms, confirming our findings with pooled data. In summary, we document that the IFRS convergence's impact on profitability and leverage ratios tends to be influenced by the sector in which firms operate, while its impact is not evidenced in relation to liquidity measures and market ratios. In conclusion, this paper provides empirical evidence of the differences between pre and

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post IFRS adoption in a developing country on selected accounting ratios. Our findings will help the policymakers, financial analysts, and future researchers about the behaviors of accounting ratios due to convergence to IFRS-based accounting regime.

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APPENDIX: RESULTS OF UNIVARIATE ANALYSIS WITH SECTOR WISE DATA

		Manufacturing Sector			Service Sector		
Panel A: Profitability Ratios							
		EPS	**ROA**	**ROE**	**EPS**	**ROA**	**ROE**
Pre IFRS	Mean Rank &	91.595	98.145	95.02	84.9	90	94.65
	Sum of Ranks	[9159.5]	[9814.5]	[9502]	[8490]	[9000]	[9465]
Post IFRS	Mean Rank &	109.405	102.855	105.98	116.1	111	106.35
	Sum of Ranks	[10940.5]	[10285.5]	[10598]	[11610]	[11100]	[10635]
	Mann-Whitney U	4109.500	4764.500	4452.000	3440.000	3950.000	4415.000
	Wilcoxon W	9159.500	9814.500	9502.000	8490.000	9000.000	9465.000
	Z	-2.176	-.575	-1.339	-3.812	-2.566	-1.429
	Asymp. Sig. (2-tailed)	.030**	.565	.181	.000***	.010**	.153
Panel B: Liquidity Ratios							
		CR	**QR**	**ATR**	**CR**	**QR**	**ATR**
Pre IFRS	Mean Rank &	106.765	100.125	96.675	100.11	100.2	101.825
	Sum of Ranks	[10676.5]	[10012.5]	[9667.5]	[10011]	[10020]	[10182.5]
Post IFRS	Mean Rank &	94.235	100.875	104.325	100.89	100.8[10080	99.175
	Sum of Ranks	[9423.5]	[10087.5]	[10432.5]	[10089]		[9917.5]
	Mann-Whitney U	4373.500	4962.500	4617.500	4961.000	4970.000	4867.500
	Wilcoxon W	9423.500	10012.500	9667.500	10011.000	10020.000	9917.500
	Z	-1.531	-.092	-.935	-.095	-.073	-.324
	Asymp. Sig. (2-tailed)	.126	.927	.350	.924	.942	.746
Panel C: Leverage Ratios							
		DE	**LDE**	**TIE**	**DE**	**LDE**	**TIE**

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Pre IFRS	Mean Rank &	107.04	110.61	91.665	101.195	104.53	99.325
	Sum of Ranks	[10704]	[11061]	[9166.5]	[10119.5]	[10453]	[9932.5]
Post IFRS	Mean Rank &	93.96	90.39	109.335	99.805	96.47	101.675
	Sum of Ranks	[9396]	[9039]	[10933.5]	[9980.5]	[9647]	[10167.5]
	Mann-Whitney U	4346.000	3989.000	4116.500	4930.500	4597.000	4882.500
	Wilcoxon W	9396.000	9039.000	9166.500	9980.500	9647.000	9932.500
	Z	-1.598	-2.470	-2.159	-.170	-.985	-.287
	Asymp. Sig. (2-tailed)	.110	.013**	.031**	.865	.325	.774

Panel D: Market Ratios

		PE	**EY**		**PE**	**EY**
Pre IFRS	Mean Rank &	101.665	93.675		96.795	77.255
	Sum of Ranks	[10166.5]	[9367.5]		[9679.5]	[7725.5]
Post IFRS	Mean Rank &	99.335	107.325		104.205	123.745
	Sum of Ranks	[9933.5]	[10732.5]		[10420.5]	[12374.5]
	Mann-Whitney U	4883.500	4317.500		4629.500	2675.500
	Wilcoxon W	9933.500	9367.500		9679.500	7725.500
	Z	-.285	-1.668		-.905	-5.680
	Asymp. Sig. (2-tailed)	.776	.095*		.365	.000***

Source: Authors' own findings

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