RECENZOVANÉ ODBORNÉ STATĚ

ADOPTION OF IFRS/IAS IMPACTING THE COMPANIES

Ing. Michaela Beranová

Brno University of Technology, Faculty of Business and Management, Kolejní 2906/4, 612 00 Brno, e-mail: beranova@fbm.vutbr.cz

Abstract

Last years have ushered in some great changes in the financial reporting. Those changes are mostly a reaction to cases of Enron, WorldCom, and the others. The article is based on the author's secondary research on current and possible future impacts of the IFRS/IAS on companies. Application of the IFRS/IAS on financial statements preparation in companies is concurrent to use of national GAAP in some countries. The example of Czech Republic is quite typical in such a point of view. It is obvious that impacts of the IFRS/IAS implementation in firms are grater in these countries.

Key Words

Accounting, Convergence, Corporate Governance, Financial Reporting, GAAP, IFRS/IAS, International Accounting

1 Introduction

Since humans made exchanges they had need to count. It is quite easy to imagine that for example the Egyptian scribe in Paris Louver museum was probably an accountant that had counted corn batches. Accounting is closely related to human economic activities. That is why accountancy has changed in tied connection to economical development.

A cradle of double-entry bookkeeping system is Italy. Double-entry bookkeeping system was created in by an Italian monk Luca Paccioli during Renaissance. With the colonisation a need for a more accurate accountancy system has been growing. In that time, the 18th century, the first annual accounts were established in a Dutch shipping company. Development of stock market, firstly in England, in continental Europe after, combined with the industrial revolution gave a birth to accountants´ bodies in several European countries. During the last century, international exchanges of every kind were growing, under the final domination of the USA. Recently, a more global market needs an international accounting system to enforce economic development and competition.

The most of current managerial actions are declared through corporate governance, as a conception declined in various presentments. The corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, while the relationships among stakeholders and the goals of which the corporation is governed are included as well.[1] The interest in corporate governance practices has been restored since 2001, particularly due to collapses affairs of a number of large firms, Enron and

[1] According to Corporate Governance from Wikipedia, the free encyclopedia.
On line: http://en.wikipedia.org/wiki/Corporate_governance

WorlCom included. With that, in 2002, the Sarbanes-Oxley Act was passed intending to renew public confidence in corporate governance[2].

It is obvious that the questions of financial information reporting can not, and are not excluded. In connection with the corporate governance, present way of thinking in the field of accounting, respectively in the field of financial reporting should be described by the schematic formula presented under.

Figure 1: Key Words of Present Financial Reporting

	Fair Value
+	Ethics
+	Due Process
+	Sustainable Development
+	Mutual Understanding
Σ	**Corporate Governance**

Source: Subedited based on Tweedie (2007)

Those schematically shown words represent a set of the key pillars of present financial reporting systems basis. This basis would ensure a really true and fair view of company's financial position and performance to enable a company management and also a company "environment" to make rational economic decisions.

2 Arguments for International Accounting Standards

Prior to 2005 most European companies applied domestic accounting standards. Thus, the adoption of IFRSs in Europe represented one of the largest financial reporting changes in recent years. European IFRS adoption represented a major milestone towards financial reporting convergence yet spurred controversy reacting the highest levels of government.

Present national borders have less meaning as barriers to international capital flows; world's capital markets know no borders. Then it seems logic that the participant in those markets should have no barriers to the high-quality, transparent, and comparable financial information they need to make sound economic decisions. (Almond, 2005) A ground of capital markets is information that is:

- Comparable from company to company;
- Relevant to investment financing decisions;
- A faithful depiction of economic reality; and
- Neutral, favouring neither supplier nor user of capital, neither buyer nor seller of securities. (Tweedie, 2007)

The effective functioning of capital markets is essential to economic well-being. According to Tweedie (2004), a sound financial reporting infrastructure must be built on four pillars. These are as follows:

1. Accounting standards that are consistent, comprehensive, and based on clear principles to enable financial reports to reflect underlying economic reality;

[2] According to Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System.
On line: http://www.sec.gov/news/studies/principlesbasedstand.htm

2. Effective corporate governance practices, including a requirement for strong internal controls, that implement the accounting standards;
3. Auditing practices that give confidence to the outside world that on entity is faithfully reflecting its economic performance and financial position; and
4. An enforcement of oversight mechanism that ensures that the principles as laid out by the accounting and auditing standards are followed.

In present world, mainly two different branches of accounting exist. It is contractual accounting, reporting about how the contracts made by a company are respected, and predictive accounting that enables investors to make forecasts about the company's future. Main bases of these two branches and their differences are shown in the figure 2.

Table 2: Predictive vs. Contractual Accounting

Contractual Accounting	Predictive accounting
▪ Consistency	▪ Change in accounting policy
▪ Historical costs	▪ Full fair value of assets
▪ Conservatism	▪ Pragmatic point of view

As the world's capital markets integrate, the logic of a single set of accounting standards is evident. A single set of international standards would enhance comparability of financial information and should make the allocation of capital across the borders more efficient. The development and acceptance of international standards should also reduce compliance costs for corporations and improve consistency in audit quality. (Tweedie, 2004)

Since 1973 the International Accounting Standard Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC) have been serving the public interest by developing a single set of high-quality, understandable, and enforceable International Financial Reporting Standards (IFRS/IAS) for equity investors, lenders, and other information users.

3 International Financial Reporting Standards Impacts on Companies

Companies are increasingly operating in multiple jurisdictions and the cost of consolidating different national accounts is costly and prove to error. In this environment, it makes sense to have a single set of high-quality financial reporting standards used throughout the world's capital markets. (Mazars, 2005)

For the present, thirty one standards IAS and eight standards IFRS exist. Many of these standards have also their interpretations, SICs for IAS and IFRICs for IFRS. In the system of IFRS/IAS the Conceptual Framework cannot be left out. Conceptual Framework approved by the IASC Board in April 1989 is not a standard. This Framework defines the objective of financial statements, identifies the qualitative characteristics that make information in financial statements useful, and defines the basic elements of financial statements and the concepts for recognising measuring then in financial statements. Then the specific topics of financial reporting are explained in particular standard.

January 2005 might be considered as a break point in the enforcement of IFRS/IAS application in the companies. This was the moment when the Regulation (EC) 1606/2002 of the European Parliament and the European Council concerning to application of International Financial Reporting Standards came into force. According to this Regulation, since 2005 EU listed companies ought to prepare their consolidated financial statements under the rules of IFRS/IAS.

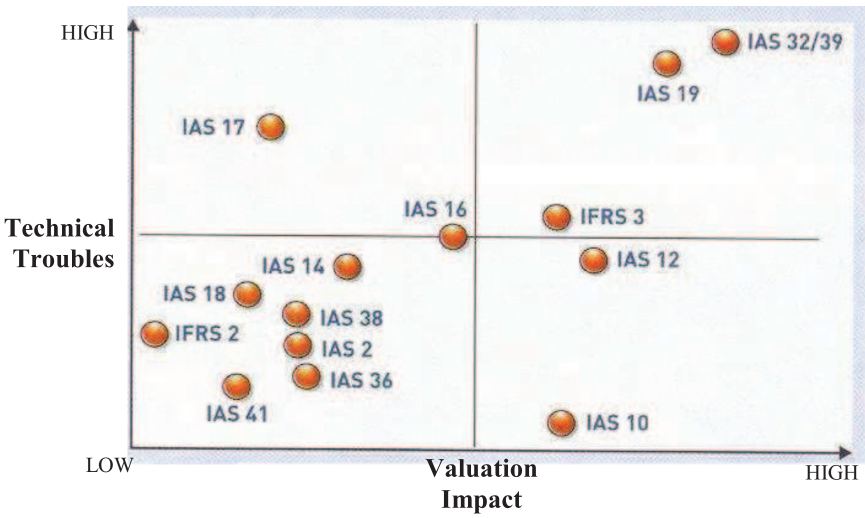
The majority of companies surveyed by Mazars (2005) recognise that IFRS/IAS brings accounting practices closer to economic substance. However, the two most common criticism relate to complexity of the standards and thus also the amount of work to correctly apply them. The mandatory application of IFRS/IAS has impacted the companies in any case. The impacts were not only on e.g. a need of staff education (accountants, CFOs etc.) or a need of new software. Other impacts, especially technical troubles and impacts on valuation have appeared as well. The standards bringing the most substantial of them are shown in the figure 3 and in the figure 4 presented below.

Figure 3: Standards causing the most substantial technical and valuation impacts

Technical Troubles	**Valuation Impact**	**Standard No.**	**Standard Content**
✓	✓	IAS 38	Intangible Assets
✓	✓	IAS 39	Financial Instruments: Recognition and Measurement
✓	✓	IAS 19	Employee Benefits
	✓	IFRS 3	Business Combinations
	✓	IAS 12	Income Taxes
	✓	IAS 10	Events After the Balance Sheet Date
✓		IAS 17	Leases
✓		IAS 16	Property, Plant and Equipment

Source: Mazars, 2005

Figure 4: Level of impact of single IFRS/IAS



Source: Mazars, 2005

It can be assumed that the main target of the IFRS/IAS implementation is to provide comparability and to improve transparency of financial statement of companies. But according to the IFRS Survey 2005 carried out by Mazars in April and March 2005 in 556 EU companies, 25 Czech companies included a reaching the target is at least arguable. While

63% of respondents agree the idea that IFRS/IAS improves comparability of financial statement, the survey results are even less conclusive related to the transparency. Only 47% of respondents agree that IFRS/IAS improve transparency, and on the opposite side, there are 35% of those who absolutely disagree the idea.

In the context of the Mazars IFRS Survey 2005, the Czech Republic belongs to the group of countries which express more mixed opinions about the expected benefits of IFRS/IAS. But Czech companies exhibit a strong mastery of the conversion process and declare themselves ready for the transition at a rate of 84%. Only 20% of firms find application of IFRS/IAS costly. This is the second lowest rate in Europe.

Discussing these observations about companies from the Czech Republic, it is necessary to take into account that only 25 companies have been implicated in the survey. In 2005 also only 54% of them have already prepared the opening IFRS Balance Sheet. Further more, only 29% of them have already communicated the impact of adopting IFRS/IAS to their stakeholders.

Presented observation from the Czech Republic might be striking especially in the light of number substantial differences between Czech accounting law and IFRS/IAS. The main difference consists in a gap of basis of these two GAAPs; while Czech accounting law is rules-based, IFRSs are principle-based. Moreover, a scissors dilates more comparing guidelines within single topics, as far as the financial statements´ formats are conceived differently. Priority of the true and fair view is also felt dissimilar, when a real economic nature or a transaction is often discriminated against its legal nature. This is e.g. the case of financial leases. Another basic difference between Czech accounting rules and IFRS/IAS consists in recognition and measurement. Czech GAAP is mostly based on a historical cost whereas IFRSs largely prefer a fair value in principle. Currently, a number of differences between the Czech GAAP and IFRS/IAS exist, and seventy five pages publication on the topic was published by PricewaterhouseCoopers in 2004.

But it was only in 2003 when IASB started projects to improve the IFRS/IAS into a set of high-quality set of financial reporting standards. In January 2003 European Parliament approved a project of Directive amending the current EU accounting Directives. This amendment eliminates contradictions between IAS/IFRS and the Directives and also restricts the possibilities to distort the liabilities by a mean of purpose-built cooperatives. It also applies pressure to the presentation of liabilities and insecurities not only in a light of financial statements but in light of environment and social aspects as well. The most of the changes is drawn as a resource that can be applied by member states. This makes a space for individual approaches to and timing of switch-over the IAS/IFRS for insight of contexture between accounting rules and taxation systems in EU member countries. The factual proves of the changes forcible from the beginning of 2005 are the current IASB´s projects, some of them have been already finished not long ago.

Until the 2005, when Mazars study on the IFRS adoption in European companies originated, only three new standards IFRS[3] have been already published. In present there are 8 IFRSs yet, including the IFRS 7 Financial Instruments: Disclosures that replaces IAS 32 Financial Instruments: Disclosures and Presentation, the standard causing the biggest technical and valuation troubles according to Mazars study. From various judgements it might be understood that an impact of IFRS 7 on the companies would be even higher. Just for example, the financial reporting community has been challenged with the requirement to express the risks of commodity financial instruments as seen through the eyes of

[3] From 2001 are published by IASB replacing the IASC that has provided the standards IAS

management. Disclosing such risks in a meaningful and understandable way for the reader of the financial statements without prejudicing the common interest of the organization will be undoubtedly a delicate balancing act.[4]

As the set of IFRS/IAS is enlarging and is also slowly but permanently implemented into national GAAP of many European countries, undoubtedly, the impacts of IFRS/IAS are going to be more significant.

4 Next Challenges for International Financial Reporting

Current events in the space of international financial reporting standard are giving a birth to an idea that IAS/IFRS are slowly going to be adopted around the world. In recent years, the significant progress was visible:

- The International Organization of Securities Commissions has recommended that the world's securities regulators permit foreign issuers to use IFRS/IAS in preparing financial statements for cross-border offerings and listings;
- Listed companies in Europe are required to use IFRS/IAS in their consolidated financial statements since 2005, and many other countries are replacing their national GAAP with IFRS/IAS for some or all domestic companies.
- Other countries have adopted policies of approving IFRS/IAS either verbatim or almost word-for-word as their national standards;
- The IASB and its U.S. counterpart, the FASB (Financial Accounting Standards Board), have embarked on a comprehensive programme aimed at converging IFRS/IAS and US GAAP to the greatest extent possible over the next several years. The IASB has also begun a convergence project with Japan, and representatives of China Accounting Standards Committee stated that convergence of Chinese Accounting Standards and IAS/IFRS is the fundamental goal as well.

The international financial reporting is dynamically changing and developing space. In present, the IASB works on several projects, and many of these projects would lead to new edition of a set of amended or completely new standards coming into force in 2009 or later. Among these projects, there is also the project of the IFRS for Small and Medium-sized Entities by that a scope of International Financial Reporting will be enlarged.

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Summary

Michaela Beranová

ADOPTION OF IFRS/IAS IMPACTING THE COMPANIES

In recent time, there were done marked changes in IAS/IFRS, changes in existing rules. Fifteen standards of IAS have been amended just before the end of 2003 and in course of the first quarter of the year 2004 updating of other standards IAS has been done. The requirement of changes hangs together, among others, also with the recent affairs about the bankruptcies of big companies. In this connection, accelerated and turning changes are proceeding in EU. Since 2005 every EU listed company has to prepare the consolidated financial statements in accordance with IFRS/IAS.

Vast survey on the impacts of IFRS adoption was carried by Mazars in 2005. 25 Czech companies have been also interviewed within the study. These Czech companies have exhibit a strong mastery and readiness for the conversion and transition process. Such a summary is quite unwonted in a number of perspectives. But the aim of the author is not to question the study. In the Czech environment, the specific facts in the field of financial reporting and accounting are given. Following these specifics, the truth is that preparing the financial statements in accordance with IFRS/IAS brings undoubtedly valuation and technical entanglements for which the process is costly.

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