Worldwide Adoption of International Financial Reporting Standards (IFRSs)

Naif Mansour M. Mathkur

College of Business Administration, Jazan University, PO box 4421, Al-Rawabi Unit 14, Jazan, 6561-82822, Kingdom of Saudi Arabia

nmathkor@jcba.edu.sa

Abstract

This paper builds upon the huge body of research in the academic fields of accounting, finance and economics. It explores the background and the adoption of International Financial Reporting Standards (IFRS) in various countries; the cost-benefit analysis associated with the practical application of IFRS in corporate reporting by individual companies in those countries that have decided to go the IFRS way; a special case of the convergence and possible adoption by the United States of America is analyzed critically. Threats and challenges to the successful adoption of the IFRSs are detailed. Emerging issues in the adoption of IFRS are examined.

Keywords: Aadoption, International Accounting, International Finance, Financial Reporting Standards, (IFRS), *International Accounting Standards Committee (IASC), International Accounting Standards (IAS), and International Accounting Standards Board (IASB)*

1. Introduction and Overview

1.1. *History and Background of Accounting and IFRS*

Before the adoption of the IFRS the local professional bodies typically issued most companies globally prepared and prepared their financial statements according to the prevailing domestic accounting standards that.

Before the adoption of the IFRS and financial reporting was pegged on imprecise accounting principles, basis, conventions and concepts such as true and fair view, prudence, matching and stewardship instead of being based a clear harmonious conceptual framework. One major inherent shortcoming in those principles and concepts was the element of human judgment. Different accountants using the same basis could arrive at different conclusions on similar matters.

Accounting is widely regarded as the language of business. The accounting function provides past, current and future information regarding the financial performance of an entity to the staff, managers, business owners, investors, government, creditors, customers as well as other stakeholders in the business. Information generated for internal use – mostly through management accounting – assists in planning, performance review and decision-making. Such information for internal consumption within a firm is not governed by standards, but only intelligent underlying analysis concepts and varies from firm to firm with regard to the nature and way of presentation. It is rather the financial information that is intended for the external users who do not have control over the preparation of the financial statements that is governed by the IFRS to facilitate comparability and understandability.

1.1. A. *International Accounting Standards and International Financial Reporting Standards Setting Bodies*

1.1. A. *i) International Accounting Standards Committee (IASC)*

Statements of International Accounting Standards issued by the Board of the International Accounting Standards Committee (IASC) between 1973 and 2001 are designated *"International Accounting Standards" (IAS).*

1.1 A. ii) The International Accounting Standards Board (IASB)

The International Accounting Standards Board (IASB) announced in April 2001 that its accounting standards would be designated *"International Financial Reporting Standards'(**IFRS**).* Also in April 2001, the IASB announced that it would adopt all of the International Accounting Standards issued by the IASC.

1.2 An overview of the main stipulations of the IFRS

1.2. A. Objectives of International Financial Reporting Standards

The spirit of IFRS is primarily expressed by the IAS 1 *Presentation of Financial Statements (revised 2012), which* is to prescribe the basis for presentation of general-purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. IAS 1 sets out the overall framework and responsibilities for the presentation of financial statements, guidelines for their structure and minimum requirements for the content of the financial statements. Standards for recognizing, measuring, and disclosing specific transactions are addressed in other Standards and Interpretations.

1.2. *B. Scope*

Applies to all general-purpose financial statements based on International Financial Reporting Standards. [IAS 1.2]
General purpose financial statements are those intended to serve users who do not have the authority to demand financial reports tailored for their own needs. [IAS 1.3]

1.2.C. Objective of Financial Statements

The objective of general-purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity's: [IAS 1.7]

Assets.

Liabilities.

Equity.

Income and expenses, including gains and losses.

Other changes in equity.

Cash flows.

That information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

1.2. D. Components of Financial Statements

A complete set of financial statements should include: [IAS 1.8]

A balance sheet, income statement, a statement of changes in equity showing either:

All changes in equity or changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders; cash flow statement, and notes, comprising a summary of accounting policies and other explanatory notes.

Reports that are presented outside of the financial statements -- including financial reviews by management, environmental reports, and value added statements -- are outside the scope of IFRSs. [IAS 1.9-10]

1.2.C. Fair Presentation and Compliance with IFRS

The financial statements must "present fairly" the financial position, financial performance and cash flows of an entity. Fair presentation 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. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation. [IAS 1.13]

IAS 1 requires that an entity whose financial statements comply with IFRSs make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs. [IAS 1.14]

Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used or by notes or explanatory material. [IAS 1.16]

IAS 1 acknowledges that, in extremely rare circumstances, management may conclude that compliance with an IFRS requirement would be so misleading that it would conflict with the objective of financial statements set out in the Framework. In such a case, the entity is required to depart from the IFRS requirement, with detailed disclosure of the nature, reasons, and impact of the departure. [IAS 1.17-18].

1.3. IFRS 1 *First-time Adoption of International Financial Reporting Standards*

In particular, the IFRS requires an entity to do the following in the opening IFRS statement of financial position that it prepares as a starting point for its accounting under IFRSs:

(a) Recognize all assets and liabilities whose recognition is required by IFRSs;

(b) Not recognize items as assets or liabilities if IFRSs do not permit such recognition;

(c) Reclassify items that it recognized in accordance with previous GAAP a type asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with IFRSs; and

(d) Apply IFRSs in measuring all recognized assets and liabilities.

IFRS 1 provides guidelines for ensuring that an entity's *first IFRS financial statements*, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) Is transparent for users and comparable over all periods presented?

(b) Provides a suitable starting point for accounting in accordance with *International Financial Reporting Standards (IFRSs)*; and

(c) Can be generated at a cost that does not exceed the benefits.

1.4. Summary of IAS and IFRS

IFRS

IFRS 1 First-time Adoption of International Financial Reporting Standards

IFRS 2 Share-based Payment

IFRS 3 Business Combinations

IFRS 4 Insurance Contracts

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

IFRS 6 Exploration for and evaluation of Mineral Resources

IFRS 7 Financial Instruments: Disclosures

IFRS 8 Operating Segments

IFRS 9 Financial Instruments

IFRS 10 Consolidated Financial Statements

IFRS 11 Joint Arrangements

IFRS 12 Disclosure of Interests in Other Entities

IFRS 13 Fair Value Measurement

IASs:

IAS 1 Presentation of Financial Statements

IAS 2 Inventories

IAS 7 Statement of Cash Flows

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

IAS 10 Events After the Balance Sheet Date

IAS 11 Construction Contracts

IAS 12 Income Taxes

IAS 16 Property, Plant and Equipment

IAS 17 Leases

IAS 18 Revenue

IAS 19 Employee Benefits

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

IAS 21 The Effects of Changes in Foreign Exchange Rates

IAS 23 Borrowing Costs

IAS 24 Related Party Disclosures

IAS 26 Accounting and Reporting by Retirement Benefit Plans

IAS 27 Consolidated and Separate Financial Statements

IAS 28 Investments in Associates

IAS 29 Financial Reporting in Hyperinflationary Economies

IAS 32 Financial Instruments: Presentation

IAS 33 Earnings per Share

IAS 34 Interim Financial Reporting

IAS 36 Impairment of Assets

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

IAS 38 Intangible Assets

IAS 39 Financial Instruments: Recognition and Measurement

IAS 40 Investment Property

IAS 41 Agriculture

2. Cost-Benefit Analysis

Just as with any venture, there should be positive net benefits to justify a course of action. In this section, the costs and resultant benefits of adopting IFRS are analyzed.
Source: Lee and Azham (2008).

2.1. *Costs*

The costs of adopting IFRS can be broadly classified into transition costs and recurring costs.

2.1. A. *Transition Costs*

These are the one-time costs associated with migrating to the IFRS. They comprise costs such as training costs, costs of preparing comparative prior year financial information as per IFRS 1 as well as costs of preparing preliminary IFRS-based financial statements. It can be costly for firms to hire specialists to train their employees and investors on IFRS.

Re-enumeration and re-evaluation of accounting information, e.g. on estimates, management contracts to comply with IFRS could take a toll on time as well as on a company's costs. There is also the learning curve element whereby it will take time before people become accustomed to accounting treatments according to IFRS.

2.1. B. *Recurring Costs*

In some cases the accounting treatment, according to IFRS contradicts the statutory laws. For instance, the IFRS allow the recognition of non-cash items like depreciation costs while these are not allowable by the tax authorities. This means that a company may end up preparing two sets of financial statements: one set according to the IFRS; and another one according to the requirements of the tax authority.

2.2. *Benefits*

There are numerous benefits that accrue to individual companies, capital markets and other stakeholders when IFRS are adopted.

2.2. A. Benefits to individual companies

To enhance the internal management of the company (MTCs) by use of a common accounting language in the management of their operations reducing irrational decision making.

IFRS provides a reliable basis for corporate analysis and benchmarking against a company's peers throughout the world.

Adoption improves the corporate image by publishing better quality financial information in some cases.

IFRS eliminate the need for multi-national corporations having to prepare different sets of accounting reports to cater for their subsidiaries domiciled in other countries. This greatly reduces the translation costs.

As a result of reduced risk premiums due to adoption of IFRS, companies can access cheaper credit.

With the adoption of IFRS comes an opportunity to gain strategic improvements in the corporate financial and accounting information systems.

It makes it easier for companies to tap into a wealth of expertise from professionals well-versed with IFRS from anywhere around the globe where IFRS are applied. This injects world-class IFRS professionalism into a company's human resource component.

Adoption of IFRS facilitates the raising of corporate finance by obtaining stock market listings across borders.

Adoption reduces analytical costs incurred in adjusting financial statements for differences in accounting practice.

IFRS enhance financial transparency and reduce the practice of financial principle shopping.

IFRS improve the comparability of financial information across borders.

IFRS provides a reliable basis for corporate analysis.

2.2. B. *Benefits to capital markets*

Greater capital market liquidity due to increased confidence in IFRS compliant financial statements.

Capital markets are able to raise more capital for companies due to increased cross-border listings.

2.2. C. *Benefits to other stakeholders*

Investors - The cross-border adoption of IFRS by firms facilitates the analysis and comparison of financial statements by potential investors. Since the underlying preparation concepts are harmonized, potential investors do not have to worry about the laborious task of making adjustments e.g. firms that have adopted IFRS will treat Earnings Per Share in the same way, that is according to IAS 33 *Earnings per Share* as well as treat assets in a similar fashion using IAS 16 *Property, Plant and Equipment.*

Lenders IFRS-prepared financial statements have higher quality information and greatly reduce the risks associated with subjective judgment provisions inherent in non-IFRS standards. As such, other factors constant, this greatly checks against distortions.

IFRS-prepared financial statements facilitate risk evaluations by lenders and this leads to low risk premium.

Governments – According to research done by Shleifer and Vishny (1997) and La Porta et al (2000), the financial reporting regime is an important determinant of aggregate economic outcome. Hence, IFRS that are of higher quality than most country-specific GAAP play a pivotal role in the macro-economic development of a country's financial system.

2.2. *Net Benefits*

As it can be seen, the numerous benefits far outweigh the costs of adopting IFRS giving rise to positive net benefits. This economically justifies the adoption of IFRS.

3. Worldwide Adoption

3.1. Europe

The adoption of IFRS by a majority of European countries has greatly facilitated comparison of financial statements across borders. Previously diverse political, legal, social and economic made comparability of financial information cumbersome. Enter the harmonizing IFRS and these problems are a thing of the past. This has greatly stimulated cross-border commerce and listings. The reception of IFRS in Europe has generally been positive. Several European countries welcomed the idea of a unifying set of accounting reporting standards as early as the early 1970's.

European Union

In June 2002 the European Union (EU) agreed that from 1 January 2005 International Accounting Standards / International Financial Reporting Standards would apply to the consolidated financial statements of the EU listed companies.

Non-European Union Countries

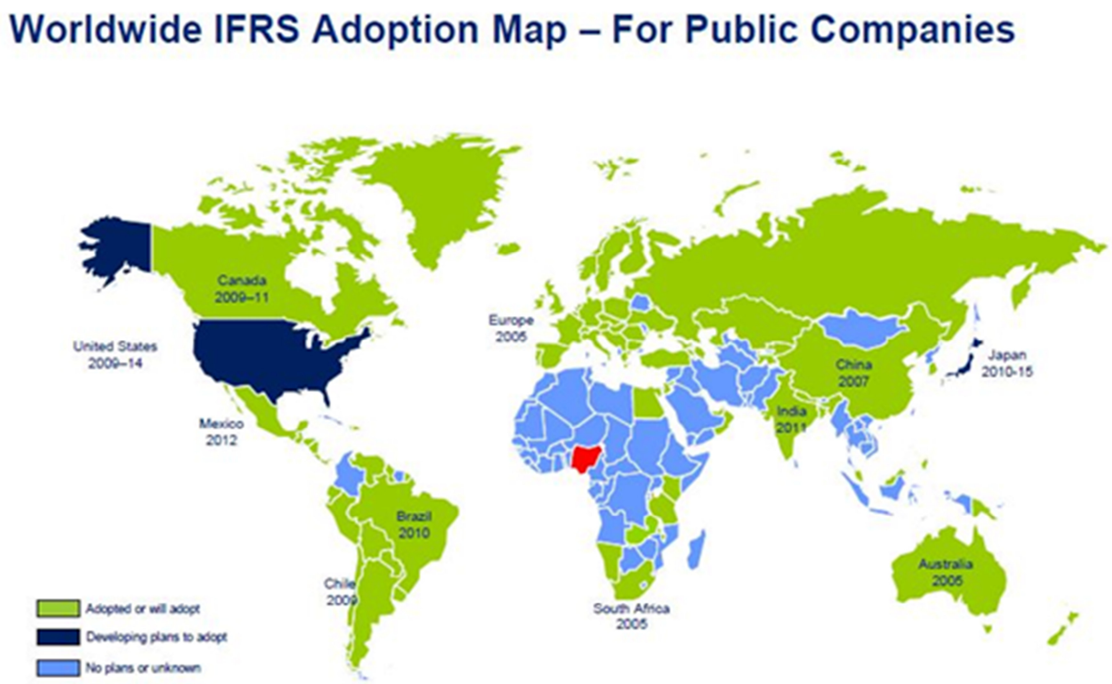
Russian Federation

Between 2004-2000, there was a mandatory transition to IFRS-based accounting by all companies with publicly traded securities and financial organizations while from 2008 other companies followed suit.

Listed companies as well as subsidiaries of foreign companies listed on Russian stock exchanges are required to prepare financial statements according to the IFRS.

Ojo, (2006) carried out research on user education based on the findings of Pierce and Kilcominns, (1996) and concluded that reasonable expectations of the concerned public could be contained through education on the role, objectives and limitations on the part of the auditor as well as the pertinent auditing and assurance standards. The public could be educated through various forums e.g. stockholders meetings and other events.

Fowzia, (2008) examine the impact of user education in narrowing the expectations gap in Bangladesh. In the study, it was shown that the expectation gap reduces according to the intensity and level of user education on auditing. These findings were in tandem with those of Monroe and Woodcliff, (1993).



Source: Deloitte

Norway

From 2011, all publicly listed companies are required to prepare IFRS-based financial statements. Subsidiaries of foreign companies and foreign companies listed on Norwegian stock exchanges are subject to different laws. They may use US-GAAP or Japanese-GAAP as they are deemed to correspond to the IFRS

Switzerland

Publicly traded companies at The SIX Swiss Stock Exchange are required to apply IFRS or US-GAAP in their consolidated financial statements

Ukraine

Pursuant to the Law of Ukraine on Accounting and Financial Reporting adopted in 2011, public joint stock companies, banks and insurance companies need to prepare IFRS financial statements. It is not mandatory for other companies to apply IFRS.

3.2. Asia

Most countries in Asia are in the beginning stages of adoption of IFRS. Other countries are at advanced stages of the convergence of local GAAP with the IFRS.

Japan

The Japanese GAAP standards-setter - developed by the Accounting Standards Board of Japan (ASBJ) - is working hand-in-hand with the International Accounting Standards Board to realize the convergence of Japanese GAAP with the IFRS.

There will be a significant cost in financial management information systems and training co-operate personnel in the use of IFRSs.

China

The Chinese Accounting Standards applicable. However, in the recent past there has been a considerable convergence with the IFRS

India

Most Indian publicly traded companies prepare their financial statements according to the Indian GAAP. However, national work plan for the adoption of IFRS is underway.

3.3 Africa
A substantial number of African countries have adopted the IFRS. In all the cases, the adoption has been without modifications to the IFRS as issued by the IASB. Most of the IFRS adoption took place in the noughties as countries re-structured their corporate reporting primarily due to yielding to pressure from various economic institutions like the World Bank.

Kenya
The Institute of Certified Public Accountants of Kenya pioneered the adoption of IFRS in the sub-Saharan region.
Both listed and non-listed countries are expected to prepare financial statements according to the IFRS framework. This has been the case since the adoption in 2000.

Tanzania
All commercial financial reporting is governed by the IFRS since the adoption in 2009.

Uganda
Since 2003, all corporate financial reporting is primarily done according to the IFRS.

Malawi, Namibia and South Africa.
All body corporates have been required to prepare their financial statements according to the IFRS since 2005.
Since 2005, all companies are required to prepare their financial reports pursuant to the IFRS

3.4 *Oceania (Australia)*
The IFRS have been received well in the Oceania region with all countries either having fully adopted the IFRS or are in the last stages of adoption.

Australia
Mainland Australia adopted a modified form of IFRS, Australia IFRS, (A-IFRS) in 2005. However, there are no major differences between the Australia IFRS and the original IFRS as pronounced by the IASB.

New Zealand
Commencing 2007, the IFRS framework had been adopted by New Zealand in all aspects of financial statement preparation.

Papua New Guinea
A 1997 amendment to the Papua New Guinea Company Law required all companies to adopt the IFRS framework.

3.5 South America
All countries have either made the big switch to IFRS or are in the stages of doing so with the exception of Paraguay and Guyana.

Peru
Peru adopted the IFRS in 1998 after having successfully completed the last stage in the adoption process – stage 4.

Brazil
Since 2010, both listed and unlisted companies are required to adhere to the IFRS.

Argentina
Being in stage 3 of the IFRS adoption process, all publicly traded companies are required to prepare their financial statements according to IFRS.

3.6 The United States of America – Special Consideration
Debate about the adoption of IFRS has raged in the past few years. The U.S. is the superpower and the most developed nation in the world and as such all eyes are on U.S. The U.S. has not adopted the IFRS in as much as it champions for the adoption of IFRS in other countries. It has opted to keep using the US GAAP. There are a lot of similarities between the US GAAP and the IFRS and few though over-riding differences between the US GAAP and the IFRS such as the accounting treatments on inventory and intangible assets. There have been talks between the setters of both standards on the possible convergence for many years now. However, adoption of IFRS is yet of see the light of day in US.
The IASB should source for unswerving source of income to reduce financial dependence on U.S. as this could lead possible pressures from the US during the release of new standards.

4. Challenges to the Adoption of IFRS

The adoption of IFRS has not been smooth sailing. The IFRS framework just like everything else that challenges the prevalent *status quo* has met bottlenecks to its adoption.

4.1 *Lack of Political Goodwill*

It is not infrequent to find that national politics have a hand behind the aversion for IFRS. For instance countries like Saudi Arabia and North Korea have not adopted IFRS due to their political differences with the west. Countries resist adopting IFRS as they consider the standards foreign and originating from their international enemies.

4.2 *Transitional Hurdles and Costs*

There is a significant cost in the restructuring of financial management information systems and training corporate personnel in the use of IFRS for adoption to see the light of day.
Some companies may lack the expertise to apply IFRSs in full. Obtaining such expertise may be costly.

4.3 *Inadequate creation of awareness*

The process of adoption of IFRS involves first of all education of the various stakeholders about the IFRS and the benefits that accrue as a result of their application. However, the channels of the IFRS knowledge transfer may be insufficient. On the broader scale the professional accounting bodies overseeing accounting at the national level may be ill equipped for the dispensation of the IFRS body of knowledge.
Training is necessary for the successful imparting of IFRS-reporting skills to employees and as such various modes of training have to be carried out. According to *Deloitte in-house Publication* the following types of training are necessary:
Classroom awareness training - Classroom training helps to build the basics of IFRS and fine-tune the minds of the staff towards IFRS reporting.
Practical IFRS training - This enables staff practice the actual preparation of the FS and also how to pass IFRS adjustments while preparing local GAAP/IFRS reconciliations.
On the job training - The learning curve on conversion leaves the staff in a better position to perform similar functions for related companies at a quicker pace.

4.4 *Conflict with Relevant Authority*

IFRSs do not lay down comprehensive guidelines for corporate governance or any legal framework. This may result in conflict with local legal requirements; hence necessitate modification of the standard.
IFRSs do not deal with specialized industries and thus local rules may apply which dilute the standards. Similarly, national tax authorities may not accept IFRSs for taxation purposes. For instance, according to the IFRS, a company may report non-cash expenses like depreciation that are disallowable or tax purposes. This may necessitate the published financial statements to be re-adjusted to comply with the applicable statutory legal and taxation framework. Differences in accounting basis for assets / liabilities will result in changes to future taxes. As such, tax specialists will probably be needed to assess the impact on current and future taxes.

4.5 *Risk of Misstatements*

Due to the extensive nature of the changes at the processing, reporting, control and transactional levels during the switch to IFRS, there is the risk that fraud and misstatements could take place thus compromising the effectiveness of the IFRS adoption.

5. Conclusion

IFRS have heralded the dawn of a new era in modern-day accounting. As it can be seen from the research disseminated in this paper, IFRS have been widely adopted in all the corners of the world. IFRS have brought good tidings with them. The benefits of adopting the IFRS far outweigh the relevant costs. As such, individual companies are encouraged to adopt the IFRS as they present new progressive developments such as the preparation of high quality financial statements; harmonization of the underlying accounting bases; cost savings to firms on translations of financial statements; opportunities for accessing a larger pool of credit; facilitation of cross-border listing and ease of comparability. Studies presented in this paper show that there are also macro-economic benefits to a country associated with the adoption of IFRS as they improve on the financial reporting framework in a country thereby enhancing economic output. IFRS also positively impact on other stakeholders and users and users of financial information such as lenders who

are presented with the opportunity of increasing the turnover of their credit as they offer it at reduced risk premium.
The pros of adopting IFRS far out-number the cons and as such companies and countries that have not done so should adopt them.

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