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Implementation of International Financial Reporting Standards (IFRS) as a requirement for standardized reporting of financial results (A desk study on UK companies)

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Abstract: The rapid globalization of the world's economy has fuelled the desire to have common international financial reporting standards that could be understood and followed across nations.

In addition, the ever increasing network of investors has not only opened new financing sources to business and industry, but has also put some pressure on the financial regulatory authorities to design and improve their financial reporting systems in a manner that could be easily understood by a wider audience.

The adoption of the international financial reporting standards (IFRS) on 1st January 2005 across the European Union member states is one of the major events in the accounting history. This is especially important after the capital markets were badly hit by a number of accounting frauds in recent years.

The adoption of IFRS across the European Union from 1st January 2005 is a defining movement which will have an immediate impact on more than 7000 listed European companies which will have to implement the new financial reporting standards first. Common international financial reporting standards could result in true global capital markets. Adopting common financial reports standards will also help in achieving a true scale of financial integration.

It is understood that it will be difficult to design an accounting system that meets everyone's demands. However, the UK listed companies have to implement the IFRS standards for accounting periods starting from 1 January 2005. Unlisted companies have been given time till 2007 to implement IFRS. The standards that UK listed companies will follow are not those issued directly by the International Accounting Standards Board, but are those that have been endorsed by the European Commission.

Both IFRS and UK GAAP share broader level aims. But there are many differences at the implementation level. IFRS further enhances the concept of fair value and its regulations place stiff definitions on assets and liabilities. Pension deficits would now be disclosed on the income statements. Financial

instruments would also undergo finer scrutiny. This may lead to some volatility in financial statements.

ملخص: لقد أججت العولمة السريعة للاقتصاد العالمي الرغبة لإيجاد معايير دولية مشتركة لإعداد التقارير المالية على أسس موحدة حتى يمكن فهمها ومقارنتها بناء على تلك المعايير. هذا بالإضافة إلى أن توفر شبكة متزايدة من المستثمرين لم يؤد فقط إلى توفير مصادر تمويل جديدة لقطاع الأعمال والصناعة ، ولكن أيضا وضع بعض الضغوط على السلطات التنظيمية المالية لتصميم وتحسين نظم الإفصاح المالي بطريقة يمكن فهمها بسهولة من قبل جمهور المهتمين في تقييم الأداء المالي.

إن اعتماد تطبيق المعايير الدولية للإفصاح المالي اعتبارا من ١ يناير ٢٠٠٥ في جميع الدول الأعضاء في الاتحاد الأوروبي يعتبر من أهم الأحداث في تاريخ المحاسبة وخصوصا بعد أن تضررت بشدة أسواق رأس المال من خلال عدد من عمليات الاحتيال المحاسبي في السنوات الأخيرة.

ومن المفهوم أنه سيكون من الصعب تصميم نظام المحاسبة الذي يلبي مطالب الجميع. ومع ذلك، فإن الشركات المدرجة في المملكة المتحدة سوف تقوم بتطبيق المعايير المحاسبية الدولية الإفصاح المالي اعتباراً من١ يناير ٢٠٠٥.وقد تم منح الشركات غير المدرجة في البورصة حتى عام ٢٠٠٧ لتطبيق المعايير الدولية. إن الشركات المدرجة في المملكة المتحدة لن تتبع المعايير الصادرة مباشرة من قبل مجلس معايير المحاسبة الدولية ، ولكنها سوف تلتزم بتطبيق المعايير التي ستقرها المفوضية الأوروبية.

إن تطبيق معاير الإفصاح المالي الدولية في دول الاتحاد الأوروبي سيكون له الأثر الكبير في توحد قياس الأداء المالي من قبل المستثمرين والمهتمين بالقطاع الصناعي وقطاع الأعمال.

وقد هدفت هذه الدراسة لبيان الآثار الايجابية لتوحيد معايير قياس الأداء المالي والصعاب التي تكتنف الالتزام بهذه المعايير في المملكة المتحدة بشكل خاص وباقي دول الاتحاد الأوروبي بشكل عام.

Introduction:

When the European Union moved towards one market across Europe, it faced the prospect of different financial reporting regimes across the EU countries. To achieve true scale of financial integration, it had become necessary to adopt common financial reporting standards.

The adoption of international financial reporting standards on 1st January 2005 across the European Union member states is one of the major events in the accounting history. This was especially important after the capital markets were badly hit by a number of accounting frauds in recent years. In the first phase, more than 7000 listed European companies will have to implement the new financial reporting standards from January 2005 (Fuller, Jan 2005).

In June 2002, the European Commission adopted a regulation requiring all listed EU companies in regulated markets to prepare their financial statements in accordance with International Accounting Standards (IAS) or International Financial Reporting Standards (IFRS). The regulation is applicable only on consolidated accounts. Companies were left free to choose their national GAAPs for subsidiaries and associate companies. The regulation came into force from January 2005.

Implementation of International Financial Reporting Standards

Companies Act 1985 governs the use of UK GAAP by UK based companies. Similarly other EU states have their own laws for accounting standards. The EU countries have now modified their national laws to include IFRS regulation to offer a common financial reporting standard. Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 has extended the application, on a non-compulsory basis, of the EU IFRS regulation to all non-charitable organizations.
The standards that UK listed companies will follow are not those issued directly by the International Accounting Standards Board, but are those that have been endorsed by the European Commission. (PwC, 2005a).
In the last quarter of previous century, the world economies have moved towards globalization. Multinational companies are manufacturing and selling across the world and many of these firms are listed at foreign stock exchanges. The increasing globalization of markets and the establishment of multinational companies led to increased desire and awareness about international markets. This was soon followed by globalization of financial markets which increased the value of understanding of international financial results and reporting formats. Rapid improvement in communication technologies and easy access through internet has further spread the profile of international investor.
This rapid globalization has fuelled the desire to have common international standards that could be understood and followed across nations.
The ever increasing network of investors has not only opened new financing sources to countries, but has also put some pressure on the financial regulatory authorities to design and improve their financial reporting systems in a manner that could be easily understood by wider audiences.
In 1973, nine countries included UK formed International Accounting Standards Committee (IASC) with an aim to develop common accounting standards. The membership has now grown well over hundred countries with each country, especially larger economies, bringing in their own perspectives of accounting standards. IASC had to deal with accounting conflictions in coming up with common acceptable accounting standards.
One would immediately think whether IASC has been successful in resolving all the conflicts with all member countries. The answer would easily be no. To fully satisfy more than hundred accounting bodies from across the world is almost an impossible task. Yet IASC has done a commendable job and from 1 January 2005, International Accounting Standards (IAS) or International

Financial Reporting Standards (IFRS) is applicable in more than 90 countries. In the EU countries, IFRS will be compulsory for listed companies only.
While the EU regulation is only enforceable on listed companies, it also gives the option to member states to extend the use of IFRS to unlisted companies within their jurisdiction. The UK Department of Trade and Industry, the government trade body responsible for company regulation in UK, has announced that while there is no mandatory move to IFRS for unlisted companies, the unlisted companies would still be allowed to adopt IFRS over UK GAAP from 2005 onwards.
The basic aim of the new financial reporting standards is the same as that of the existing standards – to provide information about financial performance and position of a company to different stakeholders. Internal stakeholders – management – normally have a good grip of what's going on in the business. It is external stakeholders like investors, auditors, suppliers and creditors who need to be informed in a clear manner about the financial implications of business decisions.
The IFRS would aim to present a more complete picture of a business by making operating income a more encompassing number.
Though the overall aim is the same, differences in implementation and financial reporting do occur due to social, economic and political backgrounds of different nations.
Will it be a good policy to allow two different accounting standards in the UK – one standard for listed companies and another for the unlisted ones? The UK's Accounting Standards Board clearly sees there is no merit in having two separate standards. ASB issued a Discussion Paper in March 2004 highlighting its strategy for convergence with IAS and says that convergence of UK accounting standards to IAS is a foregone conclusion. It has already introduced many changes in the recent past to bring UK's GAAP in line with IFRS.
Accounting Standards Board is also sensitive to the needs placed on businesses in making a transition from UK accounting standards to IFRS. Large businesses probably have sufficient resources to cope with the change in one year. But the smaller businesses will find it difficult to make all the required changes in one year. ASB has proposed a series of changes that would be implemented in 2005 and 2006 which will bring UK financial reporting standards more in line with IFRS. Thereafter, ASB will carry out a series of step changes by replacing one or more UK standards. Therefore, by the end of 2005-2006, UK standards

will almost be in line with IFRS and unlisted companies transition to IFRS in 2007 would be smooth.
However, there is a concern about the costs associated with the transition to IFRS and also the additional burden that will come with regular enhanced reporting. IFRS will help in the globalization of capital markets although cheaper costs of capital may not be of much significance for unlisted companies registered in the UK.

LITERATURE REVIEW

In June 2000, the European Commission proposed a new directive requiring that all publicly traded companies in the member states to adopt International Accounting Standards Board (IASB) standards by no later than January 2005. On 19 July 2002, the European Parliament and the Council approved the IAS regulation (EC) 1606/2002 which states that *'For each financial year starting on or after 1 January 2005, companies governed by the law of a Member State shall prepare their consolidated accounts in conformity with the international accounting standards adopted ... if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State'* (EU, 2002).

The rationale for EU's adoption of International Financial Reporting Standards

The main aim of International Financial reporting Standards is to bring convergence among different national financial reporting standards. Over time, the evolution of different national financial reporting standards has been influenced by local social, political and economic environments. Some of the major reasons for differences in accounting standards are:

- **Political – Capitalist or Communist**. Capitalist and communist countries have almost contrasting fundamental economic approach and their accounting standards reflect the same.
- **Stage of economic development**. Developed countries generally have better accounting standards in terms of transparency and clarity.
- **Corporate finance – debt or equity**. Companies in continental Europe are financed more by debt than the companies in the UK. Accounting standards have over time evolved to reflect the importance placed by different sources of financing on different aspects of financial statements.
- **Legal and taxation systems**. Different legal and taxation systems are in place in the various countries.

Convergence will help investors and analysts to compare companies across borders in a better way. But it also implies that either member countries will lose their independence to make national accounting standards that reflect local economic conditions, or if they start introducing some changes, IFRS may slowly lose its main strength of common standard. Local, political and economical conditions may force national accounting bodies to introduce variations in IFRS. EU has already introduced some changes in IAS 39 dealing with financial instruments. It is beyond the scope of this research to see which member countries have introduced variations in IFRS.

Convergence between UK GAAP and IFRS

The ASB has declared its intention to converge UK GAAP with IFRS. It issued a number of new standards in December 2004 to speed up the convergence of UK GAAP with IFRS. So sooner, even unlisted companies would be following a substantial portion of IFRS due to this convergence.

Comparison of UK GAAP and IFRS

Similarities

Although it might not be within the scope of this study to highlight each and every similarity between the UK GAAP and IAS, it could be easily assumed that the ultimate goal of UK GAAP and IFRS is similar, i.e. to present information about financial performance and position to all concerned stakeholders. Therefore, if the aim is the same, then the main approach adopted by both accounting standards should be similar.

Differences

Despite the assertion that the overall aim is the same, the differences in implementation and financial reporting do occur due to social, economic and political backgrounds of different nations.

The following are the main differences between UK GAAP and IFRS:

- **The Statement of Principles** allows the use of both historical cost and current value approaches in measuring balance sheet categories. The dual use of historical and current value methods is known as the modified historical cost basis. Under historical cost, the carrying values of assets and liabilities are stated at the lower of cost and recoverable amount. This approach is more conservative as compared to IAS approach which uses fair value method. Also the choice of historical or current value method is based on subjective analysis of a company's management and hence it is open to some manipulation.

Implementation of International Financial Reporting Standards

- **Fair value**. If we look at the global level, both UK GAAP and IFRS have adopted the fair value method as the foundation of their accounting standards. IFRS takes fair value adoption even higher when it says that income statement will include the changes in the fair value of items that have not been yet traded like derivatives. The emphasis in new accounting standards is on mark-to-market fair value of assets and liabilities rather than on actual market price based fair values. Now both realized and unrealized changes in fair values would be incorporated in income statements. The first year of transition will see high volatility in earnings and balance sheet statements. Though this brings higher volatility, it will also test the management skills in proper presentation and explanation of changes. It may also change the benchmarks of success for managements.
- **Acquisitions**. Acquisition accounting will change under the new accounting standards. Under UK GAAP, companies can choose between purchase and merger accounting. Under IFRS, companies will have to account under purchase method only.
- **Goodwill**. UK GAAP allowed amortization of goodwill by giving companies the option not to segregate intangible assets from goodwill. Under IFRS, intangible assets have to be separated from goodwill. Goodwill can't be amortized immediately as companies will have to undertake annual impairment tests to justify the value of goodwill on their balance sheets. BAT's profits for the year 2004 increased by £454m because it no longer had to amortize goodwill of that amount (Accountancy Age, 2005b).
- **Research and development costs**. Under IAS 39, research costs can't be carried on the balance sheet and would have to be written off as incurred. Companies would still be allowed to capitalize development in line with UK GAAP.
- **Inclusion of business disposals gains in profits from operations.** BAT's profits for the year 2004 increased by £1.3bn after it included gains from disposals to operating profits (Accountancy Age, 2005b). Adding disposal gains to operating profits will make it harder for investors and analysts to separate the earnings from continuing businesses.
- **Agricultural**. UK GAAP allowed companies to use a cost model for biological assets and all agricultural produce. But under IAS companies would have to use mark to market method for valuing such assets. Now companies would have to use market valuation even for assets in far off countries.

Advantages of IFRS over UK GAAP

- **Common financial language**. Adopting common financial reporting standards will open up a company to more markets and investors. The growth in telecommunications has made it easier for smaller investors to invest across physical boundaries. Such investors are normally not as financially sophisticated as some big financial institutions. They would also not like to understand more than one accounting standards as they don't have required resources in hand to do so. With one common accounting standard, more investors would like to explore companies across nations.
- **Acquisitions**. IFRS 3 is more open and transparent than UK GAAP on acquisitions. It will allow investors and analysts to judge faster the success of an acquisition. Many of the companies that have relied on acquisition as a key cornerstone for growth would now come under intense scrutiny and may have to develop a new strategy for growing business.
- **Consolidation**. In IFRS, all entities will have to provide a cash flow statement. Additionally there would be more transparency within the group companies and this should make the consolidation process more straight-forward.

Disadvantages of IFRS

- **Fair value**. While fair value in a way conveys more up to date value of a company as compared to historic costs, it also highlights a question mark on the methods used and the reliability of fair value. While valuing some of the assets or liabilities may not be difficult, the question still remains what impact such valuations will have on companies' business models. Many companies use hedging instruments as a strategic tool rather than for intentional gains. Any short-term swings in such instruments may have a significant impact on income statement and probably adverse market reactions may deter companies' from using such instruments.

An important issue is the valuing of assets and liabilities that don't have a proper market. The companies may use some valuation model, which itself may not be the right way, to value an asset or liability. The model will incorporate some subjective assumptions. An example would be brand value. The same brand can have two different values for two different companies because of its strategic importance. So at one hand, investors and other external stakeholders are getting more objective information about a companies' assets and liabilities, they are also getting valuation based on more subjective

assessments. Only time will tell whether some individuals or companies will use it to manipulate results.

An interesting issue to observe would be the treatment and importance given by analysts to unrealized fair value of assets and liabilities. Some investors may try to separate unrealized gains and losses from other operational performance. It may also prompt companies to issue adjusted earnings excluding unrealized gains and losses.

An important point to note about fair value principle is that the financial statements should not be seen as perfect prediction of things to come. That depends on the strategic and business decisions management will take in future. Just having a fair value of assets and liabilities doesn't mean that the company will be able to extract those values in future.

- **Dividends**. The new accounting standards promote payment of dividend from distributable reserves. With the inclusion of unrealized gains and losses and pension deficits, the first few years of the new accounting standards may not leave enough of distributable reserves for dividend payments.
- **Annual impairment tests**. Annual impairment tests are easier said than done. Companies would not only have to devote substantial resources to do that first would have to train its personnel to do that. Assessing true value of goodwill is not easy. If there is a comparable market then companies can easily value it. Even then it may differ from case to case as it would be very unusual to see exactly two similar companies. Goodwill is very different from tangible assets or technologies and depends a lot on market perception and strategy. Companies would have to review the whole process of valuing goodwill and would have to review the valuation process at constant intervals.
- **Net pension liability**. The inclusion of net pension liability on the balance sheet may have severe impact on the shareholders funds. Companies will be required to have annual actuarial valuation of their pension liabilities and the same would be reflected in financial statements. The majority of the pension funds invest in equity markets, which have been quite volatile in the recent years. So though over a longer period, the movements in pension liabilities may even out but in short to medium term, it may have a dramatic effect on balance sheets and earning statements.
- **Segmental information**. IAS 14 requires companies to report information on their business segments and on a scale more detailed than UK GAAP. As of date, no agreed accounting practices have emerged on how much should be

disclosed because companies may end up revealing sensitive information to its competitors. If companies disclose the turnover, earnings and expenditure for each segment, its profitable operations may come under intense competition. Ian Dilks of PwC said that "some companies have found they're giving much more information than they're comfortable with on sales and the profitability of product areas" (Tricks, 2005)

- **Expensing research costs** may result in listed companies focusing more on products in the development stage than in the research stage. This will keep their balance sheets healthy but may harm long term prospects.
- **Complex and long IFRS compliant reports**. PwC estimates that an IFRS compliant financial report for insurance companies could be up to twice as long as those prepared under existing UK GAAP. The requirement for other industry sectors though may not be as intensive as for insurance sector, their IFRS compliant financial may also be longer and resource intensive than under UK GAAP. Any company that makes an acquisition will have to do annual goodwill impairment analysis and most of them would like to explain the results as well.
- **Comparable formats**. IAS 1 is less prescriptive than the UK GAAP when it comes to the format of the balance sheet and income statement. It just distinguishes current and non-current assets and liabilities. Investors, when faced with different formats, may find it difficult to compare companies.
- **Modify organization structures**. Meall (2003) suggested that the additional burden of more financial reporting along different segments may force companies to modify their existing organizational structures within their financial systems to collect and analyze data.

While it may just be an accounting issue only, companies can still benefit from the change by looking at the ways of information collection and also at what data is collected and how it is analyzed. Additional reporting will mean that some of the companies may now have to collect more data. Internal management reporting will be looked at to confirm to new accounting standards.

Adopting accounting policies and identifying the required financial data seems to be the approach taken by many companies. Introduction of IFRS is yet to see a change in business behavior except in some areas like the granting of share options. PwC expressed the view that *'companies are limiting the scope of their transition project in the short term and putting all their resources into*

finding fast solutions to provide the appropriate information for their 2005 reporting deadline' (PwC, 2004b). Providing relevant numbers may meet the regulatory requirements but the full benefit of IFRS will only come when the principles behind its formulation are also incorporated into business thinking. IFRS 1, First-time adoption of International Financial Reporting Standards, was published by the International Accounting Standards Board to guide organizations through their transition from national GAAPs to IAS. IFRS 1 would make the transition process easier.

But still the work required to convert from UK GAAP to IFRS won't reduce substantially. Companies would have to spend considerable resources and time in analyzing and making significant changes to existing accounting policies.

Readiness of businesses

The Institute of Chartered Accountants, England and Wales (ICAEW) acknowledges that companies won't be ready for IFRS in the first year of transition. In a press release dated 26 July 2004 it said that it is inevitable that some audit reports will require qualification next year given the number of companies who are lagging behind in their preparation of IFRS (ICAEW, 2004b). Andrew Ratcliffe, Chairman of the Institute of Chartered Accountants' Audit and Assurance Faculty has warned that some companies may delay publication of their financial statements due to transition to IFRS.

Accountancy Age's survey in the last quarter of 2004 showed that companies across European Union were well short of being ready for the IFRS transition (Accountancy Age, 2004a). In a poll of 1000 companies, 42 % of the respondents were yet to start their preparation for the impact of international accounting standards. Only 15% of the companies reported that they have finished their preparations (Accountancy Age, 2004a). The level of preparedness is so low that ultimately UK's Financial Services Authority agreed to give companies additional 30 days to report their financials in line with IFRS.

Among non-listed companies, only 5.9% said that their preparation for IFRS is good and almost one-third said that their preparation is very poor (Accountancy Age, 2004b).

In a survey conducted by PricewaterhouseCoopers, 323 companies from 18 European countries and Australia and New Zealand responded to their readiness to start reporting under International Financial reporting Standards by 2005 (PwC, 2004b). The survey reported that companies are finding the change to

IFRS is much more than what they had anticipated. The change is not just reformatting numbers. Companies need to adopt systems and processes in their organizations to make IFRS a part of 'business as usual' rather than just data collecting exercise.

PwC (PwC, 2004b) concluded that many companies were focused solely on short-term quick fix solutions to data capture and reporting. A half-hearted exercise like this could result in unintentional wrong reporting or even delayed reporting. A miss or a wrong guidance could be costly. Wrong numbers will not only lead to wrong valuations but would also reflect on the poor state of internal systems – a signal that won't be much appreciated by the capital markets.

An interesting comparison would be to evaluate IFRS preparedness in different industries. Normally firms look at their peers rather than at whole market when deciding their strategies and practices. This is due to higher comparison within peer industry as compared to with whole of capital markets. In the survey conducted by PwC, companies in the financial services, technology and entertainment were ahead of organizations in the consumer and industrial products and services. Financial and technology organizations were leading consumer and industrial companies at almost all the stages of IFRS implementation with varying differences.

One probable reason for such cross-industry differences would be the level of globalization in sectors. Companies in more global sectors have to live up to international standards due to the fact that many of their customers are international companies. IFRS would help them win more international credibility.

Another interesting but obvious observation was the attention paid by different sectors on different IFRS. PwC reported that technology companies were ahead in terms of readiness in the areas of employee benefits, foreign entities whereas financial services companies have paid more attention to IAS 32 and IAS 39 which deal with financial instruments.

Costs of IFRS transition

- **Retrospective application**. Organizations would have to restate financial statements in line with IFRS requirements. This would entail additional resources and costs to make necessary restatements. The companies would have to prepare an opening balance sheet at the date of transition to IFRS. For companies with one year of comparatives, the transition date would be 1

January 2004 and for companies with two years of comparatives, the transition date would be 1 January 2003. First IFRS statement may also need information that was not collected under previous national GAAP. First time adopters can choose from some of the 10 optional exemptions available. This may reduce some transition costs.

- **Time spent** in understanding and assessing the impact of IFRS on financial performance. As the move to IFRS is much more than plain reformatting of numbers, organizations would need to spend time on assessing the impact of IFRS on their financial performance. New regulations on financial instruments, fair value may significantly change income and balance sheets. Management as well as senior managers across divisions would spend considerable time in understanding the implications of new regulations. Such a process rarely concludes in one meeting due to its contentious nature.
- **Communicating changes to stakeholders**. Listed companies have to inform changes in accounting and their implications to their external stakeholders, notably investors. The first statement with IFRS will probably include a longer description of impact of changes. Any significant negative impact may lead to lower valuation and so management would spend time on developing and executing a good communication strategy to minimize negative impact.

Training of employees. Employees, mainly in the financial departments would need training to become conversant with IFRS.

- **Regular costs**. Annual impairment costs. Costs incurred in collecting more data and analyzing it.

It may be noted from the above points that most of the costs are either applicable in the first year only or are more significant in the first year as compared to subsequent years. As companies adopt IFRS, regular costs of applying IFRS may not be significantly different from the costs incurred under national GAAP.

Reasons for apprehension towards IFRS are as follows:

- **IFRS will increase the complexity of annual financial reports**. This is an area of concern for the preparers of financial statements as it means more work. It may also result in potentially litigable financial statements.
- **There is confusion about applicable standards due to the constant revision of IFRS**. EU is also constantly reviewing and revising IFRS. UK companies have to keep a constant watch on revisions being issued by IASB and European Commission. In the first adoption of IFRS, standards as on March 2004 would form a stable platform for first implementation. Companies can also adopt further revisions of reporting standards. So though two companies might both be IFRS compliant on a date, they might be reporting on different versions.
- **Less use of summary reports**. UK GAAP gives exemption to companies based on their size. Smaller companies utilize such exemptions to prepare just summary reports using fewer resources, but at the same time they contain most of the relevant information required by the readers of such reports.
- **US dominance**. It is perceived that IFRS are underpinned by US interests. As an example of this, the European Commission has made some changes in IAS 39 before recommending it to its member states. European banks and ministers had raised serious issues on the impact of IAS 39 on their balance sheet. The US bias in accounting standards also comes from the view that International Accounting Standards Committee is dominated by US.
- **The perception that UK's accounting standards are better than IFRS**. UK's accounting standards describe formats for income statement and balance sheet. IFRS has no such formats and companies would be allowed to choose style that suits them. First of all investors and analysts would have to deal with

multiple formats which may make comparison difficult. Second, companies may vary their formats to suit their purpose.

- **Internal management reporting.** The adoption of International Accounting Standards is more than a simple technical exercise of rearranging formats and presentation of financial statements. The internal management reporting is now going to be more significant.
- **First time implementation costs**. IFRS will also result in significant implementation costs, especially for smaller companies.
- **Variation in IFRS**, as applied in different nations, may falsely lead investors and analysts to believe that companies are following IFRS in the original and true form whereas they may not be doing so. As the enforcement of accounting standards would still be with national bodies, the local auditors will look only in terms of local IFRS and may not note the differences with the original IFRS as issued by IASB. Also investors and analysts may not be able to take note of local changes.

Other Concerns

The focus of International Accounting Standards is on better performance measurement and communication of the same to internal and external stakeholders. Adoption of better and more transparent policies in reporting by a company would most probably seep down through to other companies in the sector as they would not like their peers to have an undue competitive advantage. Investors prefer more open companies and reward them by increasing their price multiples, which will tempt other companies to soon join the bandwagon of new reporting standards and formats.

It will be too early to say that new reporting standards will fundamentally change the businesses in the short run but it will definitely change the way success is measured by external stakeholders and information sharing between internal and external stakeholders. It will also have an impact on some of the related aspects – how the company's financial function is organized and how people are rewarded.

Shortage of skilled manpower

Companies would also face shortage of skilled human resources not only at the stage of transition, but also during normal implementation of IFRS on a constant basis. Enough qualified skilled staff to deal with IFRS, were in short supply. PwC survey reported the acute shortage of skilled resources. This may be due to the fact that most companies are focusing on IFRS only in the

last minute rather than implementing the change over time. PwC reported that shortage of IFRS skilled resources is a market-wide phenomenon (PwC, 2004b).

Transitional phase is always fraught with difficulties and confusion. A number of countries have adopted IFRS. But there is still no single or commonly accepted way of employing IFRS. As of date, there is no single International GAAP. A consensual International GAAP will only emerge after a few years of implementation by companies across different countries. The journey is definitely not short and easy. Companies and auditors interpretation of new financial reporting standards may differ across the cross-section and also may be within the same industry.

Based on the variations in the current national standards and the new standards, one would think that it would be naïve to assume that the profession will we see a single accepted International GAAP in the short term. It would be an ideal scenario to have a single International GAAP at some time, but the more important issue is whether a single accepted International GAAP is needed immediately. As long as the individual countries commit to implementing IFRS in true sense and allow their companies some time to navigate through the change process, it should be acceptable.

Auditors

Auditors represent the link between IFRS and companies compliance with new accounting standards. Their role is vital in ensuring compliance of IFRS by companies and becomes more in the initial years when there would be some confusion on generally accepted accounting practices. But the things are not so rosy on that front. In a survey carried out by International Accounting Standards in 2000, it was found that major audit firms issued unqualified audit opinions on IAS financial statements that did not comply fully with IAS (Cairns, 2003). If this was the state of major audit firms, it wouldn't be wrong to imagine that the situation would be similar or even worse in smaller audit firms. It was also found that auditors sometimes limit their opinion to compliance with national GAAP even when the financial statements of the company asserted compliance with IAS.

Impact on non-financial personnel

Finance personnel would have to learn new accounting standards being introduced under IFRS. They will have to develop new formats for internal reporting. The changes and their impact would also be felt by operational

managers. The new formats may impact the profitability of divisions. Managers may be forced to look at the ways business is carried out and explore new ways to maintain or increase profits.

Also since most of the employee bonuses are linked to profits, the application of new accounting standards will also impact performance bonuses. The first year of transition may result in huge variations in bonuses. Employees of insurance companies may find that their bonus packages have been severely impacted by new regulations on financial instruments. Companies may be forced to come up with new bonus packages, an extra and costly burden as bonus packages take long time to evolve.

Not only finance personnel would have to learn new changes, the impact may also be felt by operational managers. The divisional profits would be reported in under new formats and may impact the profitability of divisions. Since most of the employee rewards are linked to profits, the application of new accounting standards will also impact performance bonuses.

Non-listed firms and IFRS

Non-listed firms are generally smaller, less diverse in terms of divisions and number of international locations as compared to listed firms. All these factors mean that non-listed firms may find the IFRS transition process less complex and hence can complete it with lesser resources and in lesser time as compared to listed firms.

Impact on IT

IT has become an integral part of businesses, even for smaller businesses. Bigger companies have more elaborate IT systems to capture more data. IFRS reporting will mean that companies have to collect more data than under UK GAAP. Changing IT systems may also cause business problems.

CONCLUSIONS

1. The adoption of international financial reporting standards across the European Union from 1st January 2005 is a defining movement which will have an immediate impact on more than 7000 listed European companies which will have to implement new financial reporting standards first. Common international financial reporting standards could result in true global capital markets.
2. IFRS or IAS was supposedly developed with an eye for a larger audience. It is difficult to design an accounting system that meets everyone's demands.

Whatsoever may be the outcome of these pressures, UK companies now have to implement it. Unlisted companies have been given time till 2007 to implement IFRS. The standards that UK listed companies will follow are not those issued directly by the International Accounting Standards Board, but are those that have been endorsed by the European Commission.

3. Both IFRS and UK GAAP share broader level aims. But there are many differences at the implementation level. IFRS further enhances the concept of fair value and its regulations place stiff definitions on assets and liabilities. Pension deficits would now also need to be on income statements. Financial instruments would also undergo finer scrutiny. This means that there will be greater volatility in financial statements.
4. Studies and research on listed companies with reference to IFRS have already highlighted many areas where UK GAAP is better than IFRS. The study confirmed the uneasiness and anxiety felt by the unlisted companies. First of all IASB is yet to finalize all accounting standards, and is already issuing regular updates. Unlisted companies will find it difficult to cope with regular stream of changes.
5. Firms feel that the costs that will be incurred in transition to IFRS are significant with reference to their size. Companies will spend on training of their staff to meet IFRS requirements. It is also believed that not only financial staff has to be trained but the non-financial staff has also to be made aware of the changes. The new regulation on more detailed reporting on segments and products may result in some business changes.
6. Companies would also have to make significant changes in their IT systems. This would not only result in incurring additional costs and resources, but may also impact normal business during the time of change.
7. The concern remains that the benefits of IFRS may not justify the costs of its implementation. The benefits of IFRS are more for listed companies. Smaller companies, even listed ones, will find it difficult to cope with the extra work due to IFRS. They will lose the exemption granted under UK GAAP and will have to report full financial reports.
8. There is definitely much scope in improving International Financial Reporting Standards for unlisted companies. IFRS will help in the globalization of capital markets. However, cheaper cost of capital is not of much significance for unlisted companies registered in the UK.

9. Unlisted companies may pay more than what they will get in turn from IFRS. Unlisted companies may not have the required trained staff and IT systems, and they would find it difficult to cope with the changes.

10. Unlisted companies in general have a long way to go before they can become IFRS compliant. Listed companies were ahead in analyzing accounting policies and its impact on their financial performance. A reason for lower initiation of IFRS procedures could be that unlisted companies have time till 2007 to implement IFRS. But they should not delay the implementation process till the last date. Many listed firms have delayed the implementation of IFRS till the last minute and are now finding it hard and more costly to implement the change. Implementation of IFRS will definitely throw up minor issues that could prolong the implementation process.

11. Large firms are more advanced in their understanding and desire to implement IFRS but they were also not yet preparing for major changes in systems. Mostly accounting standards have been framed with an eye for listed and large companies. But unlisted companies have much lesser resources to spend on large regulatory requirements and hence should have different reporting requirements that match the benefits obtained from such reporting. IFRS in its present form would not be a good alternative for unlisted companies and, therefore, should be modified before it can be used by unlisted companies in 2007.

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