A critical review of financial reporting standards in European companies- Differences and Similarities with GAAP in UK

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Abstract: The adoption of international financial reporting standards across the European Union from 1st January 2005 is one of the biggest events in the accounting history. This is especially important after the capital markets were rocked by some big accounting frauds in recent years. In the first phase, 7000-plus listed European companies had to implement new financial reporting standards from January 2005. This paper discusses this reporting system, its capabilities, opportunities and challenges and the main differences between this system and United Kingdom GAAP (as an optimized system).
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1. Introduction:

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 said '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).
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 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.

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 the 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 ASB has declared its intention to converge UK GAAP with IFRS. It has 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

The ultimate goal of UK GAAP and IFRS is same – to present information about financial performance and position to all concerned stakeholders. If the aim is same, then should be the main approach adopted by both accounting standards. The UK's Accounting Standard Board's Statement of Principles for Financial Reporting is a vital contributor at macro level standard setting. It plays almost same role as International Accounting Standards Committee's 'Framework for the Preparation and Presentation of Financial Statements'. 'It is a description of the fundamental approach that the Accounting Standards Board (ASB) believes should, in principle, underpin the financial statements of profit-oriented entities' (ASB, 1999). The Statement of Principles has true and fair concept at its core, much like the focal point in International Accounting Standards. Also like IAS, Statement of Principles insists on financial information being relevant and comparable.

It is beyond the scope of this research to highlight each and every similarity between UK GAAP and IAS.

Differences

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

Main concepts behind UK GAAP and IFRS are same, but when we look at micro level, we see many differences at the individual standards level. Following are the main differences between UK GAAP and IFRS:

- The Statement of Principles allows 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 modified historical cost basis (ASB, 1999). 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.
- Fair value. If we look at global level, both UK GAAP and IFRS have adopted 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 realised and unrealised 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 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 and companies had the option of not segregating intangible assets from goodwill. Under IFRS, intangible assets have to be separated from goodwill. Goodwill can not be amortized now but companies will have to undertake annual impairment tests to justify the value of goodwill on the balance sheets. BAT's profits for year 2004 increased by £454m because it no longer had to amortize goodwill of that amount (AccountancyAge, 2005b).
- Consolidation of accounts. Under new accounting rules, companies may have to consolidate certain additional subsidiaries into group accounts. On the other hand companies will have to exclude certain subsidiaries or special purpose vehicles which were not included till now.
- Research and development costs. Under IAS 39, research costs can't be carried on the balance sheet and would have to write them off as incurred. Companies would still be allowed to capitalise development in line with UK GAAP.
- Stock options. Internet and share market last boom in late 1990s led to rapid increase in share options as a way to reward employees. The new requirements to record an expense on income statement for the value of share options granted to employees could have a significant impact on earnings. AstraZeneca said in its pro forma 2004 IFRS numbers that new accounting rules on stock options

has made it re-consider the use of stock options in rewarding its employees (Tricks, 2005).

- Distributable profits. Organizations ability to pay dividends is dependent on their distributable profits. Following are some of the major impacts of IFRS on distributable profits - Inability to discount deferred tax liabilities, higher provisions for deferred tax when companies move from historical costs to fair value and inclusion of pension deficits in income statement. All of the above will reduce distributable profits. Many companies would have to financially restructure themselves in order to have sufficient distributable profits to meet dividends paid in last year.
- Deferred tax credit. Deferred tax credit is available under UK GAAP but not under IFRS. GlaxoSmithKline's restated its 2004 earning per share by (1.9p) due to non-availability of deferred tax credit under IFRS (AccountancyAge, 2005a).
- Inclusion of business disposals gains in profits from operations. BAT's profits for year 2004 increased by £1.3bn after it included gains from disposals to operating profits (AccountancyAge, 2005b). Adding disposal gains to operating profits will make it harder for investors and analysts to separate the earnings from continuing businesses.
- Derivative contracts. Under IFRS, some derivative contracts will not qualify as hedges as they wont meet the criteria. UK GAAP allowed deferment of such contracts until transaction took place. IFRS won't allow the deferment of such contract and would impact the profit and loss account even before the transaction took place. It is better in a way that investors will know the current value of the firm as on date rather than historical costs of such instruments, especially if the duration of financial instruments was long. At the same time, it would increase the burden on the company to calculate the fair value of all such transactions.
- 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.

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 puts a question mark on the methods used and the reliability of fair value. Derivative instruments which are commonly traded on various stock exchanges can be easily assigned value. So 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.

Then comes the more important issue of valuing 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. A 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 thing 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.

- Dividend. New accounting standards promote payment of dividend from distributable reserves. With the inclusion of unrealised gains and losses and pension deficits, the first few years of new accounting standards may not leave enough of distributable reserves for dividend payments.

- Securitisation. Securitising assets into special purpose vehicles and re-financing them through had also helped companies raise funds at lower costs. The new accounting standards by restricting the use of special purpose vehicles, would diminish some sources of cheap financing. It is question yet to be fully tested in the practical world that since the assets are same, change in financing options shouldn't change the returns on total assets. By refinancing at lower rates through securitisation should result in higher financing cost for remaining assets such that the overall costs remain same. But examination of this hypothesis is beyond the scope of this dissertation. But what is mostly observed in capital markets is that when companies announce refinancing, the share price rises. How much of the rise is from relief that company will survive and how much from the fact that the overall costs have lowered is not known.
- 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 a 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. Most 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 detail 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 development stage than in research stage. This will keep their balance sheets healthy but may harm long term prospects.
- Complex and long IFRS compliant reports. PricewaterhouseCoopers estimates that an IFRS compliant financial report for insurance companies could be up to twice as long as those prepared under existing UK GAAP (Finn & Zoon, 2004). 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 has makes an acquisition will have to do annual goodwill impairment analysis and most of them would like to explain the results also.
- 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 analyse data.

Impact of IFRS on different industries

IFRS will have different impact on different industries. For some, most of the applied UK GAAP is almost same as IFRS and won't feel the difference.

But for some industries, the difference in accounting standards may have a substantial impact. Financial services and insurance companies are among them. Financial services companies would be affected by substantial change in recognition and measurement of financial instruments under IAS 39. UK GAAP has no equivalent to IAS 4 which deals with insurance contracts. Insurance companies would now have to account for this in their financial statements.

Under IFRS, insurance companies would have to book financial instruments such as derivatives at market value rather than historical value allowed under UK GAAP. Many insurers have said that this will distort their earnings (Reuters, 2005a). IFRS will put more stringent criteria for classification of insurance products and this may lead to reclassification of some insurance products as investment products.

Other industries that might face higher impact are the ones that heavily use hedging instruments in their day to day operations. Mostly companies using commodity materials like oil as a significant part of their input costs use hedging to smooth over the volatile changes in commodity markets.

New accounting standards will reduce Tesco's projected annual profit of £2,000m by £30m only, a reduction of 1.5%. But for some companies the impact would be much more. Royal & Sun Alliance said that new accounting rules would reduce its net assets by £400m (Reuters, 2005a). This is a big number by any standards and shareholders of Royal & Sun Alliance would surely be concerned. Even though the company may classify it just an accounting issue, it casts certain doubt on the business practices and assumptions followed in past by the company.

The movement in assets and profits is not unidirectional for all companies. ICI, the chemicals company, said that its 2004 year profits were boosted by 6 per cent due to the changes introduced by new accounting standards (Smith, 2005). So while the underlying business has remained same for companies, introduction of new standards has the potential to increase or decrease the value of companies.

Moving from UK GAAP to IFRS is not just same as adjusting numbers. Many companies and their managements view move to IFRS as just an accounting issue. Andrew Higginson, Tesco's director of finance and strategy said "The adoption of IFRS is an important issue for all EU listed companies and one that we take seriously, but ultimately, it is an accounting, not an operational change," (Reuters, 2005b).

New accounting standards can also lead to confusion, at least in the short term till accounting practices are well agreed by different parties. An example of this was the recent comment about Northern Rock by Credit Suisse First Boston (Smith, 2005). Credit Suisse First Boston claimed profits at the UK bank would fall by 10 per cent due to the effects of IFRS. This led to a fall in Northern Rock's share price. But Northern Rock's management didn't agree with the analysis and issued a rebuttal of the claims. Both Northern Rock and Credit Suisse First Boston are well established financial firms and if their accounting departments can have such significant differences over interpretation of IFRS, it can be imagined that smaller companies with less resources will face tougher choices.

Restatement of previous year financial statements has sometimes led to increase in profits also. British American Tobacco reported that its 2004 profits increased by £1.7bn under IFRS as compared to UK GAAP (Accountancy Age, 2005b). The increased profits have not resulted in higher valuation of the company. Jonathan Fell, analyst at Morgan Stanley commented 'The increased figures are mainly a result of changes to the accounting for disposals. They do not affect the overall view of BAT' (AccountancyAge, 2005b). It is a case of high movements in profits without a change in value of the firm.

While it may just be an accounting issue only but 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 analysed. 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 behaviour except in some areas like grant of share options. PwC said '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).

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 analysing and making significant changes to existing accounting policies.

Readiness of businesses

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. ICAEW carried out a survey of UK companies on the preparedness of companies for transition to IAS (ICAEW, 2004a). The survey received 661 responses from businesses and accounting practices in 2004. ICAEW had previously also carried out survey of British businesses on the same. The main outcomes of the latest survey and their analysis are as below:

- 81 percent of respondents were either "very aware" or "fairly aware" of the publication of the EU regulation. This is good news because in the previous survey only 61 percent of respondents were aware of EU regulations. The bad part is that even when EU regulations were so close to being coming into force, not all respondents were aware of it. Only half of respondents were aware of the IAS timetable. By mid 2004, the time of ICAEW survey, it was expected that respondents would not only be fully aware of the timetable but would have also started implementing changes in the reporting system.
- Only 38 percent of respondents were aware of ASB's plan of convergence to IAS. It is not of much concern as of now. It would have been better if more respondents knew about ASB's plan because then they could have started working on changes right now rather than waiting for the moment when ASB announces them.
- About 30 percent of respondents were not sure of any significant impact on their companies' key performance indicators due to a move from ASB to IFRS. This only confirms that companies have yet not analysed fully the differences between IFRS and UK GAAP. It also shows that Organizations are way behind in developing an implementation, and internal and external communication strategy to their stakeholders.
- Only 45 percent of respondents in business section were either on scale "very good" or "good" when asked about their Organization's understanding of the implications of IFRS. IFRS is not just re-formatting of numbers. Organizations will have to look not only at the impact on performance indicators but also analyse the way information is collected at various levels with in the Organization. Managers across different divisions should also learn about how the changes would impact their performance measurement.
- Only 39 percent of respondents noted that their Organization is prepared for the introduction of IFRS. This number is very less and companies not ready for the change may find themselves in a fix when new regulations come into force.
- Another area of concern observed in the survey was the speed at which Organizations were carrying out their IAS implementation programmes. The survey noted that implementation rate was slower than predicted in previous survey. About a quarter of respondents who mentioned that an implementation programme is required for their Organization already had one in place and another 27 per cent said that they would have one in place. About half of respondents who stated they need a programme didn't have any plans then. So first of all not all respondents knew whether they need an implementation programme or not and even of those who thought they need one, only half had concrete plans.
- IFRS will also impact how investors perceive an Organizations' performance. Only about one-third of respondents who thought that they need a communication plan to convey impact of IFRS to external stakeholders had either put a plan in place or was going to put one in short time. Rest two-thirds had not thought about formulating any communication strategy yet.

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 (AccountancyAge, 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 (AccountancyAge, 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 (AccountancyAge, 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 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.

The survey reported that most of the companies have probably missed the chance of incorporating IFRS in their internal reporting by the start of 2005 and progress to IFRS has been slow. Companies have a long path to travel before IFRS becomes an integral part of their businesses. PwC had also conducted a survey in March 2004 on the same topic and the latest survey in December 2004 showed that issues that were causing concern in the first survey were still an area of concern.

Major highlights and findings of the PwC's December 2004 survey are (PwC, 2004b):

- Larger companies better prepared than mid-cap companies. Larger companies are better prepared than mid-cap companies on almost all issues relating to IFRS transition. 83 percent of companies with market cap more than 10 billion euro had a training strategy in place where as the corresponding figure for companies with market cap less than 1 billion euro was only 33 percent. This result comes as no surprise because large companies probably have more resources than mid or low cap companies to be put on IFRS transition project without having a significant negative impact on day to day operations. Also large companies are more concerned about the capital market implications of non-conformity with IFRS. Additionally it also highlights the lack of attention being given by low and mid cap companies to IFRS transition process – an area of grave concern for financial regulators and capital markets.
- Scant communication of IFRS impact on businesses to the market. Only 4 percent of companies surveyed had communicated any broad picture of IFRS impact on their businesses to the market and about 29 percent had completed and approved a communication strategy. A large number of companies had not yet made any progress on external communication and the main reason could be that they themselves have yet to fully analyse the impact of IFRS on their financial performance and position.
- The above hypothesis is confirmed when survey reported that even near the end of 2004 only 88 percent of companies were assessing the impact of IFRS on their reporting and key performance indicators. And only about 45 percent of the sample have completed the assessment and reported the findings to their boards. So though many companies have started the work, the percentage of companies where board is fully aware of impact is still less. This means that many boards will end up with insufficient time to form a proper strategy to respond to the changes.
- IFRS conversion projects. Only 42 percent of respondents reported that their IFRS conversion project is up and running. 30 percent had either made limited progress on setting up a project framework or have made no progress at all. Small companies with one or few divisions could still squeeze through within deadline. But bigger companies with many divisions and multinational locations would find it hard to complete IFRS conversion if they haven't started yet.
- Shortage of resources. Only 19 percent respondents said that they are confident that they have sufficient resources allocated to complete the conversion in time. It is the other 81 percent who now have to get additional resources for IFRS projects. Many of such companies might have planned to procure additional resources in house. But those who have plans for outside sourcing may find it difficult to get required personnel due to shortage of such personnel.
- Internal IFRS training. 39 percent of respondents were addressing the issue of internal IFRS training. Even within that only 13 percent were implementing strategies and rest 26 percent were still analysing the needs.
- Short-term fixes. Many companies were focusing only on a core group of people to implement necessary changes that would see them through the transition phase. Improper understanding of new reporting standards by other relevant personnel may result in errors or even much longer implementation delays. 45 percent of respondents said that their

approach is based on short-term fixes rather than applying a more companywide approach.

- Poor companywide embedding of change requirements. Only about one-fifth of the companies had made necessary IT system and process changes to make IFRS a part of normal business. Even fewer were the companies who had put internal checks in place to ensure the robustness of data collection process.

The results also showed that many companies were focused solely on short-term quick fix solution 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 sate of internal systems – a signal that wont 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 (PwC, 2004b). Financial and technology Organizations were leading consumer and industrial companies at almost all the stages of IFRS implementation with differences not huge but significant.

One probable reason for such cross-industry differences would be the level of globalisation in sectors. Companies in more global sectors have to live up to international standards and some of their bigger 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 (PwC, 2004b).

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 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 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 minimise 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 analysing 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 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.

Discussion and Conclusion

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 7000-plus listed European companies who will have to implement new financial reporting standards first. A common international financial reporting standards could result in true global capital markets.

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.

Both IFRS and UK GAAP share broader level aims. But there are many differences at 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. All this means that there will be greater volatility in financial statements.

Studies and research on listed companies with reference to IFRS has already highlighted many areas where UK GAAP is better than IFRS. This research has highlighted additional areas where unlisted firms feel comfortable with IFRS. The research confirmed the uneasiness and anxiety in the unlisted companies. First of all IASB is yet to finalise all accounting standards and is issuing regular updates. Unlisted companies will find it difficult to cope with regular stream of changes.

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.

Companies would also have to make significant changes in their IT systems. This would not only incur cost and resources to do that but may also impact normal business during the time of change.

But the most concern was that the benefits of IFRS don't justify the costs incurred on IFRS. The benefits of IFRS are more for listed companies and unlisted UK-based won't stand to gain much from that. Respondents said the benefits in cheaper costs and international investor base don't apply to unlisted firms.

Smaller companies, even listed ones, will find it difficult to cope with extra work due to IFRS. They will lose the exemption granted under UK GAAP and will have to report full financial reports.

The results show that there is definitely a much scope in improving International Financial Reporting Standards for unlisted companies. Respondents were concerned about the costs associated with transition to IFRS and also the additional burden that will come with regular enhanced reporting. That IFRS will help in globalisation of capital markets and probably cheaper costs of capital is not of much significance for unlisted companies registered in UK.

More companies indicated that the impact of IFRS on key performance indicators would be negative than positive, though most of the respondents were not sure of the impact. This highlights the fact that most of the companies have not yet started analysing the impact of IFRS on their key performance indicators.

Even auditors feel that unlisted companies may pay more than what they will get in turn from IFRS. Auditors' responses were more in favour of IFRS as compared to companies responses. But auditors also agreed that unlisted companies don't have necessary trained staff and IT systems and they would find it difficult to cope with the changes.

Unlisted companies in general have a long way to go before they can become IFRS compliant. The studies conducted on listed companies showed a higher IFRS compliance than this study. Listed companies were ahead in analysing 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.

The analysis also showed that unlisted companies with near future listing plans were far ahead in terms of IFRS assessment and implementation. They know that when they will go for public floatation, both investors and financial institutions will compare them with listed firms. And it would strengthen their case as well as their credit ratings if they have IFRS systems in place for longer duration. It will also give potential investors more confidence in their financial statements.

The study also analysed the probable variation in IFRS approach and implementation because of company size. The large firms were far ahead of small firms in terms of assessing high level impact. The most likely reason could be that financial institutions will compare their performance with listed firms and hence it would be better to analyse impact of IFRS right now to present a stronger case to financial institutions.

As above, larger firms had either started training their employees in IFRS or were mostly planning to do so in near future. Successful training of employees is key to meaningful analysis of IFRS's impact on companies' balance sheets and earning statements. Unlisted companies were more or less similarly distributed in enhancement of their systems for data gathering and evaluation. 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. The results were similar to what was observed in case of system enhancements though in this case significant proportion of large firms had either put some thoughts to this or were planning to do so in near future.

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 thing for unlisted companies and should be modified before it can be used by unlisted companies in 2007.

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