Implementing IFRS from the perspective of EU publicly traded companies

Eva K. Jermakowicz a,*, Sylwia Gornik-Tomaszewski b

a Department of Accounting and Business Law, College of Business, University of Southern Indiana, 8600 University Blvd., Evansville, IN 47712, USA
b Department of Accounting and Taxation, The Peter J. Tobin College of Business, St. John’s University, 8000 Utopia Parkway, Jamaica, NY 11439, USA

Abstract

This study examines implementation of International Financial Reporting Standards (IFRS) by European Union (EU) companies. All listed EU companies are required to prepare their consolidated financial statements in accordance with IFRS for years beginning on or after January 1, 2005 (Regulation (EC) 1606/2002). The paper provides insight into the IFRS adoption process based on a questionnaire sent to EU-listed companies in 2004. The 112 responses received indicate: (1) a majority of respondents have adopted IFRS for more than just consolidation purposes; (2) the process is costly, complex, and burdensome; (3) companies do not expect to lower their cost of capital by implementing IFRS; (4) the more comprehensive the approach to conversion, the more respondents tend to agree with the benefits and costs of the transition; (5) companies expect increased volatility in financial results; (6) the complexity of IFRS as well as the lack of implementation guidance and uniform interpretation are key challenges in convergence; and (7) a majority of respondents would not adopt IFRS if not required by the EU Regulation. The results of our questionnaire were confirmed by several personal interviews with finance and accounting executives of EU publicly traded companies.

Keywords: IAS regulation; IFRS; European companies; Survey

1. Introduction

The Sarbanes-Oxley Act of 2002 recommends global accounting convergence as a means of raising the quality of financial reporting and restoring investor confidence in publicly traded companies. Probably nothing will be more important to global accounting convergence than

* Corresponding author.
E-mail addresses: ejermako@usi.edu (E.K. Jermakowicz), gornikts@stjohns.edu (S. Gornik-Tomaszewski).
the decision of the European Commission to adopt International Financial Reporting Standards (IFRS). In June 2002, the European Union (EU) Council of Ministers approved a regulation requiring EU-listed companies to prepare consolidated financial statements in accordance with IFRS for years beginning on or after January 1, 2005. The Act was approved by the European Parliament and enacted into law on September 11, 2002, as Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of July 19, 2002, on the Application of International Accounting Standards (IAS) (IAS regulation). This IAS regulation will cover all companies listed on a regulated market, including banks and insurance companies. Member States have the option to extend this requirement to unlisted companies and to individual financial statements. Companies traded both in the EU and on a regulated market outside the EU that are already applying another set of internationally accepted standards (for example, U.S. Generally Accepted Accounting Principles (GAAP)), and companies that have issued debt instruments but not equity instruments may be temporarily exempted by the Member States and not required to comply with IFRS until January 1, 2007 (EC, 2002).

The IAS regulation is expected to help eliminate barriers to cross-border trading in securities and, consequently, increase market efficiency and reduce the cost of raising capital for EU companies. Actually, the application of IFRS by listed companies is considered to be a crucial element in establishing a single European capital market. The IAS regulation will introduce the biggest changes to financial reporting in Europe in 30 years. Approximately 7000 EU-listed companies will be affected directly by this regulation. Many more consolidated subsidiaries will be affected indirectly (CESR, 2003a).

EU publicly traded companies will be required to comply with only those IFRS that have been endorsed by the European Commission (EC). The IFRS can only be endorsed if they:

1. are not contrary to EU Accounting Directives and the true and fair view principle;
2. are conducive to the European public good; and
3. meet the criteria of understandability, relevance, reliability, and comparability (EC, 2002, Article 3(2)).

The EC, following the recommendation of the Accounting Regulatory Committee, endorsed most of the IFRS, with the exception of certain provisions on the use of the full fair value option for liabilities and on hedge accounting in IAS 39, Financial Instruments: Recognition and Measurement. After the IASB published further amendments to IAS 39 in June 2005, the Commission decided to reininsert provisions relating to the application of the fair value option to liabilities. Many European banks and insurance companies objected to the IASB’s requirement for derivatives to be measured at market value.

The extension of the application of the IAS regulation in some Member States to unlisted firms and individual accounts has already been observed. The EC’s 2005 survey of the European

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1 International Financial Reporting Standards are standards issued by the International Accounting Standards Board (IASB). They include the International Accounting Standards and their interpretations adopted by the IASB from its predecessor, the International Accounting Standards Committee (IASC).

2 Daske (2005) investigated the economic benefits of adopting IFRS or U.S. GAAP. His study did not provide support for the hypothesis that the adoption of international standards should decrease the cost of equity capital for companies.

3 The Accounting Regulatory Committee operates at the political level under established EU rules for decision-making by regulatory committees and is composed of representatives of the Member States and chaired by the Commission. The function of the Committee is to provide an opinion on the Commission’s proposals to endorse IFRS.
Economic Area (EEA) countries\textsuperscript{4} indicates that virtually all of the 28 EEA members will permit IFRS for the consolidated statements of unlisted companies. Several Member States will require such statements from at least some unlisted entities. As for the individual financial statements of listed companies, 19 Member States will permit or require them at least for some companies (EC, 2005). The extension of the IAS regulation to individual financial statements in some Continental European countries, such as France and Germany, is not expected in the near future because these statements are used to determine taxable income.

In June 2003, the IASB issued IFRS 1, First-Time Adoption of International Financial Reporting Standards (IASB, 2003) to help companies with the transition to this new accounting framework. In accordance with IFRS 1, an enterprise applying IFRS for the first time must comply with all IFRS and interpretations in force at the time of the first adoption.

To facilitate a uniform enforcement of IFRS in EU Member States, the Committee of European Securities Regulators (CESR) issued a standard on a common approach to the enforcement of standards of financial information in Europe (CESR, 2003a). The standard contains 21 high-level principles of enforcement that Member States should adopt in enforcing IFRS. The International Audit and Assurance Standards Board (IAASB) also issued additional guidance on the audit of IFRS financial statements (IAASB, 2003).

In December 2003, the CESR published “Recommendation for Additional Guidance Regarding the Transition to IFRS,” which is linked with IFRS 1. The CESR recommends that the complex process of transition towards IFRS should be accompanied by a financial communication gradually preparing the markets to assess the impact of the transition on the consolidated financial statements. The first-time adopters are encouraged to explain the impact of adopting IFRS as soon as reasonably practicable (CESR, 2003b).

Proponents of accounting harmonization believe that comparability of financial statements worldwide is necessary for the globalization of capital markets. They suggest that there are many potential benefits that may arise from the use of one common set of accounting standards throughout the world. These include improved transparency, comparability and quality of financial reporting that lead to lower preparation costs, more efficient investment decisions and lower cost of capital for companies (Choi & Meek, 2005).

In the U.S., the Securities and Exchange Commission (SEC) requires foreign-listed companies to either (1) prepare financial reports in accordance with U.S. GAAP or (2) provide a detailed reconciliation of earnings and book values from foreign GAAP to U.S. GAAP in the Form 20-F. The SEC’s reason for requiring U.S. GAAP compliance is to protect U.S. investors by ensuring that all foreign companies listed in the U.S. provide comparable, high-quality financial reporting (Meek & Thomas, 2003). Since the reconciliation to U.S. GAAP is costly to prepare, foreign companies listed in the U.S. give a very high priority to removing reconciliation differences from their 20-F filing with the SEC (Walton, 2004).

Opponents of harmonization note the magnitude of the differences that exist between countries and the high cost of efforts to eliminate those differences. They argue that because of different environmental influences, differences in accounting across countries might be appropriate and necessary.

Regardless of the arguments against harmonization, most agree that “the question is no longer whether to strive for harmonization, but to what extent accounting practices can be harmonized.

\textsuperscript{4} The EEA includes the 25 EU countries as well as Norway, Iceland, and Liechtenstein. Since January 1, 1994, most of the single market legislation has also applied in the non-EU states of the EEA.
and how fast” (Doupnik & Perera, 2007). Global accounting convergence presents a number of challenges for companies involved, their auditors and all users of the financial statements. Despite the widespread adoption of IFRS, there is relatively little research on the actual problems which companies face in implementing these standards.

The objective of this study is to examine the process of implementing IFRS by European publicly traded companies, including the approach which these companies take to conversion, the impact of adopting IFRS on the financial statements, and the perceived benefits and challenges of implementing IFRS. The topic is timely because the prominence of IFRS is growing. In addition to mandatory reporting, voluntary reporting under IFRS is expected to increase significantly for companies seeking to raise capital in international markets.

Our study investigates the approaches that companies take in the conversion process. Listed EU companies, subject to the IAS regulation, can prepare consolidated financial statements under their national accounting standards and then convert them to IFRS. Alternatively, they can implement IFRS in the accounting process across the entire organization. The second option allows for harmonization of internal and external reporting.

We examine the impact of conversion on the financial statements. Traditional accounting systems in several EU countries, such as France and Germany, have been driven by emphasis on financial reporting conformity with tax regulations, conservatism, and broad-stakeholder orientation (Radebaugh, Gray, & Black, 2006). Since the domestic standards in these countries deviate from IFRS, it is expected that adoption of IFRS will be relatively more beneficial to investors in these countries and have a significant impact on the financial results. In addition, IFRS 1 gives companies a choice of accounting standards and policies during conversion which may affect future financial results.

We investigate how European companies perceive the benefits and challenges of implementing IFRS. Understanding these issues should be helpful to all users of the financial statements, including regulators facing decisions regarding individual accounts and unlisted companies.

This paper is based on a subset of the questions included in an electronic mail survey which we sent to EU-listed companies that already adopted IFRS (early adopters) as well as to those companies that were in the process of implementing IFRS by the 2005 deadline. In addition to the survey, several personal interviews were conducted with finance and accounting executives of European companies to discuss the issues of conversion to IFRS. This is an exploratory study with no a priori formulation of hypotheses because of at least two factors: (1) the experimental character of the EU approach to the accounting harmonization, and (2) the very broad and diverse spectrum of companies affected by the IAS regulation, representing various countries, industries, accounting traditions, and strategies.

The overall findings of our study suggest that the process of implementing IFRS is costly, complex and burdensome. Most companies implement IFRS for more than consolidation purposes. The more comprehensive the approach to conversion [beyond consolidated statements of a parent company], the more respondents tend to agree with the benefits and costs of the transition. The complexity of IFRS as well as the lack of implementation guidance and uniform interpretation are key challenges. Expected benefits of the change, including lower cost of capital, may not occur if subsidiaries are still required to prepare individual financial statements based on local GAAP that vary from IFRS. This study contributes to prior international accounting research by focusing on the experiences of EU companies implementing IFRS.

The remainder of this paper is organized as follows. Section 2 discusses relevant prior research. This is followed by a summary of the main provisions of IFRS 1, First-Time Adoption of IFRS, since one part of the questionnaire, directed to first-time adopters of IFRS, was developed based on
these provisions. Section 4 describes how the questionnaire was developed, tested, and distributed. An analysis of responses is presented in Section 5, followed by a discussion of the results and limitations of the study.

2. Literature review

Several studies have addressed issues related to accounting harmonization in Europe and its impact on comparability and transparency of financial statements. A study conducted by Street and Shaughnessy (1998) reported that at the beginning of the 1990s, numerous differences existed between international standards and the accounting standards of the major Anglo-American countries. Another study highlighted the significance of the enforcement issue for the IASC as it was seeking an International Organization of Securities Commissions (IOSCO) endorsement (Street & Bryant, 2000).

The research conducted by McLeay, Neal, and Tollington (1999) distinguishes harmonization from standardization and presents a method for measuring harmonization that allows for choice between alternative accounting treatments. Other approaches to studying country harmonization have used factor analysis to cluster countries based on the similarities of the accounting practices they follow (Doupnik, 1987; Doupnik & Taylor, 1985; Frank, 1979; McKinnon & Janell, 1984; Rahman, Perea, & Ganeshanandam, 1996). Kasanen, Kinnunen, and Niskanen (1992) tested alternative models for predicting IAS profit figures from financial statements based on (non-IAS) Finnish accounting regulations. Garrido, Leon, and Zorio (2002) introduced an index that allows for the measurement of formal accounting harmonization over time.

Several papers attempted to determine the level of accounting harmonization by examining selected measurement practices used by companies in Europe (Emenyonu & Gray, 1992, 1996; Herrmann & Thomas, 1995, 1996; Murphy, 2000; Van der Tas, 1988). These studies analyzed the annual reports from companies headquartered in different countries to determine the level of compliance between various accounting practices and the impact of adopting international standards on accounting harmonization.

The IAS regulation makes the application of IFRS compulsory for consolidated financial statements of EU-listed companies. For many years, however, European companies reported voluntarily under international standards. Studies have shown that a growing number of European companies, including multinationals, voluntarily adopted international standards before the IAS regulation, though compliance with these standards was not always as comprehensive in practice as claimed (Street & Gray, 2001; Street, Gray, & Bryant, 1999; Taylor & Jones, 1999). The findings from these studies offer mixed results about whether IFRS adoption improves accounting quality. Street and Gray (2001) examined the 1998 financial statements for 279 firms that referred to use of IFRS in their financial statements. The study revealed that, in many cases, disclosed accounting policies were inconsistent with IFRS. Research conducted by Schultz and Lopez (2001) suggests that uniform international accounting standards may not result in de facto uniformity among nations, particularly when the standards allow for significant discretion (ambiguity).

Prior research has identified several circumstances influencing voluntary adoption of IFRS by European companies: larger, more internationally diversified, and less capital-intensive Swiss firms with more diffuse ownership (Dumontier & Raffournier, 1998); EU firms with a lower debt-to-equity ratio (El Gazzar, Finn, & Jacob, 1999); Swiss firms with a higher percentage of foreign sales and a higher number of foreign exchange listings (Murphy, 1999); large German companies with a preference among managers for IFRS over U.S. GAAP (Glaum, 2000); firms with a U.S. or foreign exchange listing audited by large audit firms (Street & Gray, 2002); larger
EU firms with more geographically dispersed operations domiciled in countries with lower quality financial reporting as well as in countries where IFRS are explicitly allowed as an alternative to local GAAP (Cuijpers, Buijink, & Maijoor, 2003); and larger firms which have more foreign revenue and which are listed on one or more foreign stock exchanges (Tarca, 2004).

According to Ashbaugh (2001), non-U.S. firms are more likely to disclose IFRS or U.S. GAAP financial information when their equity shares trade in more foreign equity markets and when IFRS or U.S. GAAP results in more standardized financial information relative to their domestic-GAAP reports. The results also document that firms are more likely to disclose IFRS financial information when they are participating in seasoned equity offerings and when U.S. GAAP requires more disclosures and restricts accounting measure methods relative to the policies of their domestic GAAP. Ortiz (2005) analyzed European companies listed on the NYSE during the period 1997–2000 and reported that companies representing countries where national company law has been amended to allow the use of international standards in place of national GAAP prefer using U.S. GAAP. She expected that the situation will be different with the enactment of the IAS regulation.

Several studies have addressed the issue of whether presentation of financial statements under a single, global GAAP provides comparable and transparent financial information. Pownall and Schipper (1999) reported that existing research using Form 20-F reconciliations is limited to addressing the comparability of U.S. GAAP to other GAAP. These studies can provide only limited evidence on comprehensiveness, transparency, full disclosure, and rigorous interpretation and application of IFRS (Meek & Thomas, 2003). Research by Street, Nichols, and Gray (2000) suggests that the gap between IFRS and U.S. GAAP is narrowing and that the SEC should consider accepting IASC standards without condition. Other studies have found weak or no evidence that Form 20-F reconciliations are useful (Barth & Clinch, 1996; Davis-Friday & Rivera, 2000).

Various accounting items exhibit high-value relevance in common law countries that have effective judicial systems, better investor protection, and higher quality of accounting practices (including more transparent reporting) and auditing systems compared with code law countries. It is expected that the smaller the deviation of a domestic practice from the IFRS, the higher the value relevance of that practice. Accordingly, the EU countries with the largest deviation of a domestic practice from the IFRS should have the most to gain from transition to IFRS (Francis, Khurana, & Pereira, 2003; Hung, 2001). Prior research investigated problems associated with implementing the true and fair view requirement in the EU (Aisbitt & Nobes, 2001; Alexander & Archer, 2003).

Recent developments in the EU provide an opportunity to investigate the impact of the IAS regulation on national accounting standards. Previous studies have investigated issues related to possible consequences of the IAS regulation, including the costs involved and potential problems associated with the adoption of IFRS (Bradshaw & Miller, 2003; Cairns, 2003; Delvaille, Ebbers, & Saccon, 2005; Epstein & Mirza, 2006; Flower, 2004; Haller, 2002; Haller & Eierle, 2004; Mazars, 2003; Nobes & Parker, 2004; Stolowy & Jeny-Cazavan, 2001; Street & Larson, 2004; Van Hulle, 2004; Walton, 2004). Buchanan (2003) suggested that compliance, enforcement, and jurisdiction are among many issues that need to be resolved in the process of developing a single world standard. Larson and Street (2004) reported, based on the data collected by the largest international accounting firms during their 2002 convergence survey, that the two most significant impediments to convergence appear to be the complicated nature of particular IFRS (including financial instruments) and the tax-orientation of many national accounting systems.

A study conducted by Fearnley and Hines (2002) examined the attitudes of key players in implementing IFRS in the U.K. The research indicates that the regulators, auditors and com-
pany directors who were interviewed accept the concept of common global standards but do not believe that the standard of financial reporting in the U.K. will improve as a result of the IAS regulation. Doubts were expressed during interviews about Europe being the initial focus of a harmonization initiative, the feasibility of establishing common standards where there may be differences in interpretation and the consequences of possible convergence with U.S. GAAP. Our research continues work in the area of adopting IFRS and focuses on perceptions of EU publicly traded companies concerning implementation of IFRS. The issues related to this process are ongoing.

3. IFRS 1—First-Time Adoption of International Financial Reporting Standards

On June 19, 2003, the IASB issued IFRS 1, First-Time Adoption of International Financial Reporting Standards, to be effective for financial years beginning on or after January 1, 2004, although earlier adoption is encouraged (IASB, 2003). IFRS 1 provides the framework applicable to entities adopting IFRS for the first time as their basis of accounting. The standard explains the procedures that an entity must follow when it adopts IFRS for the first time as the basis for preparing its general-purpose financial statements. It requires retrospective application of each IFRS effective at the reporting date of an entity’s first IFRS compliant financial statements, with certain limited exceptions.

The standard defines a first-time adopter of IFRS as an entity that, for the first time, makes an explicit and unreserved statement that its general-purpose financial statements comply with IFRS. It also lists the following steps needed in the process of transition to IFRS:

1. Selection of accounting policies that comply with IFRS.
2. Preparation of an opening IFRS balance sheet at the date of transition to IFRS as the starting point for subsequent accounting under IFRS. The date of transition to IFRS is the beginning of the earliest comparative period presented in an entity’s first IFRS financial statements.
3. Determination of estimates under IFRS for both the opening IFRS balance sheet and other periods presented in an entity’s first IFRS financial statements.
4. Presentation and disclosure in an entity’s first IFRS financial statements and interim financial reports.

An entity must prepare an opening IFRS balance sheet at the date of transition to IFRS. The opening IFRS balance sheet is the starting point for the entity’s subsequent accounting under IFRS. In preparing its opening IFRS balance sheet, an entity will typically need to adjust the amounts that it reported previously for the same date using its previous GAAP. Adjustments required to move from previous GAAP to IFRS should be recognized directly in retained earnings or, if appropriate, another category of equity at the date of transition to IFRS.

In general, IFRS 1 requires IFRS effective at the reporting date of the entity’s first IFRS financial statements to be applied retrospectively, with certain limited mandatory and optional exceptions. An entity will be prohibited from retrospective application on issues related to: (1) financial instruments; (2) hedge accounting; and (3) estimates. Optional exemptions relate to areas where the cost of full retrospective restatement would outweigh the benefits (or restatement might be impossible). Optional exemptions include: (1) no restatement of business combinations; (2) deemed cost (fair value or prior revaluations) for certain non-financial assets; (3) cumulative actuarial gains and losses; (4) cumulative translation differences; (5) compound financial instruments; and (6) assets and liabilities of subsidiaries, associates, and joint ventures.
In many respects, entities are given a “fresh start” and will be required to redetermine their accounting policies under IFRS, fully restating past comparative information. The limited optional exceptions will also present some opportunities for entities to determine optimal outcomes. These choices of accounting policies under IFRS may have a significant impact on an entity’s future results.

4. Survey

We conducted an exploratory study to gain insight into the process of implementing IFRS by EU-listed companies from the perspective of companies that have already introduced these standards or are in the process of implementing them. To achieve our objective, we developed a questionnaire to gather information about the approach the companies take in adopting IFRS, the impact on their financial statements, and the costs and potential benefits to be gained. This paper is based on some of the results of this survey. We asked two practitioners from the IFRS Center of Excellence at the accounting firm Deloitte & Touche to comment on the instrument before it was administered. In addition to the questionnaire, several personal interviews were conducted with finance and accounting executives of EU-listed companies including Barco, Bekaert, Belgacom, Delhaize, Interbrew, and Solvay. Many telephone interviews were also conducted.

To pre-test our instrument, we sent the questionnaire to 20 large multinational corporations in spring 2004. From this pilot study, we learned that some companies have specific circumstances which were not taken into account in our instrument. The following two instances required modification of our questionnaire to accommodate future respondents with similar circumstances:

1. One company adopted IFRS in the mid-1990s, later switched to U.S. GAAP, and now has to switch to IFRS again under the IAS regulation.
2. Another company, a current user of U.S. GAAP, wanted to defer adoption of IFRS to 2007 but was unable to do so because the domestic legislation had not yet been changed to permit such a deferral.

After a slight modification of our instrument to accommodate these specific circumstances, we sent it to a large sample of companies described below. The survey was in English, although the cover letter accompanying the survey sent to Austrian, German, French, and Belgian companies was translated into German and French.

We surveyed 410 EU publicly traded companies listed on major European stock exchanges, such as the London Stock Exchange, German Deutsche Börse, Euronext-Paris, Euronext-Brussels, and EU companies registered with the U.S. SEC. The emphasis in our research was on conversion to IFRS in large public companies located in Western Europe. It did not include companies located in the 10 new EU Member States or candidate countries because of economics and the profession being in transition in these countries. From the population of companies listed on these stock exchanges and/or registered with the U.S. SEC, we contacted firms for which we were able to collect the name and the e-mail address of the Chief Financial Officer (CFO), Finance Director, or Controller. We acknowledge that this procedure resulted in self-selection of larger, more internationally oriented, and more public-relations savvy firms. The personalized cover letter with the information about the survey and the link to the questionnaire was distributed electronically in summer 2004 and the responses were collected until December 2004.
Table 1
Classification of respondents by country and timing of IFRS adoption

<table>
<thead>
<tr>
<th>Country</th>
<th>Early (pre-2004) adopters of IFRS</th>
<th>First-time adopters subject to IFRS 1</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>2</td>
<td>–</td>
<td>2</td>
</tr>
<tr>
<td>Belgium</td>
<td>7</td>
<td>15</td>
<td>22</td>
</tr>
<tr>
<td>Denmark</td>
<td>–</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>France</td>
<td>1</td>
<td>15</td>
<td>16</td>
</tr>
<tr>
<td>Germany</td>
<td>23</td>
<td>23</td>
<td>46</td>
</tr>
<tr>
<td>Ireland</td>
<td>–</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>–</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>U.K.</td>
<td>–</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Not stated</td>
<td>5</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>38</td>
<td>74</td>
<td>112</td>
</tr>
</tbody>
</table>

The survey was sponsored by the European Institute for Advanced Studies in Management (EIASM), in Brussels, Belgium, and the Fulbright Program. The instrument was posted on the EIASM web page at http://www.eiasm.org/ifrs.

5. Results

5.1. Respondents

By the end of December 2004, we received 112 responses; a 27% response rate.11 Eleven respondents preferred to remain anonymous and did not identify their firms. The respondents can be classified into two main groups: early (pre-2004) voluntary adopters of IFRS, and first-time adopters of IFRS, subject to IFRS 1. In Table 1, respondents are classified by country and timing of IFRS adoption.

All the identified early adopters in our sample are from the Continental European code-law countries with traditional creditor-protection-oriented accounting systems. It is worth mentioning that all these EU Member States, following the European Commission’s recommendation in the 1995 Communication “Accounting Harmonization: A New Strategy vis-à-vis International Harmonization,” and responding to the demand from their companies, adopted legislation that allowed listed companies to depart from the national rules on consolidation and to prepare their consolidated financial statements for domestic reporting purposes in accordance with IAS or U.S. GAAP (van Hulle, 2004).6

Table 2 provides further description of the respondents in terms of their industry, international status, listings, and who completed the questionnaire.

Table 3 presents descriptive statistics for several variables indicating size of the responding companies. The data, collected from external public sources, is presented by country and indicates average, minimum, and maximum net income, basic earnings per share (EPS), total assets, total equity, revenues, and number of employees, as reported in 2003 annual reports. For comparison,

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11 The early responses to the pilot study and the later responses to the modified instrument were not significantly different; therefore we decided to combine them into one sample.

6 The other countries which followed this policy were Finland, Italy, and Luxembourg. In Belgium, France, Germany, and Italy, the legislation was enacted in 1998 (http://www.iasb.org/about/history.asp). The application decrees, however, have never been adopted in France and Italy (Delvaille et al., 2005).
Table 2
Description of the respondents by industry, international status, listings, and the responding officer

<table>
<thead>
<tr>
<th>Industry</th>
<th>International status</th>
<th>Listings</th>
<th>Responding officer</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metals and mining</td>
<td>MNC</td>
<td>Domestic</td>
<td>Controller (Accounting Director)</td>
<td>57</td>
</tr>
<tr>
<td>Energy and utilities</td>
<td>Domestic</td>
<td>Domestic and other EU</td>
<td>CFO (Finance Director)</td>
<td>27</td>
</tr>
<tr>
<td>Construction</td>
<td>Not provided</td>
<td>Domestic and U.S.</td>
<td>Treasurer</td>
<td>2</td>
</tr>
<tr>
<td>Industrial manufacturing</td>
<td></td>
<td>Domestic, other EU, and U.S.</td>
<td>Other (usually the project manager responsible for implementing IFRS)</td>
<td>26</td>
</tr>
<tr>
<td>Automotive and transport</td>
<td></td>
<td>All categories of stock exchanges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td></td>
<td>Not provided</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electronics and computers</td>
<td></td>
<td></td>
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<tr>
<td>Telecommunication</td>
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<tr>
<td>Pharmaceuticals</td>
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<tr>
<td>Consumer products</td>
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<td>Media</td>
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<tr>
<td>Retail</td>
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<tr>
<td>Banking and insurance</td>
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<td></td>
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<tr>
<td>Investments and holdings</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Anonymous</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>112</td>
<td>112</td>
<td>112</td>
<td></td>
</tr>
</tbody>
</table>
Table 3
External 2003 data—descriptive statistics

<table>
<thead>
<tr>
<th>Country</th>
<th>Firms</th>
<th>Net income (€ in thousands)</th>
<th>Basic EPS</th>
<th>Total assets (€ in thousands)</th>
<th>Total equity (€ in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Minimum Mean Maximum</td>
<td>Minimum</td>
<td>Mean Maximum</td>
<td>Minimum Mean Maximum</td>
</tr>
<tr>
<td>Austria</td>
<td>2</td>
<td>59,447 84,932 110,417</td>
<td>1.71</td>
<td>8.95 16.18</td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>22</td>
<td>−62,448 322,386 2,197,400</td>
<td>−2.62</td>
<td>2.76 18.41</td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>2</td>
<td>241,736 47,078 652,420</td>
<td>1.11</td>
<td>1.51 1.91</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>16</td>
<td>−1,143,000 31,920 725,600</td>
<td>−4.88</td>
<td>1.22 9.64</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>46</td>
<td>−984,000 226,452 1,947,000</td>
<td>−2.58</td>
<td>1.79 5.74</td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>1</td>
<td>−815,400 815,400 815,400</td>
<td>−2.29</td>
<td>−2.29 −2.29</td>
<td></td>
</tr>
<tr>
<td>The Netherlands</td>
<td>2</td>
<td>4,043 349,521 695,000</td>
<td>0.54</td>
<td>1.27 2.00</td>
<td></td>
</tr>
<tr>
<td>U.K.</td>
<td>10</td>
<td>−2,093,172 −22,655 1,088,393</td>
<td>−0.58</td>
<td>0.13 0.46</td>
<td></td>
</tr>
</tbody>
</table>

| Country     | Firms | Revenues (€ in thousands) | Employees | |
|-------------|-------|----------------------------|-----------|
|             |       | Minimum Mean Maximum       | Minimum   | Mean Maximum                  |
| Austria     | 2     | 621,937 1,224,417 1,826,899 | 3,200     | 7,350 11,500                  |
| Belgium     | 22    | 30,409 6,400,667 50,094,500 | 78        | 28,850 141,711                |
| Denmark     | 2     | 3,564,406 5,297,791 7,031,177 | 20,725    | 22,363 24,000                 |
| France      | 16    | 12,745 6,473,598 30,133,000 | 139       | 26,838 110,000                |
| Germany     | 46    | 1,742 11,336,531 136,437,000 | 120       | 36,664 384,723                |
| Ireland     | 1     | 762,100 762,100 762,100    | 2,000     | 2,000 2,000                   |
| The Netherlands | 2 | 29,037,000 49,065,000 69,093,000 | 3,000     | 58,000 113,000                |
| U.K.        | 10    | 75,325 2,291,412 7,111,403  | 43        | 11,853 39,618                 |
all data is presented in euros, although Danish firms reported in Danish kroners and British firms reported in pounds.\(^7\)

To compare the size of the companies in the two sub-samples, that is the size of early adopters and first-time adopters, we performed a two-sample \(t\)-test for independent groups. Based on previous studies, we expected the early adopters to be larger (Dumontier & Raffournier, 1998; Glaum, 2000; Tarca, 2004). The test was performed for each of the variables presented in Table 3. Contrary to our expectations, the results show that average net income, EPS, total assets, total equity, revenues and number of employees for the two groups are not significantly different and we were not able to reject the null hypothesis.

Thirty-one companies in our sample had their 2003 consolidated financial statements in full compliance with IFRS. Four respondents were in double compliance with U.S. GAAP and IFRS, two in double compliance with national standards and IFRS, and one in triple compliance with national standards, U.S. GAAP, and IFRS.\(^8\) Among the 74 companies not in compliance with IFRS in 2003, 44 prepared their 2003 consolidated financial statements according to national standards, 14 used U.S. GAAP, 4 used national standards and U.S GAAP, and 3 used standards other than national, IFRS, or U.S. GAAP. Nine companies were in compliance with selected IFRS.

Twelve of the respondents qualified for the deferral of the application of certain provisions of the IAS regulation on the grounds of: (1) using another set of internationally accepted standards—eight companies; (2) issuing only publicly traded debt securities—one company; or (3) having another reason—three companies. Of the 12 companies qualifying for the deferral, 2 decided not to use this option and adopted IFRS earlier than required, that is in 2004.\(^9\)

One of the most interesting aspects of the implementation of the IAS regulation in the EU is the scope of the adoption of IFRS within groups of companies. We are particularly interested in the scope issue for two reasons. First is the fundamental question as to the future direction of accounting in Europe. Since in many Continental Member States a close link exists between accounting and taxation, the IAS regulation requires the adoption of IFRS only for consolidated statements. As a result, this regulation widened the disparity between consolidated and individual accounts and introduced the distinction between publicly traded and private companies. As of 2005, most EU countries at least permit the use of IFRS for the purpose of individual financial statements of listed firms. This policy was expected in the common law countries with an investor-oriented accounting system, such as the U.K. and Ireland, where national GAAP and IFRS are based on similar principles and serve similar objectives. Moreover, these countries have been actively pursuing convergence of their national GAAP with IFRS. U.K. and Irish firms have an option to adopt IFRS for individual accounts after considering costs, benefits, and timing of the transition. On the other hand, a significant number of predominantly Continental EU members, such as Austria, Belgium, France, and Germany, prohibit use of IFRS for individual financial statements. This policy is because of the distinctively statutory purpose of the individual accounts in these countries with traditional creditor-protection and stakeholder governance systems (Nobes, 1998). Nonetheless, some of these countries, for example, Germany, permit IFRS in secondary individual financial statements prepared for information purposes only.

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\(^7\) We used the December 31, 2003, exchange rates, that is 7.4461 for Danish kroner DKK per euro, and 0.7056 U.K. pounds per euro.

\(^8\) Among the early (pre-2004) adopters, 15 implemented IFRS before 2001, 4 in 2001, 5 in 2002, and 11 in 2003. Three of the early adopters did not indicate when the IFRS were implemented.

\(^9\) One of the respondents explained that the decision was made because their parent company was not allowed to defer the adoption of IFRS.
Second, there is also an information technology (IT) aspect to consider by companies implementing IFRS. Most European companies converting to IFRS in the late 1990s used to maintain one national GAAP-based bookkeeping system from which their individual and consolidated financial statements were prepared based on national (domestic) accounting standards. Next, in the last stage of the preparation of the financial statements, national GAAP-based statements were reconciled to IFRS-based consolidated statements. Recently, this approach has often been replaced with reconciliation between national GAAP and IFRS at the individual accounts level, followed by preparing consolidated financial statements compliant with IFRS from IFRS-based individual accounts. This is the most commonly observed approach to implementing IFRS among European companies today. However, this approach has some drawbacks, including the fact that backwards tracing of reconciling items when IFRS change may become quite burdensome. The most effective approach to implementing IFRS from the IT point of view would be a parallel running of the two accounting systems, based on the financial database. This approach, however, is currently not attainable for many companies because of its high cost (Barckow, 2005).

To gain insight into the approach to conversion made at the firm level, we asked whether the companies adopted IFRS for consolidation purposes only or also for individual accounts. In addition, we asked whether IFRS is adopted only for the parent company or for subsidiaries as well. Answers to the question about the approach to conversion within the group are presented in Table 4.

As indicated in Table 4, 48 respondents (43.6%) have adopted or plan to adopt IFRS for consolidation purposes only, while 62 (56.4%) of the companies use IFRS for multiple purposes. Thirty-six (32.7%) of the companies in our sample have used or will use IFRS for individual accounts of the parent company alone, or for individual accounts of the parent company and subsidiaries. Thirty-eight (34.5%) of the respondents indicated that their conversion process goes much further than external reporting, and IFRS-based information has been or will be used for internal management decision-making in the parent and/or subsidiary.

The only visible difference in responses to this question between early and first-time adopters is the increase in number of companies adopting IFRS for individual accounts of the whole group. There are only 2 early adopters (5.2%) using this approach while 13 first-time adopters (17.3%)

<table>
<thead>
<tr>
<th>Approach to conversion to IFRS</th>
<th>Early (pre-2004) adopters of IFRS</th>
<th>First-time adopters subject to IFRS</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adoption of IFRS for the consolidated accounts only</td>
<td>17</td>
<td>31</td>
<td>48</td>
</tr>
<tr>
<td>Adoption of IFRS for the consolidated accounts and individual accounts of the parent company</td>
<td>3</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>Adoption of IFRS for the consolidated and individual accounts of the parent company and subsidiaries</td>
<td>2</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>Adoption of IFRS for the consolidated accounts and for internal management use in the parent company and/or subsidiaries</td>
<td>10</td>
<td>15</td>
<td>26</td>
</tr>
<tr>
<td>Adoption of IFRS for the consolidated accounts and individual accounts of the parent company and for internal management use in the parent company and/or subsidiaries</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Adoption of IFRS for the consolidated and individual accounts of the parent company and subsidiaries, and for internal management use in the parent company and/or subsidiaries</td>
<td>6</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Total responses</td>
<td>38</td>
<td>72</td>
<td>110</td>
</tr>
</tbody>
</table>
opted for adoption of IFRS for individual accounts at the parent company and the subsidiaries level. We also looked more specifically at the choices made by the companies from the four EU countries for which we had most of the responses, that is Germany, Belgium, France, and the U.K. As the data presented in Table 5 indicate, about 30% of the respondents from these countries adopt IFRS for consolidated and individual accounts. Interestingly, the use of IFRS to prepare individual financial statements was most common among German groups, even though in Germany the original annual financial statements for the statutory purposes must be prepared based on German GAAP. To the contrary, almost all French respondents, except for one, use or intend to use IFRS for consolidation purposes only.

Further questioning of the first-time adopters indicated that 35 (47.3%) of those responding to the questionnaire either applied or intended to apply a parallel running of the IFRS system with the existing system. Thirty-one (42%) of the respondents did not use or plan to use parallel running. Among the companies applying parallel running, the most common answer to the question, “How long do you intend to run two systems?” was 1 year (13 responses); 5 companies answered 2 years. Several companies specified a much longer timeframe for parallel running, ranging from the year 2007 through less-defined future points in time described as, for example:

- Until U.S. GAAP is convergent with IFRS.
- As long as my company is obliged to submit two sets of financial statements (U.S. GAAP and IFRS).
- As long as IAS is not applicable for statutory purposes.
- As long as domestic GAAP is compulsory (for example, for tax statements); up to indefinite time horizons, described by such words as “indefinite” or “forever.”

5.2. Further questions to first-time adopters of IFRS

Of the 112 firms responding to the questionnaire, 74 identified themselves as first-time adopters, subject to IFRS 1. Only 15 (20%) of them would adopt IFRS voluntarily, if not required by the IAS regulation, while 52 (70%) stated explicitly that they would not (some commented about the complexity of IFRS and the high cost of implementation). Seven respondents did not answer this question. Eight respondents, mostly from Germany, indicated that they used IFRS at some time in the past but later switched to U.S. GAAP for U.S. listing purposes.

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10 None of the companies which adopted IFRS in 2003 identified itself as a first-time adopter of IFRS, subject to IFRS 1.
Table 6 Phases of the conversion project: advancement of the first-time adopters in 2004 vis-à-vis the KPMG timetable

<table>
<thead>
<tr>
<th>Phase</th>
<th>The KPMG timetable</th>
<th>Advancement of the conversion project in 2004 among the first-time adopters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raise awareness</td>
<td>2002</td>
<td>1</td>
</tr>
<tr>
<td>Assess</td>
<td></td>
<td>15</td>
</tr>
<tr>
<td>Design</td>
<td>2003</td>
<td>19</td>
</tr>
<tr>
<td>Implement</td>
<td>2004</td>
<td>32</td>
</tr>
<tr>
<td>Total first-time adopters</td>
<td></td>
<td>67</td>
</tr>
</tbody>
</table>

We asked the first-time adopters what phase of the conversion process their company was in at the time they were surveyed. The objective of this question was to assess the readiness of the firms to comply with IFRS at the time the IAS regulation takes effect. This is particularly important to the financial analysts following the firms and to the current and potential investors. In the questionnaire, we adopted the phases of the conversion project from the international accounting firm KPMG (2002). KPMG, one of the firms offering global conversion services to companies adopting IFRS, broke down the conversion project into key phases related to scoping and execution, and established a timetable for developing IFRS competencies. We compared the responses with the KPMG timetable in Table 6. Although the responses were collected in 2004, one of the first-time adopters was still in the phase of raising awareness about the conversion. Fifteen firms were going through the assessment, 19 through the design, and 32 through the implementation phase. Seven first-time adopters did not answer this question. The procrastinators were not from any one particular country.

In light of these answers, it was not surprising that only 27 (36.5%) of the first-time adopters responding to our questionnaire believe that their analysts and shareholders are aware of the impact of IFRS on their financial results. Thirty-nine (52.7%) of the first-time adopters stated that they are not aware of this impact, and eight first-time adopters did not answer this question.

Respondents most often listed the Chief Financial Officer or Chief Accountant (Controller) as the person responsible for the conversion project. Some firms designated an IAS project manager or accounting policies manager to oversee the transition to IFRS. In other organizations, the responsibility for the conversion was placed higher, with such officers as VP Global Financial Reporting, VP Consolidation and Financial Reporting, Senior VP Corporate Accounting and Tax, VP Accounting, or Director of International Accounting. In one instance, external consultant was listed as the person responsible for the conversion project.

Fifty-four (73%) of first-time adopters use or will use external expertise during the conversion project, while 20 (27%) do (will) not. Of the 54 respondents using external expertise, 31 use their current external auditor in this capacity, but 17 respondents use a different external conversion expert than their current auditor. Two respondents audited by KPMG indicated that they have not yet decided whom to employ in the external conversion expert capacity. One respondent answered that they will use a number of sources but did not specify any. Three of the respondents

11 In some cases, where the company is audited by multiple auditors, one of them was indicated as an external conversion expert.
12 In 13 cases, the external conversion expert is one of the Big Four firms, but different than the auditor, while in 2 cases it is a local consulting firm—in 1 case a consultant and in 1 case a commissioner.
Table 7 summarizes the provisions of IFRS 1 that companies applied during conversion. The table indicates that recognition of new assets and liabilities, as well as reclassification, apply to many more companies than derecognition of old assets and liabilities. Recognition of derivative financial assets and liabilities, deferred tax assets and liabilities, reclassification of identifiable intangible assets, and recognition of liabilities under a defined benefit plan are the provisions of IFRS 1 that apply to the largest number of first-time adopters of IFRS responding to our questionnaire. This information indicates that many EU companies in conformity with IFRS 1 are adopting a new approach to financial reporting that will have a significant impact on their financial statements.

Companies adopting IFRS can take advantage of one-time exemptions that may affect their financial results. Fifty-four first-time adopters (73%) in our sample indicated that they expect to take advantage of at least one of the optional exceptions to the basic measurement principle in IFRS 1. The most common exception is not to restate business combinations that occurred before the opening balance sheet date. Thirty-nine (52.3%) of the first-time adopters will take advantage of this option. Twenty-six (35%) of the companies will recognize cumulative actuarial gains and losses for defined benefit plans at the opening IFRS balance sheet date. Twenty-two (29.7%) of the companies will measure property, plant, equipment, and intangible assets or investment property at their fair value at the opening IFRS balance sheet date. Twenty (27%) of the companies will not recognize all translation adjustments in accumulated profits or losses at the opening IFRS balance sheet date. Only 3 (4%) of the companies will take advantage of all 4 optional exceptions, but 37 (50%) will take advantage of more than 1 exception. Twenty (27%) of the respondents did not indicate any of the optional exceptions to be used by their company. These limited optional exemptions present some opportunities for companies to determine optimal outcomes.
We also asked about new areas of disclosure to be added under IFRS that were not required under the previous GAAP. Thirty (40.5%) of the respondents will have to disclose for the first time fair values of all financial instruments. Fifteen (20.2%) of the first-time adopters will have to add discontinued operations disclosure, 19 (25.7%) segment disclosure, 7 (9.5%) the EPS disclosure, 3 (4%) contingencies disclosure, and 11 (14.8%) of the firms will add some other disclosure. Forty (54%) of the first-time adopters in our sample will have to add at least one new area of disclosure, while 26 firms (35%) will have to add multiple new disclosures. All these changes should lead to more transparency in financial reporting.

5.3. Impact of implementing IFRS on financial results

As noted above, the impact of the implementation of IFRS on firms’ financial results and position is expected to be significant, particularly in Continental European countries. Traditionally, in these countries legal compliance with emphasis on capital maintenance and creditor-protection was of greater importance than fair presentation. We asked the companies to assess the impact of First-Time Adoption of IFRS on their: (1) equity at the date of the opening IFRS balance sheet; (2) earnings and equity at the end of the first year of reporting under IFRS; and (3) earnings in the second and third years of reporting under IFRS.

For all these financial variables, more respondents indicated that the impact of adopting IFRS would be positive rather than negative. Most companies included in our sample responded that IFRS-based equity is expected to be higher than national GAAP-based equity. This result is despite the fact that a majority of companies was expected to begin recording stock options as expenses, booking pension obligations and deferred taxes as liabilities (PriceWaterhouseCoopers, 2003). On average, stockholders’ equity of companies in our sample which had already adopted IFRS (early adopters) increased 11%, although for some companies stockholders’ equity decreased (for example, due to recording extra pension obligations). We tested whether the fact that most of the companies in our sample are from Continental Europe, where more conservative measurement practices prevail, affected their responses. Our non-parametric tests did not detect any significant correlation between the countries of domicile for our responding companies and their changed financial position and results under IFRS.

Only a few companies in the process of implementing IFRS (first-time adopters) provided us with a dollar estimate of the expected impact of conversion to IFRS on earnings and equity. The amounts were consistently larger, in relative terms, for early adopters than for first-time adopters. It is possible that over time the first-time adopters, anticipating the IAS regulation, have been making accounting policy choices minimizing the differences between national GAAP and IFRS.

Factors that might lead to increased volatility in financial results, as compared to results that would have been reported under national standards, include:

- recognition of more financial assets and liabilities (including derivatives) at fair value;
- tougher rules on the requirement to record special-purpose vehicles or similar structures on balance sheet;
- more rigorous asset impairment reviews;
- a compulsory annual impairment test of goodwill; and
- the requirement to recognize actuarial gains and losses in the financial statements.

Consequently, net income and net assets, key inputs in financial ratios assessing performance, could look significantly different under IFRS.
### 5.4. Expected benefits and costs of the conversion to IFRS

Based on the literature review, we asked 15 questions about expected benefits and costs of the conversion to IFRS. The answers were measured on a five-point Likert scale from Strongly Agree (1) to Strongly Disagree (5). In Table 8, we present the mean, standard deviation, and mode (most frequent answer) for each of the 15 statements, separated into 7 expected benefits and 8 expected costs categories. The lower the score, the more the respondents agreed with the statement; the higher the score, the more the respondents disagreed with the statement.

As for the benefits of conversion to IFRS, on average the respondents agreed with the proposition that adoption of IFRS would result in: (1) better comparability with other businesses (mean response 2.28; mode 2), and (2) greater transparency (mean response 2.50; mode 2). The statements that the respondents disagreed with (or were undecided about) the most were: (1) the conversion would lower the cost of capital (mean response 3.12; mode 3), and (2) the conversion would improve quality and timeliness of management information (mean response 3.00; mode 4). The lack of agreement with the proposition that the conversion will lower the cost of capital is unexpected since this factor has often been cited as a benefit of global accounting harmonization (KPMG, 2000). Our data show that of 107 respondents who answered this question, 45 (42%) either disagreed or strongly disagreed that conversion to IFRS would lower the cost of capital, 40 (37%) were undecided, and only 22 (21%) either agreed or strongly agreed with this argument. These results confirm the conclusions reached in a prior study conducted by Daske (2005) which indicated that the change to IFRS does not necessarily result in a decrease in the expected costs of equity capital.

#### Table 8
Expected benefits and costs of conversion to IFRS: descriptive statistics

<table>
<thead>
<tr>
<th>Expected benefits/costs of the conversion to IFRS to your company?</th>
<th>Mean</th>
<th>S.D.</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expected benefits</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Greater access to capital</td>
<td>2.88</td>
<td>1.21</td>
<td>2</td>
</tr>
<tr>
<td>2. Lower cost of capital</td>
<td>3.12</td>
<td>1.16</td>
<td>3</td>
</tr>
<tr>
<td>3. Increased cross-border listings and investment opportunities</td>
<td>2.85</td>
<td>1.26</td>
<td>3</td>
</tr>
<tr>
<td>4. Better comparability with other businesses</td>
<td>2.28</td>
<td>1.08</td>
<td>2</td>
</tr>
<tr>
<td>5. Greater reporting transparency</td>
<td>2.50</td>
<td>1.18</td>
<td>2</td>
</tr>
<tr>
<td>6. Improved quality and timeliness of management information</td>
<td>3.00</td>
<td>1.19</td>
<td>4</td>
</tr>
<tr>
<td>7. Harmonization and streamlining of internal and external reporting</td>
<td>2.72</td>
<td>1.26</td>
<td>2</td>
</tr>
<tr>
<td><strong>Expected costs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. High cost of transition</td>
<td>2.35</td>
<td>1.00</td>
<td>2</td>
</tr>
<tr>
<td>9. Tied up resources</td>
<td>2.23</td>
<td>0.84</td>
<td>2</td>
</tr>
<tr>
<td>10. Increased volatility of earnings and balance sheet items</td>
<td>2.35</td>
<td>1.10</td>
<td>2</td>
</tr>
<tr>
<td>11. Financial arrangements, in place with covenants linked to reported profits or net assets, are expected to be breached as a result of conversion to IFRS</td>
<td>3.17</td>
<td>1.16</td>
<td>3</td>
</tr>
<tr>
<td>12. Our share option plans and/or other incentive plans tied to reported profits will be significantly affected by the adoption of IFRS and we have to change the provisions in these plans</td>
<td>3.19</td>
<td>1.22</td>
<td>3</td>
</tr>
<tr>
<td>13. We have to change our tax strategies as an effect of IFRS adoption</td>
<td>3.55</td>
<td>1.21</td>
<td>4</td>
</tr>
<tr>
<td>14. We have to change our dividend policy as an effect of IFRS adoption</td>
<td>3.76</td>
<td>1.17</td>
<td>4</td>
</tr>
<tr>
<td>15. Our existing information system requires significant enhancements to support the IFRS financial statements</td>
<td>2.44</td>
<td>1.19</td>
<td>2</td>
</tr>
</tbody>
</table>

Values used: Strongly Agree—1; Agree—2; Undecided—3; Disagree—4; Strongly Disagree—5.
In terms of costs of conversion to IFRS, on average the respondents agreed mostly with: (1) tied up resources (mean response 2.23; mode 2), (2) high cost of transition (mean response 2.35; mode 2), and (3) increased volatility of earnings and balance sheet items (mean response 2.35; mode 2). Most respondents disagreed with the proposition that their respective companies had to: (1) change their dividend policy as an effect of IFRS adoption (mean response 3.76; mode 4), and (2) change their tax strategies as an effect of IFRS adoption (mean response 3.55; mode 4). This result is because dividend policy and tax strategies are based on individual accounts and only about 33% of our respondents prepare or will prepare these accounts based on IFRS.

We used a chi-square statistic to test for independence between the approach to conversion to IFRS adopted by the respondent companies (Part II of the questionnaire—Table 5) and the perceived benefits and costs of the conversion (Part VII of the questionnaire—Table 8). We expected that the answers to these two sets of questions would not be independent. In addition, we applied the Spearman’s rank-order correlation and Kendall’s Tau-\(b\) statistics to measure the direction of the association between these responses.\(^{13}\) We assumed that the approach to conversion is an ordinal variable and assigned ranks to the responses in such a manner that the more far-reaching the adoption of IFRS within the organization (that is going beyond consolidated accounts of a parent company), the higher the rank assigned to the answer.\(^{14}\) As described above, expected costs and benefits of IFRS to the organization were measured on the five-point Likert scale. The results are presented in Table 9.

The results reported in Table 9 confirm our expectations. The answers the respondents gave to our questions about the approach to conversion to IFRS and expected benefits and costs of conversion were not independent for propositions 8, 7, 9, 1, 15, 6, 2, and 5 at the 1% significance level, for proposition 4 at the 5% significance level, and for propositions 3 and 12 at the 10% significance level. The null hypothesis of independence could not be rejected for propositions 10, 11, 13, and 14. Furthermore, for almost all propositions, the measures of association we used show discordant observations, that is, a higher ranking on one variable is accompanied by a lower ranking on the other variable. The highest negative correlation is observed for proposition 8. This means that the more far-reaching the implementation of IFRS throughout the group of companies, the more the respondents agreed that the transition is costly. In general, the more comprehensive the approach to conversion is within the group, the more the respondents tend to agree with the benefits and costs of the transition. Positive correlations are observed only for propositions 6 and 13. In the first case, the correlation is very weak; and in the second, the chi-square statistic is insignificant.

5.5. Challenges of implementing IFRS

Respondents listed various obstacles to implementing IFRS in their organizations. This information can be of importance to other companies implementing IFRS as well as standard-setters and regulators around the world. The responses listed most often appear in Table 10.

The standards that were listed as the most complex include two standards on financial instruments, IAS 32 and IAS 39. Other standards listed as complex were IAS 12 (Accounting for Taxes

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\(^{13}\) These measures range from \(-1.0\) to \(1.0\), with values close to \(1.0\) indicating a positive (concordant) association and values close to \(-1.0\) indicating a negative (discordant) one (Emory & Cooper, 1991).

\(^{14}\) The lowest rank 1 was assigned to companies adopting IFRS for the consolidated accounts only, while the highest rank 7 was assigned to companies adopting IFRS for consolidated and individual accounts of the parent company and the subsidiaries, and for internal management use in the parent company and/or subsidiaries.
Table 9
Tests of independence and association between the approach to conversion to IFRS and the expected benefits and costs

<table>
<thead>
<tr>
<th>Expected benefits and costs</th>
<th>Measure of independence</th>
<th>Measures of association</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value</td>
<td>Probability</td>
</tr>
<tr>
<td></td>
<td>chi-square</td>
<td></td>
</tr>
<tr>
<td>Greater access to capital</td>
<td>80.46</td>
<td>0.0009</td>
</tr>
<tr>
<td>Lower cost of capital</td>
<td>75.65</td>
<td>0.0029</td>
</tr>
<tr>
<td>Increased cross-border listings and investment opportunities</td>
<td>60.26</td>
<td>0.0637</td>
</tr>
<tr>
<td>Better comparability with other businesses</td>
<td>69.92</td>
<td>0.0101</td>
</tr>
<tr>
<td>Greater reporting transparency</td>
<td>70.00</td>
<td>0.0099</td>
</tr>
<tr>
<td>Improved quality and timeliness of management information</td>
<td>78.00</td>
<td>0.0016</td>
</tr>
<tr>
<td>Harmonization and streamlining of internal and external reporting</td>
<td>88.21</td>
<td>0.0001</td>
</tr>
<tr>
<td>High cost of transition</td>
<td>79.94</td>
<td>&lt;0.0001</td>
</tr>
<tr>
<td>Tied up resources</td>
<td>76.10</td>
<td>0.0001</td>
</tr>
<tr>
<td>Increased volatility of earnings and balance sheet items</td>
<td>48.97</td>
<td>0.3168</td>
</tr>
<tr>
<td>Financial arrangements, in place with covenants linked to reported profits or net assets, are expected to be breached as a result of conversion to IFRS</td>
<td>49.20</td>
<td>0.3088</td>
</tr>
<tr>
<td>Our share option plans and/or other incentive plans tied to reported profits will be significantly affected by the adoption of IFRS and we have to change the provisions in these plans</td>
<td>59.49</td>
<td>0.0725</td>
</tr>
<tr>
<td>We have to change our tax strategies as an effect of IFRS adoption</td>
<td>43.46</td>
<td>0.1835</td>
</tr>
<tr>
<td>We have to change our dividend policy as an effect of IFRS adoption</td>
<td>45.72</td>
<td>0.1286</td>
</tr>
<tr>
<td>Our existing information system requires significant enhancements to support the IFRS financial statements</td>
<td>69.67</td>
<td>0.0006</td>
</tr>
</tbody>
</table>

Table 10
Major challenges to implementing IFRS as listed by respondents

- Complex nature of IFRS, which is made for big companies
- Lack of IFRS implementation guidance
- Lack of uniform interpretation of IFRS
- Final rules not being ready for the 2005 deadline
- Impact on profit and loss account
- Continuing debate of IAS 39
- Constant change of IFRS, transformation of IASB decisions in EU Regulations
- Running of parallel accounting systems
- Preparation of comparative financial statements for the past years
- Lack of IFRS knowledge among employees and auditors
- Training of accounting staff and management
- To change the mindset of finance personnel
- Change of the IT structure
on Income), IAS 19 (Employee Benefits), IAS 36 (Impairments of Assets), IAS 38 (Intangible Assets), IFRS 2 (Share-Based Payments), and IFRS 3 (Business Combinations).

In the last question, we asked how long the process to converge U.S. GAAP with IFRS would take. The SEC is considering whether to adopt IFRS for listing and raising capital in the U.S. without required reconciliation. Even if the SEC does not adopt IFRS, convergence between IFRS and U.S. GAAP may lead to a situation where no major differences will be left to report in the 20-F filing. Most respondents, 50 (or 44.6%), thought that it would take 5–10 years. Other responses were as follows: 36 (32.1%) responded that it would take less than 5 years; 7 (6.3%) responded that it would take more than 10 years; and 19 (17%) had no opinion.

6. Discussion and limitations

6.1. Discussion

This study examined implementing IFRS by EU publicly traded companies as required by the IAS regulation. The regulation gives Member States an option to extend this requirement to individual (separate) financial statements and to unlisted companies. Most Continental EU members with a close link between financial reporting and taxation permit the individual financial statements in accordance with IFRS but only for additional disclosure purposes.

A majority of companies included in our study implemented or are in the process of implementing IFRS for more than just consolidation purposes, with an ultimate goal of achieving harmonization of internal and external reporting. In the development of their information systems during conversion to IFRS, European managers face “an important choice between integrating external and internal reporting in ways that might fundamentally change established controlling practices, or of continuing to operate dual accounting systems in much the same way as in the past so that adoption of IFRS is restricted to external reporting” (Jones & Luther, 2005). A large percent of our respondents indicated that IFRS-based financial statements have been or will be used not only for external reporting but also for internal decision-making and performance measurement processes in the parent and subsidiaries. This approach to adopting IFRS may prompt an integration of financial accounting and management accounting practice in European companies or even lead to an external reporting/financial accounting domination of internal reporting/management accounting as noted by Johnson and Kaplan (1987).

Many EU-listed companies, particularly in Continental Europe, will continue to prepare their individual accounts according to national accounting standards, since those accounts, based on national accounting standards, are used for purposes of taxation, profit distribution, and financial services supervision. Thus, the listed companies will bear a costly parallel running of two accounting systems. The findings from our study confirm similar conclusions reached in prior research which indicated that implementing IFRS for consolidated statements and allowing countries to require national GAAP for individual accounts adds complexity to accounting systems and constitutes an impediment to global accounting harmonization (Haller, 2002; Larson & Street, 2004). The supposed reduction in costs for multinationals may not materialize if subsidiaries based in the EU are still required to produce their own accounts to local requirements which vary from IFRS (Fearnley & Hines, 2002).

The IAS regulation should lead to greater harmonization with respect to the consolidated statements of listed companies because there are fewer options in IFRS as compared to the EU directives. However, the regulation may lead to a reduction in the level of harmonization between consolidated and individual financial statements as well as between those of publicly traded and
private companies, depending on how the Member States implement the available options. It is unlikely that Member States in which taxation is based on the individual accounts (most of the countries of Continental Europe) would permit these accounts to be based on IFRS. However, other countries may permit the use of IFRS for individual accounts (e.g., the U.K.) since cost savings can be made by using the same standards for both the consolidated and individual financial statements.

Germany permits companies to prepare individual financial statements in accordance with IFRS but only for additional disclosure purposes. In France, the President of the Conseil Nationale de la Comptabilité, the French standard-setting body, made the following comment concerning individual accounts: “...taking into account the institutional context in France, the CNC’s position is not to propose the application of the IASB’s standards for the individual accounts. The CNC... does not envisage at this stage, a separation of the individual accounts from the tax accounts... other rules of company law depend on the individual accounts, such as the determination of distributable profit, the calculation of the workers’ share in a company’s profits, the rights of creditors, the procedures to be followed for companies in difficulty...” (Delesalle, 2002). In contrast to France, the U.K. has indicated that all companies will be given the option of using IFRS or both the individual accounts and the consolidated accounts (Flower, 2004).

Interesting developments have been taking place in Italy. The Italian government has decided to make adoption of IFRS in individual accounts voluntary in 2005 but mandatory from 2006. To make the implementation of IFRS possible in Italy, the government modified both the civil code and the fiscal code (CBSO, 2005).

These decisions made at the governmental level in Italy are rather unexpected as this is a code-law country with a regulatory accounting system. The Italian accounting practices, however, were always shaped by various economic and political forces, and the situation is not any different in the 21st century. It could be argued that a full implementation of IFRS could affect a country’s reputation as a modern, organized and well-regulated place to do business. Furthermore, after a series of corporate scandals, some governments may want to distance themselves from any accounting standard-setting. Also, compulsory IFRS at the individual entity level could help not only to streamline the internal decision-making process within the group, but also to improve enforcement of the standards and to strengthen the oversight over the companies.

Another issue arising from the IAS regulation, which is only indirectly related to our study, is the impact of this regulation on unlisted companies. In most countries in the EU, unlike in the U.S., all or most companies are legally required to prepare financial statements in accordance with national GAAP. The great majority of these companies are small or medium-sized entities (SMEs). In the EU the IASB Standards will be required for consolidated financial statements of approximately 7000 listed companies while more than 7,000,000 unlisted SMEs will most likely follow national standards, based on the EU’s directives, not providing a satisfactory level of international comparability (Flower, 2005).

Since IFRS are complex and costly to implement, many regulators and preparers of financial statements see the need for a separate set of internationally accepted accounting standards suitable for SMEs. The IASB has an active project on international accounting standards for SMEs, with the likely result that these entities will eventually have the option of using a set of standards aimed specifically at smaller entities and aligned with IFRS. Over time, convergence between national GAAP and IFRS, as well as new solutions for organizing the tax computation in EU Member States should reduce the complexity and cost of financial reporting and improve comparability of financial reports among companies.

The impact of implementing IFRS on the financial statements is significant. For most companies in our sample, IFRS-based stockholders’ equity is or is expected to be higher than equity based on
national accounting standards. Our research reveals a consistent effect of the financial statement impacts of conversion from a stakeholder-oriented accounting system existing in most Continental European countries to the shareholder-oriented IFRS. On First-Time Adoption of IFRS, companies have a choice of accounting policies under IFRS, which may have a significant impact on their future financial results. In many respects, companies are given a fresh start and are required to redetermine their accounting policies under IFRS, fully restating past comparative information. The limited optional exceptions present some opportunities for companies to determine optimal outcomes.

Most respondents believe that the change in accounting and reporting under IFRS, including the robust disclosure requirements, should improve comparability among listed companies and improve financial transparency. The stated benefits of the change, such as a lower cost of capital or improved quality and timeliness of management information, are questioned by many. Several important decisions within companies, including profit distribution policy and tax strategies, will still be based on individual accounts prepared in accordance with national accounting standards.

There is general consensus that the transition to IFRS is a costly, complex and burdensome process. For this reason a majority of companies in the process of conversion to IFRS by the 2005 deadline responded that they would not adopt IFRS if not required by the IAS regulation. One key problem in conversion to IFRS is use of fair value as the primary basis of asset/liability measurement. The IASB advocates its fair value approach on the grounds of relevance, but this approach is expected to bring increased volatility in the reported values of assets as well as earnings. Major changes to the performance-based executive and employee compensation systems may be required.

There is a general consensus that one of the most important challenges in implementing IFRS is the complex nature of these standards. This complexity has contributed to the costs and efforts involved in financial reporting which often fall disproportionately on smaller public and private companies. Standards on financial instruments, IAS 32 and IAS 39, were most often cited as very complex to implement in practice. Our study, although conducted 2 years later, confirms conclusions based on the 2002 convergence survey conducted by the six largest international accounting firms that the complicated nature of particular IFRS (including financial instruments) is a significant barrier to convergence (Larson & Street, 2004).

The lack of implementation guidance and differences in interpretation of IFRS are other obstacles to accounting convergence. Schipper (2005) described several implementation effects associated with the adoption of IFRS in the EU, including a possible increased demand for detailed implementation guidance. If the IASB declines to respond to demands for detailed implementation guidance, preparers will look to U.S. GAAP or national GAAP for guidance, diminishing comparability, and convergence. According to Hoogendoorn (2006), there is an area of tension between a principles-based interpretation of IFRS and a rules-based interpretation. Trying to avoid diversity in practice results in a rules-based approach. In his opinion, IFRS should be more principles-based and less complex.

The consensus view of respondents is that a lack of adequate education, training, and knowledge of IFRS are important challenges of conversion. A training program for staff across a company is needed to let them adopt an entirely different system of business operations, performance measurement, and communication with the markets. This training will be an ongoing exercise since IFRS is a moving target. Audit firms play the crucial role in this training program. The involvement of auditors is so significant that they run the risk of becoming heavily involved in preparing the financial statements they are required to audit. This is mainly caused by the complexities of IFRS where many entities, especially smaller listed entities, lack sufficient expertise (Hoogendoorn, 2006).
The consequences of implementing IFRS will undoubtedly go far beyond a simple change of accounting rules by the companies concerned (Eichhorst, Steen, van der Tas, & Smits, 2002). It is critical that European standard-setters and legislators act now to determine the future of accounting and financial reporting in their countries. But the future of financial reporting will also be shaped by the preparers themselves. Many decisions as to the process of implementation of IFRS have been left to the companies. It is vital that company management recognize the far-reaching impact that IFRS will have on business.

A number of issues raised in this study would benefit from further research. Some respondents expressed doubts as to whether common standards within the EU can be achieved due to differences in interpretation and the lack of implementation guidance. Research is needed to analyze the impact of differences between IFRS and national GAAP on accounting convergence. Finally, common accounting standards create the need for a common approach to auditing and enforcement within the EU, currently determined at the national level.

6.2. Limitations

Our sample may not be representative of the population of all 7000 firms subject to the IAS regulation. Firms which responded to our survey are mostly large multinational corporations. We targeted this group of firms for two reasons: (1) it is easier to find information about such firms, including the name and e-mail address of the person who would be the addressee in the cover letter, and (2) such firms are better prepared for conversion to IFRS and would be more willing to respond to a survey. Our response rate as of December 2004 was over 27%, but 38 (34%) of the respondents were already in full compliance with IFRS in their 2003 financial statements. This may indicate a self-selection bias in our sample.

Also, our instrument was long and perhaps too time-consuming to complete. And finally, as always, there is a limitation typical to all surveys, the response error resulting from respondents failing to report fully and accurately.

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References


15 We tried to improve the response rate by resending the cover letter and instructions to those companies that did not respond within a few weeks.


