WHY IFRS – REASONS FOR TRANSITION

Olivera Gorgieva-Trajkovska, assistant professor, University "Goce Delcev" Stip, Faculty of Economics, Republic of Macedonia

Aleksandar Kostadinovski, assistant professor, University "Goce Delcev" Stip, Faculty of Economics, Republic of Macedonia

Abstract

The ultimate goal of a transition to IFRS- International Financial Reporting Standards is the process of application of a single set of global accounting standards, which will produce high quality, transparent financial information. This is to help investors and other stakeholders in the world's capital markets to make efficient economic decisions, based on financial data which are easily and directly comparable. Many believe this is a necessity for a vital and growing global economy, but they are also aware of many problems and constraints. There are a lot of reasons "why to move to IFRS", which are subject of this paper.

Key words: international financial reporting standards, transition, reasons

Introduction

The efforts for successful conversion to International Financial Reporting standards (IFRS) are characterized by a thorough strategic assessment, creation of a robust step-by-step plan, alignment of resources to the efficient execution of the plan, and smooth integration of the change into normal business operations. In a business-wide conversion, all departments that contribute to the creation of financial information, or that use financial information in their daily activities, should be involved. Adopting IFRS will likely impact key performance metrics, requiring thoughtful communications plans for the managers, shareholders and other key stakeholders. Internally, IFRS could have a broad impact on a company's infrastructure, including underlying processes, systems, controls, and even customer contracts and interactions. The full benefits of such a global benchmark will be realized only when it is implemented around the world in a consistent manner. Many developing countries and countries with economies in transition lack the accounting infrastructure and professional institutions needed for building the technical capacity required to meet the challenges posed by the transition to a common set of global standards – standards that are formulated with developed markets in mind and which have been becoming increasingly sophisticated.

Conversion experience in Europe, as well as in other parts of the world, shows that conversion projects often take more time and resources than anticipated. Historically, that has led some companies to rush and risk mistakes or outsource more work than necessary, driving up costs and hindering the embedding of IFRS knowledge within the company.

Reasons and advantages of adopting IFRS

Why IFRS? Simple answer to this question is that IFRS is acceptable globally and provides a common accounting/reporting language to the world! The history and development of international standards for accounting and auditing trails back all the way to the late 1960s, but never have they reached greater prominence than today as the world moves closer towards international convergence.

A key moment in the move to IAS/IFRS came on 6th June 2002 when the European Council of Ministers approved the regulation that would require all EU companies listed on a regulated market to prepare accounts in accordance with International Accounting Standards, for accounting periods beginning on or after 1 January 2005.

With over 100 countries requiring or accepting International Financial Reporting Standards, the likelihood of companies around the globe using the same accounting standards is in view. Never in history has there been a time when we were closer to the ideal where companies around the globe all use the same accounting standards in their financial reporting. International Financial Reporting Standards (IFRS) are now required or accepted in over 100 countries, and some estimate that number will grow to 150 countries in the next few years.

For accounting standards to garner worldwide acceptance they must be universally applied. Comparability is essential if "in accordance with IFRS" means that the same or similar transactions are accounted for the same way everywhere, producing financial statements in accordance with IFRS will add value. Investors would no longer need to waste time and effort to reconcile financial information as they compare similar companies from different countries. Capital would flow more efficiently, at less cost to more companies in more places.

Financial statements prepared according to globally accepted standards are easier to analyze and understand for foreign stakeholders than those based on the FAS. Investors, of financial resources and knowledge, can compare the financial situation of the company with other equivalent companies worldwide.

Companies operating in today's business world face rapid worldwide economic integration and increased cross border capital flows. Entrepreneurs seek for the least expensive financing for the company's operations. To be able to convince the foreign investors of the business and its ability to create cash flow and profit, the investors must understand the financial information provided by the company.

The harmonization of the financial reporting enables a comparison of financial statements and financial situation of companies operating in different countries. For the first time, transparency and comparability exists for multinational companies and their stakeholders enabling the expansion of the global business. The foregoing enables international investors to read financial statements and compare investment opportunities globally. Creditors may use the information to make better lending decision. Thus, companies may find foreign venture capitalists or other investors to invest in their business and enable the growth intended.

As markets become increasingly global, it is important to be able to rely on financial reporting and make international comparisons, both of which require a uniform set of high quality accounting standards. Investors also stand to benefit from a single financial "language" with which to interpret corporate activities. Learning a new "language" for accounting and reporting certainly requires time and effort for education. Investors, issuers, auditors and regulators will all need to learn and understand IFRS, which will require training across the board.

Perhaps the most widely circulated explanation of IFRS is that it is “principles based” while U.S. GAAP is “rules based.” Because IFRS has less rules, proponents argue, companies will be able to choose from a wide range of options as to how best to reflect a particular transaction; further, IFRS financial statements will benefit investors who will be able to more easily compare companies from various countries.

The assumption that flexibility and comparability can coexist in worldwide financial reporting standards will be a challenge for professionals to surmise, especially if transactions can be recognized within the broad range of a set of accepted accounting principles (entities within the same industry could report the same transactions differently, thus leading to decreased comparability of these companies’ financials). One study, for example, has already shown that most countries are now using IFRS’ flexibility as an excuse to adjust financials to pre-IFRS local GAAP[1.] Professionals will need to be aware of the implications of this flexibility principle potentially leading to decreased comparability, and seek solutions to narrow any potential uncertainty with financial reporting under IFRS.

IFRS are developed specifically for wide international use. Proponents of IFRS argue that by adopting a common body of international standards, countries can expect to lower the

[1] http://www.afg.asso.fr/upload/3/Fichier735.pdf

cost of information processing and auditing to capital market participants (Barth, 2007; 2008). More preparers, users, and auditors of financial reports can be expected to become familiar with one common set of international accounting standards than with various local accounting standards. If the adoption of IFRS is expected to lower information costs to capital markets, it can be expected that countries which are more dependent on foreign capital and trade, to value these economic benefits more.

Some authors introduce several potential advantages of the IFRS international adoption to equity investors:

- Increased financial information disclosure leads to lower risk to investors.
- Small investors can compete better with professional investors since small investors are less likely to receive financial information from other, than financial statements, sources.
- The cost of processing financial information to investors decreases (as there is no need for international adjustments).
- Lower costs of processing financial information increase the market efficiency.

Covrig (2007) studied the firm-level holdings of over 25.000 mutual funds from around the world and found out that foreign investors are differentially attracted to companies that have voluntarily adopted the IFRS. Covrig (2007) show evidence that firms using IFRS have higher foreign mutual fund ownership compared to firms using local GAAP. Companies reporting according to globally known reporting standards can lower the risks of the investors by providing high-quality financial accounting information. Due to the high quality financial information these companies can get access to external financing easier. Rapidly growing companies need this external financing more than mature companies to enable the development of the business and the growth.

The benefits of transition to IFRS are longer lasting than the costs that occur during the implementation phase. But, for smaller firms the implementation costs may become obstacle to full the IFRS implementation. Regardless, the management needs to think of the effects of the implementation in the long run.

Even though the IFRS implementation in the empirical research mostly shows the benefits of the adoption process, we shall be cautious when deciding whether to implement the IFRS and when analyzing the financial statements of two companies from totally different cultures. Therefore, the investors need to be aware of different customs and institutional structures of the financial reporting.

After Jermakowicz et al. (2006, 193) statement: "*It is vital that company management recognize the far-reaching impact that IFRS will have on business.*", it is interesting to utilize empirical research to study the impacts that might be found within organizations, especially the most internationalized companies.

Conclusion

A single system of financial reporting would benefit a host of constituents. With quality standards, consistently applied, investor understanding and confidence rises. That translates to strong, stable, liquid markets. With quality reporting, investors wouldn't need to compensate for a lack of under-standing by demanding a risk premium. With consistent application and the resulting comparability investors and analysts have an easier time knowing how to best allocate capital. Having one financial language reduces preparation and audit costs. No longer is there a need to learn different standards, or keep current in them, at the expense of more fruitful pursuits. Regulation can be easier if properly coordinated. Education and training become easier and more focused. Convergence of accounting standards has played a major role in the growing acceptance of IFRS. As the differences narrow between IFRS and other widely-accepted accounting systems, resistance to IFRS is beginning to fall away.

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