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REVIEW OF PRACTICAL IMPLEMENTATION ISSUES OF INTERNATIONAL FINANCIAL REPORTING STANDARDS*

Note by the UNCTAD secretariat

Executive summary

The UNCTAD secretariat has prepared this note as a follow-up to the request of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) at its twenty-first session to review practical implementation issues of International Financial Reporting Standards (IFRS). In 2005, an unprecedented number of enterprises and countries around the world adopted IFRS as their basis for financial reporting, regarding these as a means to improve the quality of information on enterprise performance, reduce the cost of capital, increase investors' confidence and facilitate investment flows and economic development. In this context, member States are pursuing coherence between current global developments and their national strategies and policies in the area of corporate transparency in order to reap the full benefits of a transition towards harmonization of reporting requirements. However, while the advantages of a common set of global reporting standards are recognized, there are a number of serious implementation challenges at the international and national levels if the objective of an improved and harmonized reporting system is to be achieved. The efforts of member States towards this goal could be facilitated through exchange of experiences and views on these issues in a representative forum such as ISAR.

This document gives an overview of recent trends in the IFRS convergence process and highlights major practical issues that are arising in the implementation process, such as institutional challenges, enforcement mechanisms and technical issues. The note is designed to facilitate discussions at the twenty-second session of ISAR to assist developing countries and countries with economies in transition in assessing the implications of adopting IFRS and considering feasible implementation strategies that could enable them to meet international standards in enterprise accounting and reporting.

* This document is being issued on the above date for technical reasons.

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Introduction

1. Many developing countries and countries with economies in transition strive to mobilize financial resources from domestic and international sources to attain their economic and social development goals. The availability of relevant information on potential investment targets has a bearing on efforts to mobilize investment for financing economic and social development, as such information plays an important role in critical investment decisions and risk assessment. It also contributes to improved investor confidence and decreased cost of capital.

2. Recognizing the significant influence that corporate reporting has on investment decisions, developing countries and countries with economies in transition are attaching greater importance to corporate transparency and reporting and are making efforts to strengthen the various components of the accounting infrastructure so that financial resources can be mobilized and used more efficiently.

3. However, different countries use different national accounting standards, which makes it difficult and costly to compare opportunities and make informed financial and investment decisions. In addition, faster globalization, the growing interdependence of international financial markets and increased mobility of capital have increased the pressure and demand for the harmonization of reporting frameworks and related standards.

4. The need for a global set of high-quality financial reporting standards has long been apparent. The process of international convergence towards a global set of standards started in 1973 when 16 professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and the United States agreed to form the International Accounting Standards Committee (IASC), which in 2001 was reorganized into the International Accounting Standards Board (IASB). The IASB develops global standards and related interpretations that are collectively known as International Financial Reporting Standards (IFRS).[1]

5. The process gained speed when the International Organization of Securities Commissions (IOSCO) endorsed the IASC standards for international listings in May 2000. It was further facilitated by the Regulation approved by the European Commission in 2002 requiring the preparation of the consolidated (group) accounts of listed companies in the European Union in accordance with IFRS.[2] Recently, many more countries have announced their transition to IFRS, in some instances extending the scope of application beyond group accounts to legal entities and incorporating IFRS into their national regulatory frameworks.

6. However, some developing countries and countries with economies in transition lack the accounting infrastructure and professional institutions that are needed to meet the challenges posed by transition to a common set of global standards – standards that are formulated with developed markets in mind and are becoming increasingly sophisticated. Therefore, there is a need to address these issues and to identify ways of helping these countries build capacity to implement internationally recognized accounting practices.

7. A number of international organizations are involved in the process of harmonizing accounting requirements and practices. While the IASB formulates the IFRS, another global standard setter, the International Federation of Accountants (IFAC), formulates International Standards on Audit (ISA) and other professional requirements needed for harmonization of

[1] See the IASB website for further information on IAS and IFRS and the history of the IASC and the IASB.
[2] Regulation (EC) 1606 of July 2002.

accounting practices, including in areas such as education and ethics. The World Bank and UNCTAD are also involved in the harmonization process, particularly in the context of economic development and how it could be enhanced through implementation of best accounting and reporting practices in developing countries and countries with economies in transition.

8. The United Nations has contributed for over three decades to global efforts to promote comparable and reliable corporate reports. In 1973, the UN Secretary-General convened a group of Eminent Persons that recommended the creation of an internationally comparable system of standardized accounting and reporting.[3] After a series of deliberations on these issues, the Economic and Social Council of the United Nations established the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) in October 1982 by resolution 1982/67.

9. Through ISAR, which is the only intergovernmental group at the international level that deals with corporate accounting and reporting, UNCTAD has contributed to an international debate on harmonization of accounting requirements with a view to facilitating understanding of the implementation challenges faced by developing countries and countries with economies in transition, and it has assisted these countries in implementing best international practices.

10. UNCTAD's efforts have been closely coordinated with the IASB and the IFAC through participation in events and standing committees. In November 2004, UNCTAD and IFAC signed a Memorandum of Understanding to work closer together to increase awareness of the importance of accountancy in economic development and to strengthen the accountancy profession in developing countries and economies in transition.

11. At UNCTAD's tenth quadrennial conference (in Bangkok, Thailand), member States requested that the organization "promote increased transparency and disclosure by encouraging the use of internationally recognized accounting, reporting and auditing standards and improved corporate governance" (para. 122 of the Bangkok Plan of Action). At the eleventh conference (in São Paulo, Brazil), member States reaffirmed the Bangkok Plan of Action and requested that UNCTAD "collect, analyse and disseminate data on best practices for stimulating enterprise development and identify ways and means for enterprises, especially developing countries' SMEs, to meet international standards, including accounting standards" (para. 55 of the São Paulo Consensus).

12. Given the scope of the challenge of the international transition to IFRS, ISAR, in concluding its twenty-first session in October 2004, proposed to include this issue in its agenda and to review issues involved in implementing IFRS at its twenty-second session.[4]

13. This note has been prepared by the UNCTAD secretariat to facilitate discussions of this topic at ISAR's twenty-second session. The note summarizes and highlights key issues of implementation of IFRS based on related literature and ongoing discussions in this area. It also aims to help developing countries and economies in transition assess the implications of

[3] *The Impact of Multinational Corporations on Development and on International Relations*, Report of the Group of Eminent Persons, E/5500/Rev.1/ESA/6, 1974, United Nations, New York.

[4] International Financial Reporting Standards (IFRS) are the international accounting standards developed by the International Accounting Standards Board. Standards developed by its predecessor, the International Accounting Standards Committee, are referred to as International Accounting Standards (IAS). The whole set of IFRS and IAS, including related Interpretations issued by the International Financial Reporting Interpretations Committee, are collectively known as IFRS.

adopting IFRS and develop feasible implementation strategies in order to meet international requirements in enterprise accounting and reporting.

I. Overview of recent trends in the IFRS convergence process

The rationale for convergence

14. A number of factors have contributed to the evolution of IFRS and the acceleration of the convergence towards IFRS since the mid-1990s.

15. Over the last three decades, the world economy and capital markets have become increasingly globalized and integrated. Evidence of the globalization of capital markets is widespread. For example, currently 459 non-US companies from 47 countries are listed on the New York Stock Exchange. They account for about 20 per cent of the listings and 33 per cent of the total market capitalization. On the NASDAQ, 338 companies from 35 countries are listed. Of those companies listed on the London Stock Exchange that account for over 60 per cent of its market capitalization, 17 per cent are foreign. The proportion of foreign companies in selected other markets is as follows: Euronext, 25 per cent; Germany, 21 per cent; New Zealand, 21 per cent; Singapore, 14 per cent; and Switzerland, 31 per cent.[5]

16. World capital markets have become so integrated and interdependent that the stability of one market affects others. The need for global financial reporting standards to support the stability of international financial markets has become so critical that the Financial Stability Forum has identified IFRS as one of the 12 global standards needed for the sound functioning of the global economy.[6]

17. Another argument for global standards is that they can help achieve greater mobility of capital and more efficient allocation of resources by reducing technical barriers created by national accounting differences. When listing their securities for trading in other jurisdictions, entities are required to present financial statements prepared on the basis of standards that are acceptable to the jurisdictions where they intend to offer their securities. The higher the number of markets in which an entity wishes to offer its securities, the more diverse the accounting standards it has to deal with.

18. In this respect, the benefits of having one set of high-quality globally recognized financial reporting standards are significant. Not only can they improve the mobility of capital flows and dialogue between different stakeholders, they can also reduce the costs of attracting capital. An entity that prepares its financial reports on the basis of such standards can avoid the additional issuance and transaction costs that it would incur in providing financial statements that complied with a variety of accounting regimes. For example, according to some estimates, each of some 250 European companies listed on stock exchanges in the United States spends between $5 million[7] and $10 million a year to comply

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[5] P. Pacter, "What Exactly Is Convergence? *International Journal of Accounting, Auditing and Performance Evaluation* 2 (1/2): 67–83.
[6] Further information on the 12 standards is available at the site of Financial Stability Forum, www.fsforum.org.
[7] All references to "dollars" ($) are to US dollars.

with requirements relating to reconciliation with US Generally Accepted Accounting Principles (GAAP).[8]

19. It is also argued that the use of IFRS would improve the quality of financial reporting and ensure a better presentation of enterprise performance. Various studies have documented the usefulness of global financial reporting standards. For example, a recent study by a team of researchers including a member of the IASB Board compared financial reports of entities that adopted IFRS with a matching sample of firms that did not. The study included a sample of IFRS-using firms from 23 countries and covered adoption years from 1994 to 2003. The researchers concluded that, after adopting IFRS, firms appeared to experience a decline in earnings management (the practice of using accounting tricks to mask true operating performance), recognized losses on a more timely basis and provided more value-relevant data. To a limited extent, the study also found a decrease in the cost of capital for IFRS-adopting entities.[9]

Overview of convergence trends

20. The convergence process has speeded up greatly in recent years. Today about 90 countries around the world reportedly either require or permit entities listed in their markets to use IFRS. Examples of IFRS requirements in some jurisdictions appear in tables 1 and 2.

Table 1. Examples of countries and economies where use of IFRS by all domestic listed companies is currently required

Armenia	Dominican Rep.	Kyrgyzstan	Peru
Bahamas	Ecuador	Macedonia	Qatar
Bahrain	Egypt	Malawi	South Africa
Bangladesh	Georgia	Mauritius	Tajikistan
Barbados	Guatemala	Namibia	Tanzania
Bosnia and Herzegovina	Guyana	Nepal	Trinidad and Tobago
Bulgaria	Haiti	Nicaragua	Ukraine
Costa Rica	Jamaica	Oman	Yugoslavia
Croatia	Jordan	Panama	
	Kenya	Papua New Guinea	

Source: Deloitte Touche Tohmatsu, IAS Plus, 2005.[10]

[8] According to Charlie McCreevy, European Commissioner for Internal Market and Services, in a speech on the Commission's Financial Services Policy 2005–2010, Brussels, 18 July 2005.
[9] M. Barth, W. Landsman and M. Lang, *International Accounting Standards and Accounting Quality*, March 2005.
[10] Detailed information can be found at http://www.iasplus.com/country/useias.htm,

Table 2. Examples of countries and economies where use of IFRS by domestic listed companies is currently permitted

Bermuda	Dominica	Myanmar	Turkey
Bolivia	El Salvador	Sri Lanka	Uganda
Botswana	Lao PDR	Swaziland	Uruguay
Brunei Darussalam	Lesotho	Switzerland	Zambia
			Zimbabwe

Source: Deloitte Touche Tohmatsu, IAS Plus, 2005.[11]

21. Countries vary in their requirements related to the application of IFRS. For example, in the European Union, IFRS must be applied to the consolidated financial statements of listed companies. Non-listed companies, which number over three million, are required by law to prepare and file financial statements in accordance with the GAAP applicable in their respective jurisdictions. However, EU member States are authorized to permit such companies to use IFRS in the preparation of their financial statements. Countries that do so include Austria, France, Ireland, Slovenia and the United Kingdom. In some other EU member States, non-listed entities are required to prepare IFRS-based financial statements; these countries include Cyprus, Malta and Slovakia. Certain EU member States require non-listed companies to use national GAAP and prohibit them from using IFRS. These include Latvia, Lithuania and Poland.[12]

22. There are also countries where only certain entities are permitted to use IFRS. These include, for example, China, Kazakhstan, Romania, and the Russian Federation. At the same time, a number of countries, including some of the world's largest economies, do not permit the use of IFRS for listing, at least without reconciliation. These include Argentina, Brazil, Canada, Chile, India, Japan and the United States. However, efforts are underway to bring domestic standards into line with IFRS. While they do not currently permit the use of IFRS for listing, several UN member States such as India, Malaysia, the Philippines and Singapore have brought their domestic GAAP into line with IFRS.

23. In the United States, since September 2002, the Financial Accounting Standards Board (FASB) and the IASB have been working to achieve better compatibility between their respective sets of standards in accordance with the Norwalk Agreement signed by the two entities.[13]

24. The IASB has undertaken several projects in response to this Agreement.[14] For example, it replaced IAS 35 with IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations, to converge with the FASB's Statement of Financial Accounting Standard 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The FASB has also undertaken activities to move towards convergence with IFRS in areas such as share-

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[11] Detailed information can be found at http://www.iasplus.com/country/useias.htm.
[12] P. Pacter, "What Exactly Is Convergence? *International Journal of Accounting, Auditing and Performance Evaluation* 2 (1/2): 67–83.
[13] Further details on the Norwalk Agreement are available at http://www.fasb.org/news/memorandum.pdf
[14] Sir David Tweedie, Chairman, International Accounting Standards Board, and Thomas R. Seidenstein, Director of Operations, IASC Foundation, "Setting a Global Standard: The Case for Accounting Convergence", *Northwestern Journal of International Law & Business* 25 (3): 589–608.

based payments, the treatment of idle capacity and spoilage costs in the cost of inventory, and asset exchanges. In mid-2005, the IASB and the FASB published their first joint proposals to improve the accounting and reporting of business combinations.[15]

25. An important issue relating to convergence efforts by the FASB and the IASB is whether the US Securities and Exchange Commission (SEC) will accept financial statements prepared by foreign registrants without reconciliation to US GAAP, and when this could happen. In April 2005, the US SEC announced its "road map" highlighting the steps needed to eliminate the US GAAP reconciliation requirements for foreign private issuers that use IFRS. The road map indicates that the requirement for reconciliation to US GAAP could be eliminated by 2009 if not sooner.[16] Currently there is no indication of whether companies in the United States will be permitted or required to use IFRS instead of US GAAP for their financial reporting.

26. Japan's Accounting Standards Board, too, is currently working towards convergence with IFRS. In March 2005, the IASB and the Accounting Standards Board held initial discussions on a joint project for convergence. In the initial phase, the project was to consider topics such as Measurement of Inventories (IAS 2), Segment Reporting (IAS 14), Related-Party Disclosures (IAS 24), Unification of Accounting Policies Applied to Foreign Subsidiaries (IAS 27) and Investment Property (IAS 40).[17]

27. In March 2005, the Accounting Standards Board of Canada published its five-year draft strategic plan for comment. The strategic plan, on which comments were due by July 2005, proposed that, for public companies, the Board would direct its efforts towards participating in the movement towards the global convergence of accounting standards. The plan states that the best way to achieve a single set of globally accepted high-quality accounting standards is to bring Canadian GAAP into line with IFRS over a transition period expected to last five years (2006–2011). The proposal envisages that at the end of the transition period, Canadian GAAP will cease to exist as a separate, distinct basis for financial reporting by public companies.[18]

Equivalence to IFRS endorsed by the European Union

28. As of 1 January 2007, the European Union–wide rules on Prospectuses require foreign companies wishing to offer their securities to investors in the European Union to prepare their prospectus, including financial reports, in accordance with IFRS endorsed by the European Union, or IFRS equivalents. These requirements also apply, under the Transparency Directive,[19] to foreign registrants already listed in the European Union. Third-country GAAP would be considered equivalent to IAS/IFRS "when financial statements prepared under such third-country GAAP enable investors to take at least similar decisions in terms of whether to invest or divest, as if they were provided with financial statements prepared on the basis of IAS/IFRS".[20]

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[15] IASB Press Release, 30 June 2005.
[16] For further details see US SEC press release 2005-62.
[17] See IASB Press Release, 11 March 2005, IASB and the Accounting Standards Board of Japan hold initial meeting on joint project for convergence, http://www.iasb.org.
[18] *Accounting Standards in Canada: Future Directions* can be found at http://www.acsbcanada.org/
[19] Directive 2004/109/EC of the European Parliament and of the Council
[20] The Committee of European Securities Regulators, Concept Paper on Equivalence of Certain Third Country GAAP and on Description of Certain Third Country Mechanisms of Enforcement of Financial Information, Consultation Paper, October 2004.

29. The European Commission has mandated that the Commission of European Securities Regulators (CESR) conduct assessments of third-country GAAP. The CESR's task also included describing the enforcement mechanisms in the three countries whose accounting standards were being reviewed for equivalence.

30. In April 2005, the CESR published a consultation paper on its review of Canadian, Japanese and US accounting standards to determine their equivalence to IFRS.[21] It completed its final technical advice for the European Commission on equivalence between Canadian, Japanese and US GAAP and IFRS in early July 2005. Based on its assessment, the CESR has concluded that, considering the needs of investors in EU financial markets, Canadian, Japanese and US GAAP, each taken as a whole, could be considered as equivalent to IFRS, subject to a number of remedies (additional disclosures).

31. On the basis of the CESR's conclusion, companies listed in EU financial markets that present their financial statements in accordance with any of the three countries' GAAP would not be required to present a complete reconciliation of their financial statements with IFRS. Instead, such companies would be expected to provide additional disclosure on a list of significant differences between the respective GAAP and IFRS that the CESR identified in its advice.[22]

II. Key issues relating to practical implementation of IFRS

The scope of application of IFRS

32. Initially the IAS were developed for consolidated accounts of listed companies. However, with increased globalization of economies and financial markets, the number of internationally active companies is growing, and use of IFRS for international financial communication is increasing. In countries that are building or improving their accounting infrastructure, IFRS-based corporate reports are considered by investors, particularly international ones, to be more reliable and understandable than statutory reports.

33. Therefore, in many countries, regulatory authorities try to improve their statutory accounting regulations, and in some instances adopt IFRS as their statutory requirement for legal entities. In such cases, one implementation issue for a country may be the need to reconcile the national legislative framework with the requirements of IFRS, which may include a number of legislative acts affected by such a transition.

34. Another significant group of issues on which debate continues is whether and how a transition to IFRS would affect small and medium-sized enterprises (SMEs), whether a separate set of standards for SMEs is needed, and what should be the underlying conceptual and methodological basis of such standards. Many argue that, given the complicated nature of IFRS, the costs to SMEs of applying them may overweigh the benefits. Still another issue is whether international harmonization should affect the smallest companies or should be addressed at the national level.

[21] Committee of European Securities Regulators, Draft Technical Advice on Equivalence of Certain Third County GAAP and on Description of Certain Third Countries' Mechanisms of Enforcement of Financial Information, Consultation Paper, April 2005, available at http://www.cesr-eu.org.
[22] Committee of European Securities Regulators, Press Release - Ref. 05-451, 5 July 2005.

35. ISAR has been addressing the issue since 2000, when it first discussed the impact of the increasing volume and complexity of IFRS on SMEs and the need for simplified, understandable and user-friendly guidance for that sector. It also urged the IASB to address the needs of the sector. ISAR deliberated on this issue during three consecutive sessions and in 2003 issued its guidance on accounting and financial reporting for two levels of SMEs – SMEGA Levels 2 and 3. The guidance is based on IFRS and is intended to help growing SMEs make smooth transitions from Level 3 to Level 2 and later to IFRS.[23]

36. In 2001, the IASB launched a project to address the needs of SMEs.[24] The IASB project is expected to issue a standard for SMEs by 2008. The recently established Developing Nations Permanent Task Force of the IFAC has also been looking into the issue of the suitability of IFRS for SMEs, particularly from the perspective of developing nations. The UNCTAD secretariat has been providing input on this issue to both initiatives.

Institutional issues

37. There seems to be growing emphasis at the international level on the challenges involved in implementing IFRS and on the related issues of due process of global standard setting and institutional mechanisms needed to achieve consistent application of the IFRS across borders. For example, in 2004, the IFAC commissioned a study on challenges and successes in the implementation of IFRS and ISA.[25] The study highlighted important issues that many stakeholders need to address in order to overcome the challenges in implementing these standards.

38. Since November 2001, the World Bank has been preparing Reports on the Observance of Standards and Codes (ROSC) on accounting and auditing standards and practices among its constituencies.[26] The objectives of the ROSC on accounting and auditing standards and practices are to assess the comparability of national accounting and auditing standards with IFRS and ISA and the degree to which corporate entities comply with established accounting and auditing standards in the country being assessed. The ROSC provide member States with useful insights on implementing IFRS and ISA successfully. Some of the main findings were summarized in 2004 in a report prepared by the World Bank.[27]

39. Another indication of growing emphasis on the issue is a revision of the International Accounting Standards Committee Foundation's Constitution. One of the changes in the Constitution issued in July 2005 calls for trustees to have an understanding of and be sensitive to the challenges associated with the adoption and application of IFRS.[28]

40. The review of the Constitution has also called for steps to enhance the role of the Standards Advisory Council (SAC) of the IASB to make its operations more effective and

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[23] The guidance documents developed by ISAR (SMEGA Levels 2 and 3) can be accessed at http://www.unctad.org/isar.
[24] Further information on the IASB project on SMEs is available at http://www.iasb.org/current/active_projects.asp.
[25] Peter Wong, *Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs*, International Federation of Accountants, September 2004.
[26] To view World Bank ROSC reports, visit http://www.worldbank.org/ifa/rosc_aa.html.
[27] "Implementation of International Accounting and Auditing Standards: Lessons Learned from the World Bank's Accounting and Auditing ROSC Program",
International Accounting and Reporting Issues, 2004 Review, UNCTAD, 2005.
[28] The revised IASC Foundation Constitution can be found at http://www.iasb.org/uploaded_files/documents/8_887_RevisedConstitution1July2005.pdf.

improve links and dialogue between SAC members on the one hand and the Board and Trustees on the other, especially regarding strategic and implementation issues as they relate to the standard-setting process.

41. Another element essential for efficient implementation of the IFRS is that the debate be geographically diverse and inclusive. To address the issue of the new Constitution, the number of trustees has been increased from 19 to 22. The three additional trustees will come from countries outside of North America and Europe. This issue has also been taken into consideration in the SAC's new structure, with a new chairman coming from an emerging economy such as Brazil.[29] However, such mechanisms are still evolving, and further steps seem necessary to facilitate broader involvement of developing countries and countries with economies in transition in the global dialogue. One mechanism that has been debated at a number of events could be participation through regional representation.

42. Effective implementation also calls for a mechanism for ongoing interaction between the standard setter and national regulators. In February 2005, the IASB issued a draft Memorandum of Understanding on the role of Accounting Standard Setters and their relationship with the IASB that is an important step towards establishing such a mechanism. However, further steps might be required to ensure efficient continued interaction between national and global standard setters for the benefit of coherence between IFRS and national regulations and for the consistent application of IFRS.

43. The task of interpreting IFRS remains with the International Financial Reporting Interpretations Committee (IFRIC). The demand for implementation guidance and hence the volume of work for the IFRIC are expected to increase "dramatically" after 2005.[30] In the 2004 annual review of the European Financial Reporting Advisory Group (EFRAG), the Chairman of the Technical Expert Group of EFRAG called on the IFRIC to speed up its activities to meet the perceived demand.[31] The increase in demand is attributed to the increase in the number of enterprises applying IFRS and the heterogeneity of such enterprises in terms of jurisdiction, size, capital structure, ownership structure and degree of accounting sophistication. The task is complicated by the fact that IFRS are a moving target and a number of new changes are yet to come.

44. Therefore, one can ask whether additional mechanisms are needed to cope with demand of such scope and diversity. For example, in its four years of work, IFRIC has issued six interpretations, and one of those (IFRIC 3) has since been withdrawn. To address these challenges, in July 2005, EFRAG issued a discussion paper "Achieving Consistent Application of IFRS in the EU".[32] The objective of the paper is to obtain information about IFRS implementation issues that are arising in Europe and assess the need for follow-up action. Some experts also argue that there might be a need for technical guidance at the national level to reflect particular economic contexts in which the judgement is being made as to how transactions should be recorded and reported.

45. Another issue related to the institutional challenges of IFRS implementation is a translation mechanism, which also requires ongoing interaction between national authorities and the IASB. IFRS are officially developed and published in English. Many member States require considerable amounts of time and other resources to translate IFRS pronouncements

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[29] See IASB Press Release of 18 July 2005, "L. Nelson Carvalho appointed Chairman of the Standards Advisory Council".
[30] Katherine Schipper, "The Implementation of International Accounting Standards in Europe: Implications for International Convergence", *European Accounting Review* 14 (1): 101–126.
[31] The EFRAG 2004 annual review can be obtained at http://www.efrag.org.
[32] The discussion paper can be accessed at http://www.efrag.org.

into their national languages. This process poses a significant challenge, particularly in countries where capacity for such highly technical translation is low.

46. In such cases there could be a need for consultations with the IASB regarding the proposed terminology, especially in cases where there is a conflict with existing national terminology or even legislation. While such mechanisms are especially needed at the beginning of the implementation process, they will have to be established as a standing part of a global standard-setting machinery, since the IFRS will change over time to reflect the needs of international financial infrastructure.

47. Variations in translation could also introduce inconsistency into the implementation of IFRS. Furthermore, time lags in the local "endorsement" process and in translating new IFRS into local languages and, in some jurisdictions, gazetting the translated standards before they become legally binding, may mean that at some point the set of IFRS available in a local language may not include some IFRS, owing to translation and gazetting delays. Such variations could lead to different sets of IFRS requirements applying in different countries and might result in financial reports that are not consistent with the original IFRS or lack comparability. Therefore there is a need for a coordinated mechanism and a reasonable time frame for translating IFRS into national languages. This could involve a database of issues raised and how they were resolved.

48. Another important element of a global mechanism for IFRS implementation is human resources and training materials that comply with IFRS. Today the availability of training materials and qualification programmes leading to certification in IFRS is very limited owing to a number of factors, including language and cost barriers. Many of the IFRS materials and programmes now available have not gone through an independent international assessment of their compliance with the IFRS, since a mechanism for this does not exist.

49. In addition to high-quality financial reporting standards, sound financial reporting infrastructure implies effective corporate governance practices, strong internal controls over the financial reporting process, high-quality auditing standards and practices, and effective enforcement or oversight mechanisms.[33] Therefore, the successful implementation of IFRS will depend partly on the robustness of the other elements of a global financial reporting infrastructure. Therefore, close coordination between all stakeholders at the global as well as the regional and national levels is important.

50. The accountancy profession, through IFAC, and international development organizations such as the World Bank, UNCTAD and others play an important role in strengthening the global financial reporting infrastructure. In addition to the International Accounting and Assurance Standards Board (IAASB), other standard-setting committees within IFAC, such as the Education and Ethics Committees, provide guidance that contributes to successful implementation of IFRS and other elements of the international financial reporting infrastructure.

51. A number of institutional challenges also exist at the national level. One such challenge is formulating an IFRS implementation strategy. On the one hand, any strategy has to be coherent with the IASB strategy and work plan and has to take into consideration the fact that IFRS are a "moving target". On the other hand, it should allow for consistent introduction and practical application of IFRS, which implies that necessary guidance is

[33] US Securities and Exchange Commission, SEC Concept Release on International Accounting Standards, 2000.

available on how IFRS could be applied in the national context, and that steps are taken to avoid possible conflicts with national regulations.

52. Another issue is whether an endorsement mechanism is needed as part of the implementation infrastructure. In the European Union, for example, after IFRS are issued by the IASB, they must go through an endorsement process before companies, listed in the European Union are required to apply them. An endorsement process can create endorsed IFRS that differ from those originally issued by the IASB, as has been the case with the IAS 39 carve-out in the European Union. Other member States, such as Australia and New Zealand, are adopting IFRS after making changes to address specific national needs.

53. Such an endorsement mechanism could pose yet another implementation problem, since its creation and efficient functioning require the existence of a critical mass of expertise and resources in order to exercise judgement related to IFRS endorsement which may not be readily available in countries with less developed financial markets.

54. Significant efforts are needed to educate all users of IFRS-based information since, depending on the jurisdiction, IFRS-based reports could be significantly different from reports prepared under the previous GAAP. Such target groups could include regulatory and tax authorities, investors, financial analysts and rating agencies, civil society, academia and others.

55. Another institutional issue at the national level is the need for coordination of legislative requirements related to or affected by IFRS, since implementation of IFRS can have implications for a number of legislative areas. The more complex the regulatory framework in a country, the more effort is required to achieve coherence among these requirements at the national level.

56. Therefore, it is important to clearly define the authority that IFRS have in relation to other regulatory reporting requirements that may exist in a jurisdiction. It is also essential to have a coordination mechanism at a national level to ensure that such issues are taken into account. For example, an assessment of the impact of the transition to IFRS has to consider possible tax, price control and statistics implications and possible adjustments or reconciliation arrangements that might have to be made as part of the transition if the desire is to maintain tax base and statistical records that existed prior to the implementation of IFRS. Other legislative areas such as company law or even higher-level legislative norms could also be affected. Certain sectors of the economy such as banking and insurance may be subject to additional regulation that may include special reporting requirements.

57. For example, when a business moves from domestic financial reporting standards to IFRS, its financial ratios, on which lenders provide their funding, could be significantly affected. Thus entities may need to review existing covenants that they have with lenders and assess the impact of transition on their ratios. This process may entail further negotiations with lenders with respect to the transition. If a lender and a borrower who moved to IFRS fail to reach agreement on the IFRS-based ratios, the borrower may be required to provide financial reports on the basis of previous GAAP. Such a situation may mean that the borrower has to maintain multiple sets of financial records, which lessens the utility of IFRS.

58. Corporate law, which is normally jurisdiction specific, or the incorporation agreements of a specific entity often limit the amount of funds that an entity can borrow. This limitation may be expressed in terms of legal capital, based on domestic GAAP. After switching to IFRS, an entity may find itself in breach of such requirements if legislative amendments are not made to reflect the impact of IFRS.

59. A related matter is the regulatory requirements that an entity needs to meet in order to be able to distribute dividends to its shareholders. In most cases, such requirements are expressed in terms of unappropriated retained earnings or the equivalent that the entity needs to have in order to be able to pay dividends. However, unless the necessary amendments are made, such requirements would remain based on national GAAP even after the entity moves to IFRS. Such a situation may create unintended confusion with respect to the ability of the entity to distribute dividends.

60. Significant efforts are needed to educate preparers of IFRS reports, especially in countries where accounting was not previously used as a tool for investment decision making. To ensure consistent application of the IFRS, such training should not be limited to accounting issues only but should also cover related areas such as finance and investment. Concerted training efforts are also needed for users of IFRS-based information. They could include regulatory and tax authorities, investors, financial analysts and rating agencies, civil society, academia and others.

Enforcement issues

61. Effective enforcement is essential for the successful implementation of IFRS. Actual enforcement of accounting and auditing standards, including securities and corporate laws, is something to be handled at the national level. Countries have different mechanisms, traditions and capacities for enforcing such standards and related laws.

62. Therefore an international mechanism for the coordination of enforcement mechanisms relating to IFRS is essential for the successful interpretation and implementation of IFRS. Currently the International Organization of Securities Commissions (IOSCO) provides an important infrastructure for coordinating enforcement activities carried out at the national level with respect to publicly listed companies.

63. In May 2004, IOSCO announced that its Technical Committee had initiated a project on "regulatory interpretations of International Financial Reporting Standards". The objective of this project is to address communications among IOSCO members with a view to promoting consistent application and enforcement of IFRS. The main outputs of the project were expected to be a central database of regulatory decisions and a process for facilitating communication and cooperation among regulators and other enforcers relating to IFRS. IOSCO also announced that its Technical Committee would undertake an initiative on "review of enforcement of application of financial reporting standards".

64. In April 2005, IOSCO announced that it had distributed a consultation paper to its members outlining principles to be adopted and options available in its approaches to encouraging cooperation and consultation among members in the regulatory interpretation and enforcement of IFRS.[34] A final model from the initiative was expected during the second half of 2005, in time to be used in conjunction with reviews of the 2005 annual financial statements.

65. At the regional level, the European Union could be regarded as more cohesive in terms of enforcement of traditions and practices. There the importance of coordinating enforcement of standards on financial reporting was recognized early on. In particular, in its decision of 6 June 2001 (2001/1501/EC), the European Commission established the Committee of European Securities Regulators (CESR). The main objectives of the CESR are

[34] International Organization of Securities Commissions, Final Communiqué of its thirtieth Annual Conference, 7 April 2005.

to improve coordination among securities regulators; act as an advisory group to assist the European Commission, in particular, in its preparation of draft implementing measures in the securities field; and ensure more consistent and timely day-to-day implementation of community legislation in the European Union. So far the CESR has issued two standards. These pertain to enforcement of financial information and coordination of enforcement activities respectively.[35]

Technical issues

66. IFRS implementation is also associated with a number of technical challenges. The highly and increasingly complex nature of the IFRS and their sheer volume make the task of practical implementation even more difficult, particularly in developing countries and countries with economies in transition that lack expertise, resources and infrastructure to accomplish such a comprehensive task.

67. An important feature of IFRS is that they are principles based. While this may be a useful feature in their applicability in a variety of jurisdictions and circumstances, it may also contribute to unintended inconsistencies when those implementing IFRS differ in their mastery of the expertise required in order to apply the standards effectively and accurately. This challenge becomes more difficult when countries begin the transition to IFRS without a critical mass of adequately trained and sufficiently experienced accounting professionals who are familiar with the principles underlying the use of accounting information for investment decision making.

68. While IFRS are developed at a global level, most accounting professionals responsible for implementing them would normally have been trained to apply domestic accounting standards. It is likely that where there are options in implementing IFRS, preparers will tend to choose options that are closer to requirements in their national GAAP. For example, in an IFRS seminar that ING Group NV conducted to communicate the impact of moving to IFRS, the Chief Financial Officer said that, where the company had choices, it ended up as close as possible to what it did before (that is, on the basis of national GAAP).[36]

69. One of the major technical issues is fair-value measurement requirements, which have become an important feature of certain IFRS. Given the increasingly innovative financial instruments and growing liquidity of financial markets, there are grounds to argue that fair value is more relevant to users of financial information than historical costs. For example, in this context, Paul Volcker, Chairman of the IASC Board of Trustees, remarked that "the old rule book of historical value does not seem quite right for a world with layers and layers of volatile finance".[37] IFRS also require or permit fair-value measurements of many non-financial items, including property, plant and equipment; investment property; agricultural assets; assets acquired by government grant; and assets held for sale.

70. In UN member States, where the economy is well developed, capital markets could be expected to be liquid enough so that the information required for fair-value measurement can be easily obtained. The more liquid the markets are, the more likely they are to provide the measurement information needed to more accurately reflect the underlying value of the item being measured.

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[35] Further information on CESR standards is available at http://www.cesr-eu.org/.
[36] Cees Maas, CFO and Vice Chairman of the Executive Board, ING Group, "IFRSs Seminar" Conference Call, Fair Disclosure Wire, CCBN Inc. 11 March 2005.
[37] Remarks by Paul A. Volcker at the 150th Anniversary Conference of the Institute of Chartered Accountants of Scotland, Edinburgh, Scotland, 22 October 2004.

71. In reality, however, the liquidity of capital markets around the world varies. Trading activities in some markets and trading of some particular instruments could be so low that recent market information is not available. Such variations are likely to complicate the IFRS transition efforts of some member States. For example, the new members of the European Union were expected to face tougher challenges in their transition efforts mainly owing to the lower liquidity of their capital markets.[38]

72. In obtaining fair-value information, the alternative source for measurement information is simulating a hypothetical market or mathematical modelling. However, such alternatives are likely to be more consistently and accurately computed by professionals in developed economies than by those in developing ones, since the former have more experience of and regular exposure to such estimations.

73. On the other hand, to preparers and users who are used to easily verifiable historical cost-based valuation, recognizing estimated gains or losses based on market information while actual transactions are still pending might be a new and hard-to-grasp concept.

74. IFRS measurement requirements include important assessments or estimates that depend on other professional assessments and standards – for example, actuarial estimations with respect to pensions, investment property valuations, impairment testing, valuing share-based payments, and so on. The availability and proficiency of experts in the areas in which such estimates and assessments are needed vary from one UN member State to another. In some countries, the institutions that train such professionals are well established. In these cases, demographic and other essential data on which actuarial estimations can be based have been maintained for hundreds of years. Such institutions might not be well developed or even exist in other countries, and maintaining demographic and related data might be a relatively new practice. Variations in this respect are likely to introduce undesirable differences into valuations and other estimates, thereby lessening the comparability of financial statements prepared in accordance with IFRS around the globe.

III. Preliminary observations on the impact of IFRS on financial statements

75. For most entities that adopted IFRS as their reporting basis starting 1 January 2005, a full set of annual financial statements will only be due after December 31, 2005. As part of the requirements of IFRS, these entities need to prepare comparative figures for 2004. However, they are not required to release IFRS-based (restated) comparative annual financial statements for 2004 until the ones for 2005 are released.

76. At the time of this note's publication, many entities are tending not to provide disclosures on the impact of IFRS on their financial reports. For example, Standard and Poor's reported that, among the European industrial groups it rates, about half did not provide such information. Most of those that provided information were transnational corporations.[39] Those that disclosed information on the impact of IFRS provided either a full set of 2004 financial reports restated in IFRS or some general indication of the impact of IFRS on their financial reports. Most of the information available so far is unaudited and is intended to provide indicative rather than definitive figures. Nevertheless, a review of such reports and

[38] "New EU Members Face Accounts Struggle", *Accountancy*, 1 April 2004.
[39] "European Corporates Effect a Smooth Transition to IFRSs – So Far", Standard & Poor’s, 11 May 2005.

indications provides useful insights into what the general impact of IFRS may be on financial statements.

77. A survey of implementation of IFRS conducted by the accounting firm Mazars and involving 550 listed companies in 12 European countries, including Turkey, released in July 2005 shows that 87 per cent of the respondents consider themselves well prepared for the adoption of IFRS; 74 per cent have already prepared their opening balance sheets; and 66 per cent have assessed the impact of the restatements on their 2004 financial statements.[40] With respect to the cost of conversion to IFRS, only 45 per cent of the respondents considered it high, while 55 per cent believed that the benefits of conversion justified the costs.

78. The magnitude of changes caused in the financial statements of reporting entities by the transition to IFRS differs from country to country, sector to sector, and entity to entity, depending on the extent of similarities between previous (usually national) GAAP and IFRS. The magnitude also depends on the accounting policy choices that the reporting entity made from among various options that existed under its prior reporting basis and later under IFRS. For example, an analysis of some of the information available at this point seems to indicate that in Europe the transition to IFRS will have a greater impact on the balance sheet of companies than their income statements. A study of 28 large European companies that reported on the impact of IFRS on their financial statements indicated that debt and other liabilities rose an average of 16 per cent while net income decreased by about 3 per cent among the sample of companies studied.[41]

79. Within the set of IFRS, certain requirements seem to be having greater impact than others. For example, a number of requirements in IFRS are prompting first-time adopters to recognize significant liabilities in their balance sheets. In moving to IFRS, entities may be likely to recognize larger amounts in pension obligations, deferred tax liabilities and provisions than under local GAAP. Under IFRS, first-time adopters may be bringing back to the balance sheet many financial arrangements that were moved off the balance sheet under prior GAAP. Some assets that either were not recognized at all or were valued at cost under prior GAAP, such as investments and derivatives, are now valued at fair values under IFRS.

80. One of the major changes that first-time adopters are experiencing is that, under the revised IFRS 3, Business Combinations, goodwill is not amortized but rather is tested for impairment annually, in accordance with IAS 36, Impairment of Assets.[42] This requirement is having a significant impact on the financial reports of some first-time adopters, particularly if they have recently made major acquisitions. A dramatic impact of this requirement can be seen in the restated 2004 financial reports of Vodafone, which transitioned from UK GAAP to IFRS in 2005. In the company's reconciliation of its UK GAAP–based financial reports with IFRS-based 2004 financial reports, its pre-tax loss of £2.18 billion under UK GAAP translated to pre-tax profit of £4.54 billion under IFRS. This result stemmed mainly from the fact that, when reporting on an IFRS basis, the company was no longer required to amortize goodwill in excess of £7 billion annually, as it used to do under UK GAAP.[43]

81. Moving to IFRS has important implications for entities that make share-based payments, either as compensation to their employees or for other transactions in the regular course of business. In accordance with IFRS 2, Share-Based Payments, preparers are required

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[40] IFRS 2005, European Survey, Mazars, http://www.mazars.com.
[41] *Financial Times*, 16 June 2005, citing a survey conducted by Dresdner Kleinwort Wasserstein.
[42] IFRS 3, Business Combinations, paragraphs 54–55.
[43] See "Reconciliations of UK GAAP to International Financial Reporting Standards", Vodafone Group, Plc, http://www.vodafone.com.

to expense such payments. Given the fact that share-based payments were not expensed under most national GAAP, the impact of this particular standard could be somewhat significant among first-time adopters that have regularly made use of share-based payments. For instance, applying this standard to the financial reports of Alcatel resulted in a decrease of 21 per cent in the company's 2004 earnings.[44]

Conclusion

82. This note has outlined a number of practical issues that are arising in the implementation of IFRS. It has also highlighted the possible implications of the adoption of IFRS to other related areas. The note was prepared in the early stages of the large-scale implementation of IFRS around the world in 2005; however, some important practical implementation issues and challenges of significance to UN member States can already be identified. These challenges require the concerted engagement of all parties in order to maximize the benefits of IFRS for the economies of countries around the world through consistent interpretation and application of IFRS. Many entities that are adopting IFRS and the relevant institutions in the respective countries are developing solutions to practical issues that are being encountered in the implementation of IFRS. Sharing of experiences among UN member States could make a positive contribution to this process.

83. During future sessions, ISAR may consider conducting further reviews of IFRS implementation issues in order to gain more insight into the challenges involved and to outline possible solutions. As entities that have already adopted IFRS complete a full reporting cycle and additional ones begin to implement IFRS, more comprehensive findings may be compiled in this area with a view to assessing progress in achieving comparability on a global basis and highlighting courses of action that countries might find useful for achieving more consistent implementation of IFRS.

84. ISAR may also wish to review other relevant issues with respect to the practical implementation of IFRS that pertain, for instance, to specific elements of the global financial reporting infrastructure such as global efforts towards consistent enforcement of IFRS with a view to facilitating the sharing of experiences and best practices among UN member States.

[44] For further details see "Alcatel Transition to IFRS 2004" at http://www.alcatel.com.