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REVIEW OF PRACTICAL IMPLEMENTATION ISSUES OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Note by the UNCTAD secretariat[*]

Executive Summary

In concluding its twenty-second session, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) agreed to conduct further reviews of the practical implementation challenges of International Financial Reporting Standards (IFRS), as well as best practices that evolve to meet these challenges. It was also agreed that one of the ways to conduct such reviews could be by preparing country case studies with a view to developing guidance on good practices in IFRS implementation in order to assist developing countries and countries with economies in transition to succeed in their efforts towards harmonization of their national accounting policies and practices with international requirements. Accordingly, five country case studies covering Brazil (TD/B/COM.2/ISAR/33/Add.1), Germany (TD/B/COM.2/ISAR/33/Add.2), India (TD/B/COM.2/ISAR/33/Add.3), Jamaica (TD/B/COM.2/ISAR/33/Add.4) and Kenya (TD/B/COM.2/ISAR/33/Add.5) have been prepared.

This issues note presents a brief update on recent developments in the process of IFRS implementation and a summary of the main practical implementation issues identified in the case studies covering regulatory framework, enforcement, and technical capacity-building.

[*] This document was submitted on the above-mentioned date as a result of processing delays.

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I. INTRODUCTION

1. For over three decades, the United Nations provided an important forum where policymakers, regulators, standard-setters, professional accountancy organizations, academia, and other stakeholders deliberated with a view to increasing the comparability and reliability of corporate reports. The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) at UNCTAD has served as a focal point within the United Nations system for deliberations on corporate transparency matters.

2. The year 2005 marked a watershed in the history of financial reporting. An unprecedented number of enterprises and countries around the world adopted International Financial Reporting Standards (IFRS) as their basis for financial reporting. In the light of the widespread transition to IFRS, the twenty-second session of ISAR reviewed practical implementation issues of IFRS. The UNCTAD secretariat prepared an issues note on the *Review of practical implementation issues of International Financial Reporting Standards* (TD/B/COM.2/ISAR/28) to facilitate ISAR's consideration of the topic.

3. In concluding its deliberations, ISAR reiterated the importance of a common-set of principles-based and high-quality financial reporting standards in support of the coherence and consistency of the international financial system for mobilizing and efficient allocation of financial resources and for facilitating investment needed for the economic development of member States. Sound and internationally comparable corporate financial reporting that meets the requirements of financial markets improves investor confidence, facilitates risk assessment in making investment decisions, and helps to reduce the cost of capital.

4. ISAR also recognized that in order to reap the full benefits of harmonized global reporting standards and their consistent application in countries with different economic and business environments, a number of practical implementation challenges need to be addressed to assist developing countries and countries with economies in transition in meeting internationally recognized standards, particularly in the area of institutional and technical capacity-building.

5. In concluding its twenty-second session, ISAR agreed to conduct further reviews of the practical implementation challenges of IFRS, as well as ways to meet these challenges, including by preparing country case studies. One of the objectives of such reviews would be to develop guidance on good practices in IFRS implantation that could assist policymakers, regulators and others in considering feasible implementation strategies to meet international standards in enterprise financial reporting and enhance their input into the process of international convergence.

6. In accordance with the request of the twenty-second session of ISAR, the UNCTAD secretariat conducted country case studies in Brazil, Germany, India, Kenya and Jamaica. The objective of the case studies is to draw important lessons learned in the practical implementation of IFRS and share these with member States that are either implementing IFRS or that intend to do so in the future. The main findings of the case studies are summarized in this paper. It is important to note that although countries were selected to ensure coverage of diverse regions, economic systems and approaches in IFRS implementation, the case studies that have been prepared do not represent the whole range of issues in this area. The objective of the case studies is to provide an overview of status of IFRS implementation and main challenges faced in this respect rather than an in-depth and detailed analysis of these issues which could be a subject of further research and discussion.

7. The individual country case studies can be found in the following documents: Brazil – TD/B/COM.2/ISAR/33/Add.1, Germany – TD/B/COM.2/ISAR/33/Add.2, India – TD/B/COM.2/ISAR/33/Add.3, Jamaica – TD/B/COM.2/ISAR/33/Add.4, and Kenya – TD/B/COM.2/ISAR/33/Add.5.

II. RECENT TRENDS TOWARDS CONVERGENCE WITH IFRS

8. Since the twenty-second session of ISAR, several developments have occurred supporting the trend towards convergence with IFRS. In assessing the widespread transition to IFRS in 2005, Sir David Tweedie, the Chairman of the International Accounting Standards Board, stated that the implementation of IFRS had gone "surprisingly well". However, the Chairman also noted that those tasked with the implementation of IFRS found the process to be more demanding than expected.[*] He also indicated that close to 100 countries now require, permit, or have adopted a formal policy of convergence with standards developed by the IASB.[†]

9. At the end of February 2006, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) in the United States published a Memorandum of Understanding (MoU) reaffirming their shared objectives of developing high quality, common accounting standards for use in the world's capital markets.[‡] The IASB and the FASB stated that the MoU was a further elaboration of the objectives and principles first described in the Norwalk Agreement that they signed in October 2002.

10. In accordance with the MoU the FASB and the IASB signed in February 2006, the two organizations will reach a conclusion on whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and if so, their goal will be to complete or substantially complete work in those areas by 2008. The two organizations will examine several topics for short-term convergence − some of them jointly, and others just one Board alone. Topics that both Boards will examine jointly are impairment and income tax. The FASB will examine fair value option, investment properties, research and development, and subsequent events. The IASB will examine borrowing costs, government grants, joint ventures and segment reporting.

11. In March 2006, the European Federation of Accountants (FEE) called for mutual recognition between IFRS and the U.S. Generally Accepted Accounting Principles (GAAP).[§] FEE took the view that an acceptable minimum level of convergence between the two standards had been reached and urged for the elimination of reconciliation statements or other forms of disclosure for foreign issuers that prepare their financial statements in accordance with IFRS and that are listed in the United States of America, or US issuers listed in the European Union that prepare their financial statements in accordance with US GAAP.

12. In May 2006, the *Financial Times* reported that some partners based in the United Kingdom at the accounting firm of PricewaterhouseCoopers (PwC) were of the view that convergence of IFRS and US GAAP would "result in a set of US-style standards likely to be too complex and prescriptive". These PwC partners also considered that the IASB should

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[*] KPMG (2006). *International Financial Reporting Standards: Views on a financial reporting revolution*, April , pp. 35-38.
[†] Statement of Sir David Tweedie, Chairman, IASB before the Committee on Banking, Housing and Urban Affairs of the United States of America Senate, Washington D.C: 14 June 2006.
[‡] Further information on the Memorandum of Understanding can be found at; http://www.iasb.org.
[§] Fédération des Experts Comptables Européens (FEE) (2006). Financial Reporting: Convergence, Equivalence and Mutual Recognition, FEE position paper, March.

focus on improving its standards.[**] Following this, the then Chairman of the Trustees of the International Accounting Standards Committee Foundation was obliged to publish a response in the *Financial Times* justifying why efforts towards convergence should continue.[††]

13. The Accounting Standards Board of Japan (ASBJ) and the IASB held their third meeting in March 2006 and reviewed progress towards convergence of Japanese Generally Accepted Accounting Principles (GAAP) with IFRS. The meeting noted that significant progress had been made in six areas, namely: valuation method of inventories; segment reporting; related-party disclosures; uniformity of accounting policies on overseas subsidiaries; investment property; and cost of issuing new shares. The ASBJ and the IASB agreed to add three new items to the convergence programme. These are asset retirement obligations, construction contracts and disclosure of financial instruments at fair value.[‡‡]

14. In February 2006, the Ministry of Finance of China released 39 Chinese Accounting Standards for Business Enterprises. The new system of accounting standards in China is a step towards substantial convergence with IFRS. All listed companies in China will be required to prepare their financial statements in accordance with the new accounting standards starting from 1 January 2007.[§§]

15. In January 2006, the Canadian Accounting Standards Board approved a five-year strategic plan with respect to the future direction of Canadian Generally Accepted Accounting Principles (GAAP). In accordance with the plan, Canadian GAAP applicable for listed companies will converge with IFRS over a transitional period of five years. At the end of the transition period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for listed companies.[***] The Canadian Accounting Standards Board initiated its deliberations on this matter by issuing a draft strategic plan for comment in March 2005.

16. In March 2006, the Central Bank of Brazil announced that it will require all Brazilian financial institutions under its supervision, including leasing companies, savings and loans etc., to prepare their consolidated financial statements in accordance with IFRS, as issued by the IASB, beginning with financial statements for the year ending 31 December 2010.[†††] The Central Bank has established working groups that will conduct a comprehensive analysis of the efforts required to achieve convergence with IFRS by 2010.

17. Among countries working towards convergence with IFRS, there is also a noticeable trend towards convergence with International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). For example, in February 2006, when the Ministry of Finance of China issued the new Chinese Accounting Standards for Business Enterprises, it also issued 48 Auditing Standards for Certified Public Accountants. In December 2005, the Chinese Auditing Standards Board and the IAASB held a meeting to discuss convergence of China's auditing standards to ISAs.

18. In November 2005, the Auditing and Assurance Board of Canada issued an invitation to comment on its proposal that calls for the convergence of Canadian auditing and

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[**] Financial Times, London, 3 May 2006.
[††] Tommaso Pada-Schioppa, "Work on converging accounting standards must go on", Financial Times, London, 19 May 2006.
[‡‡] Further information can be found at the website of the Accounting Standards Board of Japan at: http://www.asb.org.jp.
[§§] Ministry of Finance of China, Release Ceremony for Chinese Accounting Standards System and Auditing Standards System held in Beijing, Press Release 15 February 2006.
[***] The Canadian Institute of Chartered Accountants (CICA), Communiqué 10 January 2006.
[†††] Central Bank of Brazil, Communiqué 14,259, Brasilia, 10 March 2006.

assurance standards with ISAs. The proposed convergence programme would commence in 2006 and would be completed by 2011. In its communiqué issued in March 2006, the Central Bank of Brazil also announced its commitment to require by 2010 that external auditors that provide auditing services to financial institutions under its supervision to conduct their work in accordance with International Standards on Auditing.

19. With the wider implementation of IFRS around the world, it became clearer that the financial reporting needs of SMEs are different from those of large companies. There has been growing demand on the IASB to develop an accounting standard for SMEs. Over the past two years, the IASB has been working towards developing such a standard. It established a Working Group, published a discussion paper and a questionnaire on possible modifications of the measurement and recognition principles in IFRS, and held public roundtables on possible accounting measurement and recognition simplifications. In August 2006, the IASB posted on its website a draft of an Exposure Draft of an IFRS for SMEs[‡‡‡] that was prepared by IASB. A final Exposure Draft for public comment is expected before the end of 2006.

III. MAIN PRACTICAL IMPLEMENTATION ISSUES OF IFRS

20. As discussed above, the country case studies cover Brazil, Germany, India, Jamaica and Kenya. These countries have taken a variety of approaches towards implementing IFRS. In the case of Brazil, the implementation of IFRS will come into effect in 2010 and will affect financial institutions under the supervision of the Central Bank of Brazil. German companies started preparing financial statements based on International Accounting Standards beginning in the early 1990s. The approach in India has been to adapt IFRSs to the economic realities of the country. Jamaica started implementing IFRS in 2002, while Kenya began the implementation process in 1998.

21. The factors that initially contributed towards the introduction of IFRS in the countries covered in the case studies vary. In Brazil, the Central Bank’s intention is to bring financial reporting practices of financial institutions in line with international best practice with a view to facilitate the comparability of financial reports and foster investor confidence. In Germany, a number of large companies began to prepare their financial statements in accordance with International Accounting Standards, not because they were required by national regulators, but in order to be able to access financial markets outside Germany. In 1998, German lawmakers gave listed companies the option to prepare their consolidated financial statements in accordance with International Accounting Standards. The implementation of IFRS for the preparation of consolidated financial statements of listed companies in Germany became mandatory following the decision of the European Union to implement the IAS Regulation of 2002. The case study of Germany illustrates a European Union-wide approach to implementing IFRS. Therefore, the implementation challenges extend beyond domestic factors.

22. The case study of Kenya shows a desire to raise national financial reporting requirements to international best practices in the aftermath of significant collapses in the country's financial services sector that occurred in the 1980s and 1990s. The case study of Kenya also indicates another factor that was taken into consideration in deciding to adopt International Accounting Standards in place of national ones. By adopting IAS, the standard-setting body intended to reallocate resources away from setting national accounting standards

[‡‡‡] This document can be accessed at: http://www.iasb.org/uploaded_files/documents/16_33_DraftEDSMEs.pdf.

to strengthening other activities aimed at more effective implementation of accounting and auditing standards.

23. In India, the case study shows again a desire to harmonize domestic financial reporting requirements with international standards. However, in the case of India, yet another approach is taken, i.e. a programme of converging Indian accounting standards with International Accounting Standards by adapting the latter to the economic reality of the country. The case study of Jamaica also cites an intention to harmonize corporate reporting practices across countries in the Caribbean in accordance with international requirements and with the position taken by the International Organization of Securities Commissions (IOSCO) on its endorsement of International Accounting Standards.

24. The scope of application of IFRS in the countries included in the case studies varies from one country to another. As discussed earlier, the application of IFRS in Brazil will be required for financial institutions. Listed companies are required to follow national standards that are gradually being converged with IFRS. In the case of Germany, listed companies are required to apply IFRS for preparing their consolidated financial statements. Non-listed companies are also allowed to use IFRS for the preparation of their group financial statements. However, both listed and non-listed companies are prohibited from using IFRS for preparing their individual (separate) financial statements. In Jamaica and Kenya, all listed and non-listed companies are required to prepare their financial statements – both consolidated and non-consolidated – in accordance with IFRS.

25. In India, there is a three-tier system of classification of entities (Level I, II and III). Those in the first-tier are required to apply IFRS, as adapted for the country. The remaining two tiers are composed of small- and medium-sized enterprises (SMEs). The reporting system allows certain simplifications and exceptions with respect to Level II and III entities.[§§§]

26. There are long established laws and regulations governing corporate reporting, including parliamentary legislation on, among others, commercial codes and company acts. There are also a number of sector-specific regulations and institutions covering areas such as banking and insurance. For example, in Brazil and Germany regulation on corporate financial reporting is strongly linked to the legislative system. As a result, the introduction of new reporting systems or amendments to exiting ones requires significant consultation and processing through the legislative system. In the case studies of India, Jamaica and Kenya, the professional accountancy bodies, i.e., the Institutes of Chartered Accountants in India and Jamaica and the Institute of Certified Public Accountants in Kenya play a central role in the setting of accounting standards or the implementation of IFRS and ISAs. The legislative systems in these countries delegated the task of standard-setting in the areas of accounting and auditing to these private institutions.

27. New German institutions have been established in recent years with significant responsibilities in the areas of corporate financial reporting is noted. These are the German Accounting Standards Committee (and its standard-setting arm − the German Accounting Standards Board), the German Financial Reporting Enforcement Panel and the Federal Financial Supervisory Authority. The latter two were established following the passing of the Accounting Enforcement Act of 2004. In Brazil, the proposed amendments on the current Corporate Law call for the establishment of a single entity responsible for preparing and

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[§§§] This approach is similar to the one ISAR recommended in (UNCTAD 2004) Guidance on accounting and financial reporting for small- and medium-sized enterprises (UNCTAD/ITE/TEB/2003/5 and UNCTAD/ITE/TEB/2003/6).

issuing accounting standards. These provide examples of the types of new institutional developments that are needed for the proper implementation and enforcement of IFRS.

28. The country case studies illustrate a number of practical challenges faced by these countries in implementing IFRS. These issues can be grouped into three main areas: institutional, enforcement and technical.

Institutional issues

29. When IFRS are introduced in a given jurisdiction, they form part of the pre-existing laws and regulations in the country pertaining to the governance of business entities. The case study of Jamaica shows a large number of regulatory institutions that have a bearing on the implementation of financial reporting standards. Often, laws and regulations overlap or become inconsistent with each other, especially when the roles and responsibilities of different institutions are not clearly defined and coordination mechanisms are not in place. Lack of coherence in the regulatory system becomes cause for serious misunderstandings and inefficiency in the implementation of IFRS.

30. As the case studies reflect, most of the laws and regulations pertaining to corporate reporting were enacted several decades before the introduction of IFRS. For example, the Companies Act of India was passed into law in 1956. These laws remain in place without amendments to recognize the introduction of IFRS in the respective countries. As a result, the IFRS lack the necessary legal backing. For example, some company laws require specific formats for financial statements. These requirements often contradict the ones in *IAS 1 Presentation of Financial Statements*. For example IAS 1 specifically requires a cash flow statement. Such a situation impedes the smooth implementation of IFRS.

31. In recognition of that fact some countries have started to introduce necessary changes. For example, in Jamaica the Companies Act was passed in 2004 superseding the Companies Act of 1965. This new act does not specifically require compliance with IFRS, it states that companies should prepare their financial statements in accordance with the Generally Accepted Accounting Principles promulgated by the Institute of Chartered Accountants of Jamaica. In Brazil, a Bill has been proposed to revise the Corporate Law which was passed by Congress in 1976.

32. The case study of India illustrates some approaches of how the accounting standards issued by a professional body could be given the necessary authoritative clarity and backing by various regulators. The Reserve Bank, the Securities and Exchange Board, and the Insurance Regulatory and Development Authority specifically require compliance with the accounting standards issued by the Institute of Chartered Accountants of India (ICAI). The same case study also illustrates the interactions between standard-setters, preparers and the courts when differences of opinion arise between standard-setters and preparers. For example, when the ICAI issued an accounting standard on leasing, based on the equivalent IAS, the Association of Leasing Companies approached the courts to seek relief from the standard, arguing that it was onerous on the leasing companies.

33. IFRS are intended to be used for the preparation of general-purpose financial statements. However, as the case studies show, IFRS-based financial statements could be also required to be prepared for statutory purposes as well. However, while extending the use of IFRS for such purposes might appear to be cost-efficient, it may create misunderstanding between reporting entities and regulators, particularly in situations where the regulator for a given sector has specific financial reporting requirements that differ from IFRS. Some of the regulatory bodies that put in place statutory financial reporting requirements on specific

sectors include banking and insurance oversight authorities. For example, in the case study of Kenya, we noted the lack of coordination between the Insurance Commissioner, who is responsible for the enforcement of the Insurance Act and the Institute of Certified Public Accountants of Kenya (ICPAK), which has the responsibility to ensure that its members comply properly with implementing IFRS. Differences emerged due to differing requirements in IFRS 4 on Insurance Contracts and specific schedules required by the Insurance Commissioner. The Insurance Commissioner and ICPAK reached an agreement covering situations when the IFRS-based schedules differed from those required by the Insurance Commissioner, a reconciliation certified by the auditor of the entity would be provided.

34. There are also further examples of inconsistencies between prudential regulation and IFRS-based measurement requirements. For instance, *IFRS 4 Insurance Contracts* requires that the percentage to be applied for calculating claims reserves on insurance contracts should be based on the past experience of the reporting entity in question. However, the prudential regulation on insurance would usually prescribe a pre-determined percentage to be applied sector-wide, regardless of the prior experience of the entity in question. A similar situation arises with respect to provisioning for losses in the banking sector. Central banks often set a prescribed percentage amount that does not take into account the loss experience of the reporting entity as IFRS requirements would do.

Enforcement issues

35. One of the critical elements in the implementation of IFRS is the rigorous enforcement of standards. The responsibility of enforcing IFRS rests with a number of parties. Institutions such as securities exchange commissions, banking and insurance supervisory authorities, stock exchanges and capital market authorities play important roles in enforcing financial reporting requirements such as IFRS.

36. As discussed earlier, the case study of Germany shows examples of additional institutions established in the country with a view to ensuring proper enforcement of IFRS. The German Accountancy Enforcement Act of 2004 established a two-tier enforcement mechanism. The first-tier is the German Financial Reporting Enforcement Panel composed of fifteen professional and industry associations. The second-tier in the mechanism is the Federal Financial Supervisory Authority. The Financial Reporting Enforcement Panel examines both consolidated and non-consolidated financial statements of entities listed in Germany. If the Panel discovers violations that cannot be resolved with the entity examined, it refers the case to the Federal Financial Supervisory Authority. Listed entities in Germany make financial contributions to cover the costs of the Financial Reporting Enforcement Panel. An interesting aspect of such an institutional arrangement is that it makes use of the extensive technical expertise that resides with private sector bodies, while still retaining the enforcement responsibility with the government entity, in this case the Federal Financial Supervisory Authority.

37. The case study of India also shows how the professional accountancy body, i.e. ICAI, plays a positive role in strengthening the financial reporting practices of entities in India. The Institute established the Financial Reporting Review Board (FRRB). The Board selects and reviews financial statements of various entities to ensure that, among other things, the entities comply with accounting standards. In situations where the FRRB identifies lack of compliance with accounting standards and other applicable standards and codes, it advises the ICAI and/or refers the case to the appropriate authorities for action.

38. One of the common aspects of the countries covered in the case studies is that all require that an audit of IFRS financial statements be conducted in accordance with International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Board of IFAC. The Brazilian convergence programme also envisages the implementation of IFRS and ISA by 2010. The Basel-based Financial Stability Forum has recognized ISAs as one of the twelve core standards (including IFRS) which are needed to ensure financial stability of countries around the world. Thus, coupling the implementation of IFRS with ISA both helps to raise the quality of financial reporting and auditing to international best practice. ISA provide an important tool in enforcing the proper implementation of IFRS.

39. Professional accountancy bodies also play a role in the enforcement of IFRS as they discharge their responsibilities with respect to ensuring adherence to their membership by-laws. The case studies of India and Kenya provide examples of peer review programmes that the respective professional accountancy bodies in these countries introduced to ensure proper implementation of financial reporting and auditing standards.

Technical issues

40. The case studies illustrate a number of technical challenges in the practical implementation of IFRS. The concurrent implementation of IFRS and ISA further compounds the difficulties. One of the principal difficulties encountered in the practical implementation process is the shortage of accountants and auditors who are technically competent to implement the IFRS and ISA. Usually, the time between when a decision is made to implement the standards and the actual implementation date is not sufficiently long to train a sufficient number of professionals who could competently apply international standards. For example, the case study of Kenya shows that the decision to implement IAS and ISA effective in 1999 was actually made in 1998. The case study on Kenya further shows that there is still a shortage of actually professional accountants in general, and those who are adequately trained on IFRS and ISA in particular.

41. A related technical problem is the limited availability of training materials and experts on IFRS at an affordable cost. The case study of Kenya shows the challenges ICPAK faces in this respect. The difficulty is further complicated in countries where training materials on IFRS that are currently available in English are not readily usable due to language barriers. The case study of Brazil highlights this issue.

42. Another technical challenge occurring after completing the initial implementation process is the difficulty in coping with the rapid frequency and volume of changes made by the IASB to existing IFRS, as well as keeping pace with new standards. A particular example highlighted in the case studies of India and Kenya is IASB's decision to amend 13 standards at the same time as part of its improvements project. As a result, more than 20 standards were affected because of the consequential amendments that were made. Repeated amendments on IFRS strain available technical capacity, which in many cases could have been already insufficient.

43. Fair value measurement requirements in IFRS pose yet another significant technical implementation challenge. In particular, the case studies of India and Kenya indicate that where trading volume is low and capital markets are not sufficiently liquid, obtaining reliable fair value for IFRS measurement purposes becomes difficult. Preparers face difficulty in obtaining reliable measures and data for, among others: discount rates in a volatile financial environment, cash-flow trends, crop yields, loan yields, loan default rates and sector-wide

benchmarks for determining fair value for some items. The technical difficulties discussed above pose challenges to auditors as well – since they need to assess the reliability of fair value measurements contained in the financial statements.

44. There are also regulatory complications that arise when fair value requirements in accordance with IFRS are applied in certain circumstances. For example, when life insurance contracts are unbundled in accordance with IFRS 4, gains on the investment (deposit) component of the life insurance contract are recognized on a fair value basis. However, insurance regulators might decide not to accept such gains as a part of profits available for distribution to shareholders.

45. The case study of Germany shows that the basis for classification of financial instruments either as equity or debt in accordance with IAS 32 differs from the requirements in German GAAP and law. When classified in accordance with IAS 32, certain instruments that would normally be classified as equity under German GAAP, would be categorized as liability. This is mainly due to the right granted under German law to certain shareholders such as private partnerships to put back their shares to the entity. The result is a significant shift of equity to liabilities in a balance sheet prepared under IFRS. The legal form of a partnership is common in Germany and such partnerships are often subsidiaries of listed companies that are required to apply IFRS. As the case study indicates, the reduction in equity discourages many German entities from adopting the option of preparing their financial statements in accordance with IFRS.

46. The case studies reveal the difficulties encountered in implementing *IAS 17 Leases*, particularly among entities such as banks and insurance companies that would be required to re-classify certain leaseholds as operating leases to comply with the standard. The impact of this re-classification on banks and insurance companies was a reduction of capital with serious implications on capital adequacy requirements. The case study on Kenya gives examples of situations where financial institutions had to dispose of non-core assets such as leasehold land and buildings that were held as investments. As discussed earlier, the Association of Leasing Companies in India challenged in Indian courts the Indian standard on leasing which is based on IAS 17.

47. Implementing the requirements of *IAS 12 Income Taxes* on recognition of deferred tax liability for taxable temporary differences seems to be another area where preparers are experiencing difficulties in complying with the requirements. The case study in India indicates that Indian Accounting Standard 22 – the IAS 12 equivalent – that is supposed to introduce the concept of deferred taxes in India for the first time is being challenged by preparers in the courts.

48. *IAS 16 Property, Plant and Equipment* takes the components approach to depreciating assets. Thus, each part of a tangible fixed asset is to be separately depreciated. This approach might be new to various preparers whose previous basis of financial reporting did not require a components approach. A technical issue that might need further guidance in this area is the extent to which prepares need to go on breaking a fixed asset into its various components for depreciation purposes.

49. The complexity of certain IFRS and the need for estimating certain elements of the financial statements require expertise beyond those issues that would normally fall within the domain of professional accountants and auditors in developing counties. For example, *IAS 19 Employee Benefits* requires actuarial valuation to measure the obligations of a reporting entity. This valuation requires input from professional actuaries on a regular basis. The availability of qualified actuaries is critical in this context. Furthermore, there might be a

need for coordination between the professional bodies of accountants and actuaries with a view to reaching agreements on how estimations are to be conducted and the nature of details to be provided by the actuary. The case study of India provides an example where the Institute of Charted Accountants of India and the Actuarial Society of India worked together to ensure that the actuaries report contained the details required in IAS 19.

IV. LESSONS LEARNED

50. In general, a review of the case studies shows that there is growing appreciation of the usefulness of IFRS by countries in different regions of the world irrespective of the size of their economies or financial reporting traditions. However, there are serious institutional, enforcement and technical challenges that countries need to overcome in order to benefit fully from the introduction of IFRS in their jurisdictions.

51. There are clear indications in the case studies that the implementation of IFRS requires considerable preparation both at the country and entity levels. One of the critical considerations is the need for ensuring coherence in the regulatory framework and for providing clarity on the authority that IFRS will have in relation to other existing national laws. Undertaking the necessary tasks to ensure coherence and clarity will require considerable resources and time. The case studies show that the implementation process of IFRS needs to be a gradual process in order to allow time for the necessary preparations to be made.

52. The transition plan to IFRS and its implications for preparers, users, educators and other stakeholders has to be effectively communicated. As can be seen in the case study of Jamaica, the country's transition action plan to IFRS needs to have a logistical framework of targeted activities to be completed within a specified period of time. The communication programme could include elements such as road shows to present the objectives of the transition to IFRS, sensitizing regulatory bodies on the potential impact of the conversion, identifying regulatory synergies to be derived, and communicating to preparers and users the potential temporary impact of the transition on business performance and financial position.

53. As the case study of Germany illustrates, entities need an average preparation period ranging from 12 to 18 months. Entities in countries where there is a need to translate IFRS from English into another language might need a considerably longer period of time to be ready to transition to IFRS. The cost of staff training, updating information technology systems and arranging for obtaining external advice in preparation for the implementation of IFRS could be significant and needs adequate consideration.

54. The transition plan needs to clearly define the scope of application of IFRS with respect to the size and type of entities and also on whether IFRS will apply for the preparation of consolidated as well as separate financial statements. The case studies show that SMEs encounter serious difficulties when they are required to apply IFRS to prepare their general-purpose financial statements. Therefore, prior to the transition to IFRS, a reporting regime for SMEs needs to be in place. It should also be clearly communicated to preparers and users. As the case study of India indicates, a three tier approach could be used: a first tier to apply IFRS, a second tier to apply IFRS-based standards adapted for that particular tier, and a third tier consisting of micro-entities applying a highly simplified system that is close to cash-based accounting.

55. Certain national financial reporting systems are traditionally integrated to serve general-purpose as well as some special-purpose reporting needs such as taxation and

dividend distribution – as the case studies of Brazil and Germany illustrate. While the IFRS financial reporting model is designed to serve a range of accounting models, it might not be easily adapted to meet special-purpose requirements in line with what the traditional emphasis of the financial reporting system in a country was – for example creditor protection and capital maintenance in the case of Germany. As can be observed in the case study of Germany, both listed and non-listed companies are prohibited from using IFRS for preparing their separate (individual) financial reports.

56. The case of certain countries that transition to IFRS might need a special consideration of their economies experience of hyperinflationary situations. As indicated in the IASB *Framework for the Preparation and Presentation of Financial Statements,*[****] through consultations with the IASB, such countries might be able to specify a financial reporting model that is suitable for their specific circumstances. Thus, in addition to the general implementation that transition to IFRS implies, countries with hyperinflationary currencies need to make additional considerations.

57. The role of professional accountancy organization in implementing IFRS has been highlighted in the case studies. Successful implementation of IFRS needs extensive and ongoing support from professional accountancy associations. Therefore, an IFRS implementation programme needs to adequately assess the state of readiness of relevant professional accountancy organizations so that the necessary resources are available to ensure competent and continuous support from such organizations. In this respect, it is also important to recognize the importance of standards that are being issued by the International Accounting Education Standards Board (IAESB) of IFAC which address various aspects of pre- and post-accountancy qualification programmes and also continuing professional development (CPD) requirements.[††††] The model accountancy curriculum adopted by ISAR in 1999 and updated and revised in 2003, is another resource that could be useful in aligning national qualification requirements with international standards and guidelines.[‡‡‡‡]

58. Integrating IFRS and ISA modules into university accountancy education curricula and coordinating university accountancy education programmes with professional qualification and regulation could contribute positively to the smooth implementation of IFRS in an economy. Lack of coordination in this area could lead to inefficient management of financial and human resources, especially in situations where university programmes are supported by local or national governments as part of national human resources development programmes.

59. As presented in the case studies, professional accountancy bodies contribute to the effective implementation of IFRS and ISAs through requirements that hold their members responsible for observing due care in implementing these standards. As part of the implementation strategy of IFRS, professional accountancy bodies could establish task forces or response teams that would reply to queries from members on IFRS and ISA implementation issues. Such a structure could be in place at the earlier implementation phase and could also be reconstituted at latter stages in response to the issuance of new standards or amendments that require extensive elaboration for preparers and auditors to apply.

60. Peer review programmes among auditors are a useful oversight mechanism and also provide information on difficulties that are encountered in the financial reporting and/or audit process. Implementation difficulties that frequently arise in the findings of peer reviews

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[****] This issue is addressed in paragraph 110 of the IASB Framework for the Preparation of Financial Statements.
[††††] Further information on the IAESB is available at: http://www.ifac.org/Education/.
[‡‡‡‡] UNCTAD, International Accounting and Reporting Issues - 2003 Review, pp. 200-257.

provide useful feedback on where further education programmes need to focus. In those cases where challenges are sector specific more focused training programmes and additional resources such as sample audit files could be prepared by the relevant professional association or responsible regulatory body.

61. The case study of Kenya describes an annual award programme whereby the Institute of Certified Public Accountants of Kenya selects and recognizes entities that ranked highest in preparing their financial statements in accordance with IFRS. Contestants submit their financial statements for review on a voluntary basis. Such an award programme encourages improved implementation of IFRS. At the same time, it provides the Institute with valuable information on the particular areas of IFRS that preparers frequently encounter difficulties in implementation, and which could be considered for directing future continuing professional education programmes and other training events.

62. Data compiled on the 2005 IFRS Awards by the ICPAK highlights the need for continued efforts to improve IFRS-based financial reporting. Despite Kenya’s transition to IFRS which began over six years ago, there is clear lack of compliance with disclosure requirements in IFRS particularly in the banking sector. As the companies participating in the IFRS Awards programme are among the largest, and also subject to multiple regulatory regimes, such low compliance in financial reporting is reason for concern. The broader message is that implementation of IFRS is not a one-time process, but rather an ongoing effort that requires continued institutional support.

63. The shortage of expertise in the field of IFRS affects not only the private sector but also regulators and other governmental agencies. Therefore, in order to effectively discharge their oversight responsibilities, such agencies need to assess early enough in the implementation process their needs for expertise in IFRS and accordingly establish a human resources development programme. As IFRS change due to amendments to existing standards or new standards being issued, regulatory agencies need to have a plan in place to keep up with the changes. Part of the plan needs to include continuing education programmes for personnel in charge of reviewing IFRS-based statements for regulatory purposes. As discussed earlier, regulatory agencies could benefit from expertise that resides with the private sector, including with preparers and auditors, by creating a mechanism whereby regulators receive technical advice, but maintain the regulatory decisions with the governmental oversight body.

64. Professional accountancy bodies, preparers and users, including regulators, could provide the IASB with useful feedback not only after standards are finalized and ready for implementation, but early in the drafting process. The case studies show that while some professional bodies and national accounting standard setters are in a position to directly or indirectly (on a regional basis) interact with the IASB, others are not – mainly due to a lack of resources. One of the approaches suggested in the case studies is to develop a coordination mechanism at a regional level so that by pooling resources countries are able to influence the standard setting process starting from the early stages.

65. Unlike countries that implement IFRS, those that have chosen to adapt IFRS to their specific circumstances have more flexibility with respect to issuing additional interpretation and guidance on the IFRS equivalents which are deemed to apply to their economies. As shown in the case study of India, the ICAI issues various interpretations and guidance on the IFRS adapted to the economic environment of India. However, interpretation or guidance that diverges from the general thrust of IFRS might defeat the purpose of adapting IFRSs in the first place, particularly if the objective is to ultimately comply with IFRS as issued by the

IASB. This is especially relevant when considering that the IASB does not allow any further guidance or interpretation other than the implementation guidance it issues or the interpretations issued by the International Financial Reporting Interpretations Committee.

66. The case studies indicate that substantial financial support is needed to achieve the goal of IFRS implementation. International and regional development banks can provide assistance in overcoming the implementation challenges faced by developing countries in implementing IFRS. As the case study of Jamaica indicates, subsequent to the decision of the Institute of Chartered Accountants of Jamaica to implement IFRS, the World Bank conducted an assessment of the implementation of accounting and auditing standards as part of a programme to determine the gaps in standards and compliance. This was carried out as part of the World Bank's programme of the reports on the observance of standards and codes (ROSC) initiative. The Inter-American Development Bank provided the ICAJ financial support in the form of technical cooperation to disseminate information on IFRS, training and outreach, building enforcement and compliance capabilities, and establishing sustainable training programmes.

V. CONCLUSION

67. This note has summarized the main findings of the selected case studies on review of practical implementation issues of IFRS in Brazil, Germany, India, Jamaica and Kenya. These countries have taken a variety of approaches in implementing IFRS. While in most cases the main objective of implementing IFRS was to raise national financial reporting practices to the level of international benchmarks and ensure economic stability, other considerations also include promoting better integration of regional and international capital markets.

68. The case studies illustrated institutional, enforcement and technical implementation challenges that the countries face in implementing IFRS. Lack of coherence in the regulatory framework, insufficient legal backing of IFRS as reporting standards in a country, extending the use of IFRS beyond the scope of large companies and beyond general-purpose financial reporting may pose significant challenges in implementing and enforcing IFRS. Shortage of personnel with technical expertise in IFRS, unavailability of training materials at affordable prices and in national languages, technical complexity of IFRS and frequent and extensive amendments to existing standards form technical barriers in the process of implementing IFRS.

69. The Intergovernmental Working Group of Experts might wish to consider the following issues for further deliberations:

- What are some good practices with respect to promoting coherence in the regulatory framework so that the implementation of IFRS is conducted smoothly and effectively?
- While some countries have chosen to adopt IFRS as issued by the IASB, others have decided to adapt them to their specific economic environment. What could be the implications of such divergent approaches for the progress towards achieving one common financial reporting benchmark around the world?
- There are concerns with respect to the practical implementation of fair value based measurements in IFRS. Would it be advisable for the IASB to examine current

implementation challenges before issuing further standards that require fair value based measurements?

- The IASB has active convergence programmes with accounting standard-setting bodies in some major economies of the world. How is the decision made to initiate a convergence programme? If more and more countries wished to initiate convergence programmes, would the IASB be in a position to accommodate convergence programmes with each country?
- What are some good practices in making IFRS training materials available at affordable prices, particularly in developing countries and countries with economies in transition and in places where such materials are needed in languages other than English?
- How could some of practical implementation issues be addressed through international technical cooperation programmes?

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