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Effects of Adopting International Accounting Standards on Financial Statements

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Abstract: *To gather some knowledge with regarding to provide some important views and suggestions about the effect of adopting International Accounting Standards is the main objective of this paper. Two methods have been followed to prepare this paper. Firstly, the authors have taken an interview to a manager of a company where recently adopted International Accounting Standards to improve the firms position. Secondly, a case study has been analyzed for getting better and clear knowledge about the effect of adopting International Accounting Standards on firm's financial statement and decision making process. It has found that there is a great positive impact on cost of capital, the availability of relevant and crucial information accountability of management, operating environment of the business and decision making process of the managers of those companies who are adopting International Accounting Standards.*
Keywords: *IAS, financial statement, effects, accounting, changes, adoption etc.*

I. Intrduction

In recent years, the interest about International Accounting Standard (IAS) has increased significantly to the people of all over the world. IAS means the standards which are accepted by all over the world. Management and decision making process of any firm is improved by adopting these standards. IAS provides the guidelines by which any firm can prepare the financial statement with decreasing the cost and increasing the quality of the statement. Even by adopting IAS management of any firm becomes more accountable for running the business and its results. Therefore, the impact of IAS on firms' management and financial statement are analyzed. Normally, there are different accounting systems in different countries. For these reason, accounting function is done in different ways in different countries which makes a great problem to understand about these accounting systems internationally. From this point of view, the importance of harmonization of international accounting system is prompted.

The effects of International Accounting Standards' (IAS) adoption on firms are considered in two points of views for the purpose of this paper. First one is their impact on the firms' management and decision making and second is their influence on financial statements. Hence, the next part of the paper is organized as follows; firstly, the IAS effects on management and decision making process is examined referring to the available literature and an interview with a financial manager. Then, IAS impact on financial statements is discussed. The next part of the study consists of the discussion about the effects of adopting International Accounting Standards on the financial statements of the firm.

II. Literature Review

Barth et al. (2008) predict that firms that adopt IAS/IFRS will exhibit more volatile earnings (less smoothing) than firms applying domestic standards. If adoption of IAS/IFRS standards deters earnings management, they also predict Early Adopter firms will exhibit a lower (higher) frequency of small positive earnings (large negative earnings) in the post-adoption period relative to the pre-adoption period and relative to Non-IAS Control Firms. Consistent with their predictions, Barth et al. (2008) find that early IAS/IFRS-adopting firms exhibit less earnings smoothing, higher frequency of large losses and slightly lower (but insignificant) frequency of small positive earnings in the post-adoption period relative to the pre-adoption (local GAAP) period, but they find no significant over-time changes for the Non-IAS Control Firms. Based on these findings, Barth et al. (2008) conclude that IAS/IFRS adoption deters earnings management (smoothing).

Christensen et al. (2015) argue that firms' orientation to external versus internal financing affects their incentives to adopt IAS/IFRS early and to be more transparent (less earnings management) in their reporting. Early adoption of IFRS and a commitment to greater transparency reflects a trade-off for managers of losing their informational advantage over parties external to the firm versus the benefits from being able to attract external financing to exploit growth opportunities. These arguments lead Christensen et al. to predict that firms with greater insider orientation will be less likely to adopt IFRS early. Consistent with this prediction, they find that firms that delayed adoption (resisters) have more bank ownership (where information asymmetries are resolved through private channels), higher long-term leverage, issue equity less often, and have a higher proportion of shares that are closely held. They also find that firms that delayed IAS/IFRS adoption have lower analyst following, suggesting these firms face less demand for transparent information from the capital markets.

Ahmed et al. (2013) compare earnings management (smoothing) metrics for a sample of 1,631 Late and Mandatory Adopter firms from 21 countries that adopted IAS/IFRS standards for the first time in 2005 to firms from non-IFRS countries (largely firms from the US). They find that firms that adopted IAS/IFRS standards in 2005 exhibit greater earnings smoothing and lower frequency of large negative earnings relative to the benchmark control firms in the post-adoption period, consistent with greater earnings management (smoothing).9 Interestingly, they find that both IFRS adopters and benchmark control firms exhibit a significantly lower likelihood of reporting small positive earnings in the post adoption period relative to the pre-adoption period, which is inconsistent with greater earnings management. However, the difference between treatment and control samples is not significant suggesting that the decreased incidence of small positive earnings in the post–adoption period is more likely due to general economic trends than to newly-adopted accounting standards.

Auer (1996) considered Swiss firms that had switched from Swiss GAAP to EC-Directives or IAS. Since the new standard sets were supposed to have higher information content, he expected the volatility of abnormal returns to be higher for EC-directives or IAS compared to Swiss GAAP. A higher volatility (variance) would have suggested higher information processing of the market within the event window represented by earnings releases. Results showed a significant change in the variance of abnormal returns for firms which had switched to the EC-Directives or IAS but no statistically significant differences in the variance of abnormal returns for earnings based on EC-Directives or IAS, therefore suggesting that for investors IAS-based earnings do not convey higher information than EC-Directives.

Leuz (1999) documented that the choice of German firms between IAS and U.S. GAAP has no measurable consequences on their bid-ask spreads and trading volume.

Leuz and Verrecchia (2000) studied German firms that had switched from German GAAP to IAS or U.S. GAAP and showed that bid-ask spreads were lower and trading volumes higher for firms employing international standards. They also checked whether the switch to the IAS or the U.S. GAAP led to less share price volatility but they were unable to document a negative association around the switch.

Blanc (2003) found that though, International Accounting Standards create a common language for defining, interpreting and publication of financial statements in the whole world, In this case their main objective is to provide a standardized and coherent sight of the companies to the shareholders and investors.

Rudhede and Wahlberg (2003) accentuate the lack of accounting synchronization and relate this with the investors' and companies' difficulties in understanding the variety of accounting principles among countries.

Houston and Reinsten (2001) have found that the international accounting harmonization will trim down the costs of doing business, especially across national borders, then will contribute towards greater efficiency of the market regulations and will reduce the costs for conducting financial statements analysis and investments in international context.

Karamanou and Nishiotis (2005) found that adopting IAS is associated with viewing the firm as entity with high value because of the higher disclosure required. Moreover, this is considered as reputation building effect. By reviewing these literatures it can be conclude that management becomes more accountable by adopting IAS.

III. Objectives of the Study

The main objectives of this study are stated in below:

1. To know about the effect of adopting IAS on firms financial statements.
2. To know the effect of adopting IAS on management decision making process.
3. To provide some important suggestions about the emergency of the adoption of IAS in the firm.

IV. Limitation of the Study

It is not very easy to research about the IAS. In this study, authors have faced some problems which have been stated below:

1. To take any interview to any financial manager is not too easy task.
2. There are not available companies in our country which have adopted International Accounting Standards.

V. Methodology of the Study

5.1. Data Collection:

For preparing this paper data have been collected from both primary and secondary sources. For finding out primary data a formal Interview was taken with the Financial Manager of K M Hasan & Co, New

Eskaton Road, Dhaka-1217 and secondary data were collected from the financial statement of a selected company, daily news paper, different journals & articles etc.

5.2. Data analysis:

Different methods have been used to analyze the collected data such as Ratio analysis (Liquidity Ratios, Activity Ratios, Debt-Equity Ratios, and Profitability Ratios), Horizontal analysis, and Vertical analysis etc.

VI. Findings and Analysis

6.1. Effects of adopting IAS on firms' management and decision making processes:

Adopting IAS has a great impact on firms. By adopting IAS, management becomes more accountable for conducting the business. For instance, Wilson (2001; cited in Rudhede and Wahlberg, 2003) emphasizes the improve market communication of the firm which has adopted IAS, because every disclosure should be further explained by the management. To conduct this study authors had met with the financial manager of K M Hasan & Co, New Eskaton Road, Dhaka-1217. This firm has adopted IAS some years before. The manager was asked to compare management and decision making process in the firm, before and after adopting IAS, which he works for. He said that there have great impacts of adopting International Accounting Standards on firms financial statement along with management and decision making process. The main advantages of adopting IAS for the firm's management process is the availability of relevant, crucial and accurate information, which in turn are the platform for making good and accurate decisions. Actually, he ensured that adoption of IAS in the firm provide more understandable, comparable, unified and valid information for the assets, liabilities, equity, revenues and costs. He also said that last year all the investors became able to collect more reliable information and also able to estimate accurately for the firm when they attempted to invest in the firm. He also stated that there was another important area where IAS adoption was effectuated in our case was the opportunity of other firms- our business partners, which have adopted International Accounting Standards also, to precisely assess our company, in regards to the potential risk in the business relations, but also in regards to the possibility of eventual further mergers and making our business activity broader in the future. Barth et al (2005) supports the view that adopting IAS improves financial reporting.

6.2 Effect of adopting International Accounting Standards on Financial Statements:

6.2.1. Theoretical aspect:

The effect of adopting IAS can be described different point of views. But the most important factor is that the adoption of International Accounting Standards affects very much the financial statement of any organization. Hung and Subramanyan (2004) and Barth et al. (2005) have examined the effect of adopting IAS on financial statements, particularly on some accounting measures and financial ratios. Hung and Subramanyan (2004) have used a sample of 80 firms in Germany that have adopted IAS for the first time and found some significant results. In that research they found that the total assets and the book value of equity are considerably higher under IAS and that the latter plays more significant while the former plays less significant "valuation role under IAS". They have also found that adopting IAS might lead to indirect economic consequences, the only direct effect is changed financial statements. They have concluded that "IAS emphasizes fair values and balance sheet valuation" (p.36). Barth et al. (2005) found that companies that have adopted IAS experience more volatility in net income. They also found that these firms "evidence less earnings management, more timely loss recognition and more value relevance of accounting amounts" (p5), compared with firms that haven't adopted International Accounting Standards. Many companies, accepting IAS, face with the facility to implement new accounting definitions and valorization principles and procedures, than to acquire more exhaustive and detailed reporting for their operations and activities and finally, to satisfy the needs for a variety of financial statements users (Blanc, 2003) The literatures relating to my topic are not available. For this reason I have examined a case study in this section in my study to get more clear idea about the effect of adopting IAS on financial statements:

6.2.2. Case Study on the effects of adopting IAS on Financial Statements:

Here a case study is analyzed to know the effects of adopting IAS on financial statement. I have chosen Saint-Gobain Group for this purpose. Saint-Gobain Group is a world-wide producer of high-tech products and comprises more than 1200 consolidated companies all over the world (Saint-Gobain Group web site). This group needed compliance with IAS in order to achieve more reliable picture for its world-wide business. For this, IAS was applied on the opening financial statements at the date of adoption - 1st January, 2004 (Saint-Gobain Group, 2005). Restated financial statements figures are shown in the appendices. Here the financial report of Saint-Gobain Group for the year 2004 is used. The Impacts of adopting IAS are shown below:

6.2.2.1. Effects of IAS on Balance Sheet:

Because of following IAS, the main changes of Balance Sheet are (Saint-Gobain Group, 2005) given in below as it can be seen from the Appendix-1:

- The firm used the cost method of depreciation which is set out in IAS-16, which directly results in increase in net book value of PPE at 1st January. For this there is an increase in property, plant and equipment which are mainly reflecting the retrospective increase in the useful lives of these assets and also the resulting write-back of depreciation, when applied IAS-16 comes up with a greater figure. In this case the firm used the cost method of depreciation.
- There is an increase in debt for 11.7%,
- The shareholders equity decreases for 7.6%,
- Increase in gearing ratio, from 46.5% under GAAP to 57% under IFRS.
- Decrease in goodwill under IFRS-3, which is due to re-measuring the foreign operations according to IAS-21 and also, the negative goodwill cancellation,
- Intangible assets are recognized as indefinite-lived intangible assets, Under IAS-38.
- Under IAS-19, employee benefits recognized a decrease which is due to the "full recognition of cumulative actuarial gains and losses at 1st January, 2004". According to this IAS, the group passed on including the interest cost referring to persons, which was previously included in the operating items.
- Under IAS 12, increase in deferred tax, which reflects all above restatement under the other applied IAS, but the main impact comes from the pension and post retirement benefits under IAS 19.
- The group also applied IAS 32 and 39 to achieve more comparative figures. The result of such application has increases certain items.

IFRS 1- First time adoption of IFRS,
IFRS 3- Business combination,
IAS 16- Property, plant and equipment,
IAS 12- Income Taxes,
IAS 19- Employee benefits,
IAS 38- Intangible assets,
IAS 32 & 39- Financial instruments.

There was a great impact on the net debt also because of adopting all these IASs. It can be found that there was an increase in capital gearing ratio which results an increase in the net debt for 11.7% (Appendix-1).

6.2.2.2. Effects of IAS on Income Statement:
- It can be found that there was an increase in sales and operating income. For this there was an increase in operating margin from 8.2% to 8.5% automatically (Appendix-2).
- Net income has also increased for 14.4% (Appendix-2).

Here, the operating income increases because of adopting IAS-19 and IAS-16, where IAS 19 influence is through the decrease in reclassification under financial income a portion cost and IAS 16 influence is through the decrease in related depreciation charge because of adjusted useful lives of PPE. Here the elimination of goodwill amortization under IFRS 3 increases the net income. Normally, for analyzing the impacts of IAS on financial statement this way is to be followed. There is no doubt that IAS affects in various ways in the firm's financial statement, but it depends upon the nature, types of production and environment of the firm.

VII. Conclusion

From my research it is clear that there are various impacts of adopting IAS on firm but the most important factor is that IAS has a great impact on financial statement of the firm. Though, further vast analysis is needed to explore every impact that certain-standard adoption has on the financial statements. Every company could be significantly influenced from the couple of standards and hence these effects should be taken in consideration. Even it has also found that adopting IAS has not only direct impact but also indirect impact on firms. IAS affects management decision making process, cost of capital, the availability of relevant and crucial information accountability of management, operating environment etc of the firms. In conclusion, it can be easily said that every process there have the combination of good effect and bad effect but in adopting IAS there are too many positive effect on firms to describe.

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Appendix 1: Overview of the impacts of IFRS (audited figures) on the Balance Sheet at 1st January and 31st December, 2014 (in EUR millions)

Item	**January 1, 2004**			**December 31, 2004**		
	French GAAP	**IFRS**	**Impact**	**French GAAP**	**IFRS**	**Impact**
Goodwill	4902	4755	(147)	5170	5203	33
Other Intangible assets, net	1836	1756	(80)	1883	1804	(79)
Property, Plant and Equipment	8686	9085	399	8939	9367	428
Investment in associates	75	78	3	61	64	3
Available for sale and other securities	217	248	31	87	92	5
Other Non-Current assets	1521	346	1175	1375	252	(1123)
Non-Current Assets	**17237**	**16268**	**(969)**	**17515**	**16782**	**(733)**
Inventories	4509	4483	(26)	4838	4817	(21)
Trade Accounts Receivable	4240	4539	299	4467	4789	322
Other Accounts receivable	1035	1030	(5)	1099	1070	(29)
Short Term loans	160	160	0	69	69	0
Cash and Cash equivalent	2914	2913	(1)	2899	2898	(1)
Current Assets	**12858**	**13125**	**267**	**13372**	**13643**	**271**
Total assets	**30095**	**29393**	**(702)**	**30887**	**30425**	**(462)**
Shareholders Equity and minority interests	11310	10214	(1096)	11806	10910	(896)
Non-voting participating securities	170	0	(170)	170	0	(170)
Pension and other post-retirement benefits	2305	2839	534	2249	2750	501
Deferred tax liability	599	249	(350)	548	238	(310)
Other liabilities	1032	959	(73)	954	901	(53)
Long term debt	6518	6680	162	5396	5629	233
Non-Current Liabilities	**10624**	**10727**	**103**	**9317**	**9518**	**201**
Trade Accounts Payable	3592	3570	(22)	3967	3954	(13)
Other payables and accrued expenses	2356	2290	(66)	2659	2556	(103)
Short term debt	2213	2592	379	3138	3487	349
Current Liabilities	8161	8452	291	9764	9997	233
Total Liabilities and Shareholders' equity	**30095**	**29393**	**(702)**	**30887**	**30425**	**(462)**
Net debt under French GAAP	(5,657)			(5,566)		
Net debt under IFRS		(6,359)	(702)		(6,218)	(652)

Source: Saint-Gobain Annual Report 2004

Appendix 2: Overview of the impact of IFRS (audited figures) on the 2004 statement of income (in EUR millions)

Item	**2004**		
	French GAAP	**IFRS**	**Impact**
Sales and ancillary revenue	32025	32172	147
Operating income	2632	2743	111
Dividends from non-consolidated subsidiaries	3	3	0
Non-operating costs	(280)	(271)	9
Profit/(loss) on sales of assets and asset write-downs	(44)	(63)	(19)
Amortization of goodwill	(155)	6	161
Business income	2156	2418	262
Net financial income/(loss)	**(441)**	**(535)**	**(94)**
Income taxes	(603)	(616)	(13)
Shares in net income of equity investees	8	8	0
Net income before minority interests	1120	1275	155
Minority interests	(37)	(36)	1
Net income	**1083**	**1239**	**156**
EPS(in EUR)	3.18	3.63	0.45
EPS excluding treasury stock (in EUR)	3.23	3.70	0.47
Net income excluding capital gains	1122	1289	167
EPS excluding capital gains and losses (in EUR)	3.29	3.78	0.49
EPS excluding capital gains and losses and treasury stock (in EUR)	3.35	3.85	0.50

Source: Saint-Gobain Annual Report 2004