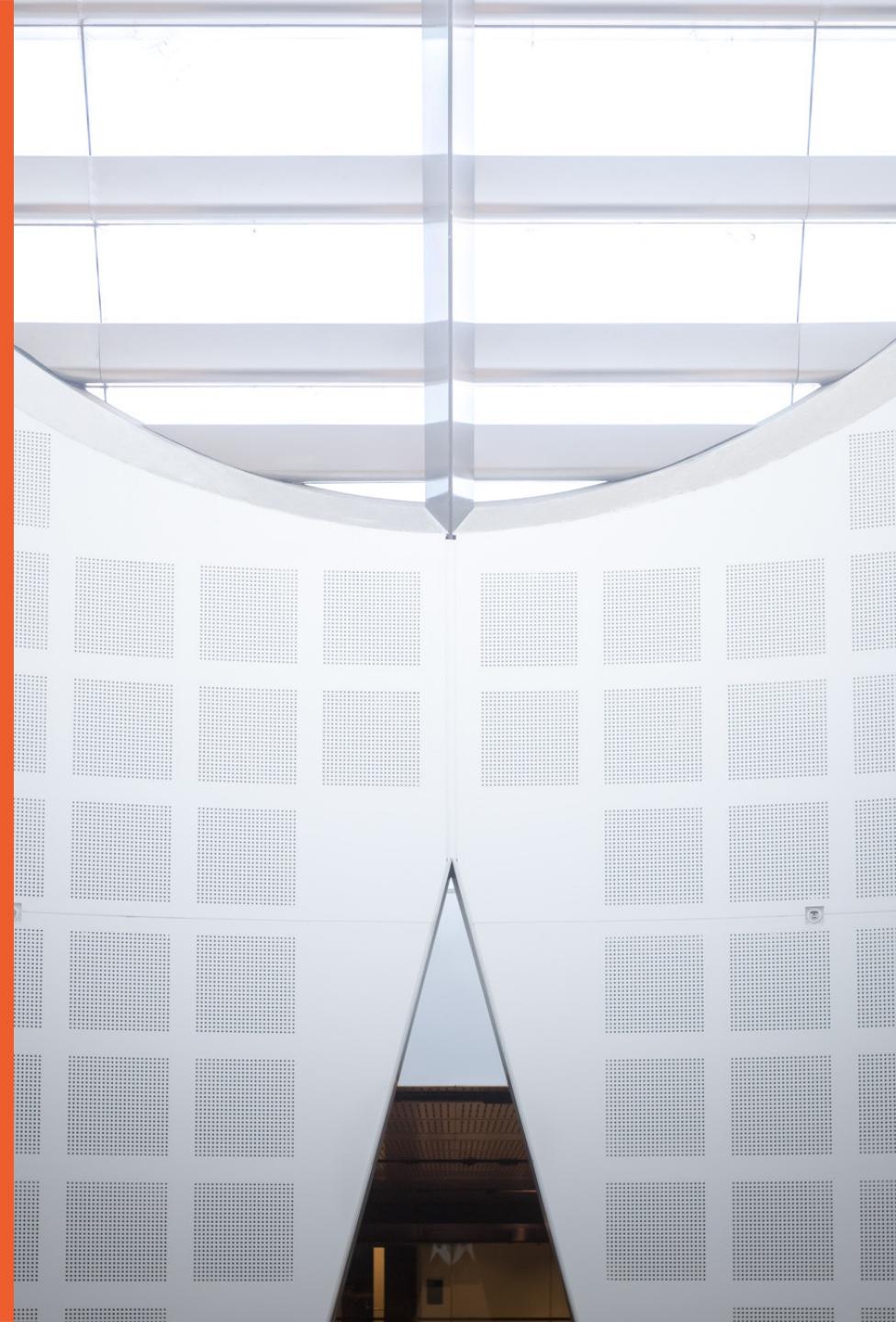


ACCT 6002

Adoption of IFRS, and variations in IFRS practice



THE UNIVERSITY OF
SYDNEY



Adoption of IFRS; and international variations in IFRS practice

- **Text readings:**
- *Comparative International Accounting*: Chapters 5 (especially 5.1-5.4) and 9
- **Academic papers, on Canvas:**
 1. Nobes, C. and Zeff, S., 'Have Canada, Japan and Switzerland adopted IFRS?', *Australian Accounting Review*, 26(3), 2016.
- **Self-Study Questions:** See Canvas for instructions

Learning objectives

After this week's studies, you should be able to:

- explain the difference between adoption of IFRS and convergence of one accounting system with another
- suggest why, and explain how, IFRS has been adopted in Australia and for certain purposes in the EU, and approximately in China
- explain how the potential reasons for international accounting differences, as discussed in previous chapters, might still be relevant under IFRS
- give examples of how different versions of IFRS can be in force at the same time
- give examples of how gaps, choices and estimations in IFRS can lead to varied practices
- give examples of actual variety in IFRS practice

Adoption of IFRS and variation in practice

- Key questions:
 - What does a **country** do about IFRS?
 - What does a **company** complying with IFRS do? How does it deal with the choices within IFRS?

Question 1: what does a country do?

- Spread of IFRS
- Adoption and convergence
- Versions of IFRS
- National systems of IFRS practice

Spread of IFRS

- Voluntary or compulsory?
- For all purposes or just for some?
- “IFRS as issued by the IASB” or some special version?

Some examples of IFRS use over time

- Voluntary or compulsory use in British Commonwealth countries from 1980s
- Voluntary use by Swiss multinationals from 1990s (absence of Swiss requirements)
- Voluntary use by German multinationals: a few from 1994-7 (when it was not legal); more use from 1998 (when legal)
- From 2005, compulsory for all Australian statements and EU **listed/consolidated** statements (voluntary in some EU countries for other purposes)
- US SEC issued a proposal to adopt IFRS in 2008, but has not done it (SEC allows IFRS for **foreign** companies from 2007)
- Japan **allows** IFRS from 2010; increasing use
- Brazil and Canada adopted in 2011; Russia in 2013

Example: application on companies in Europe

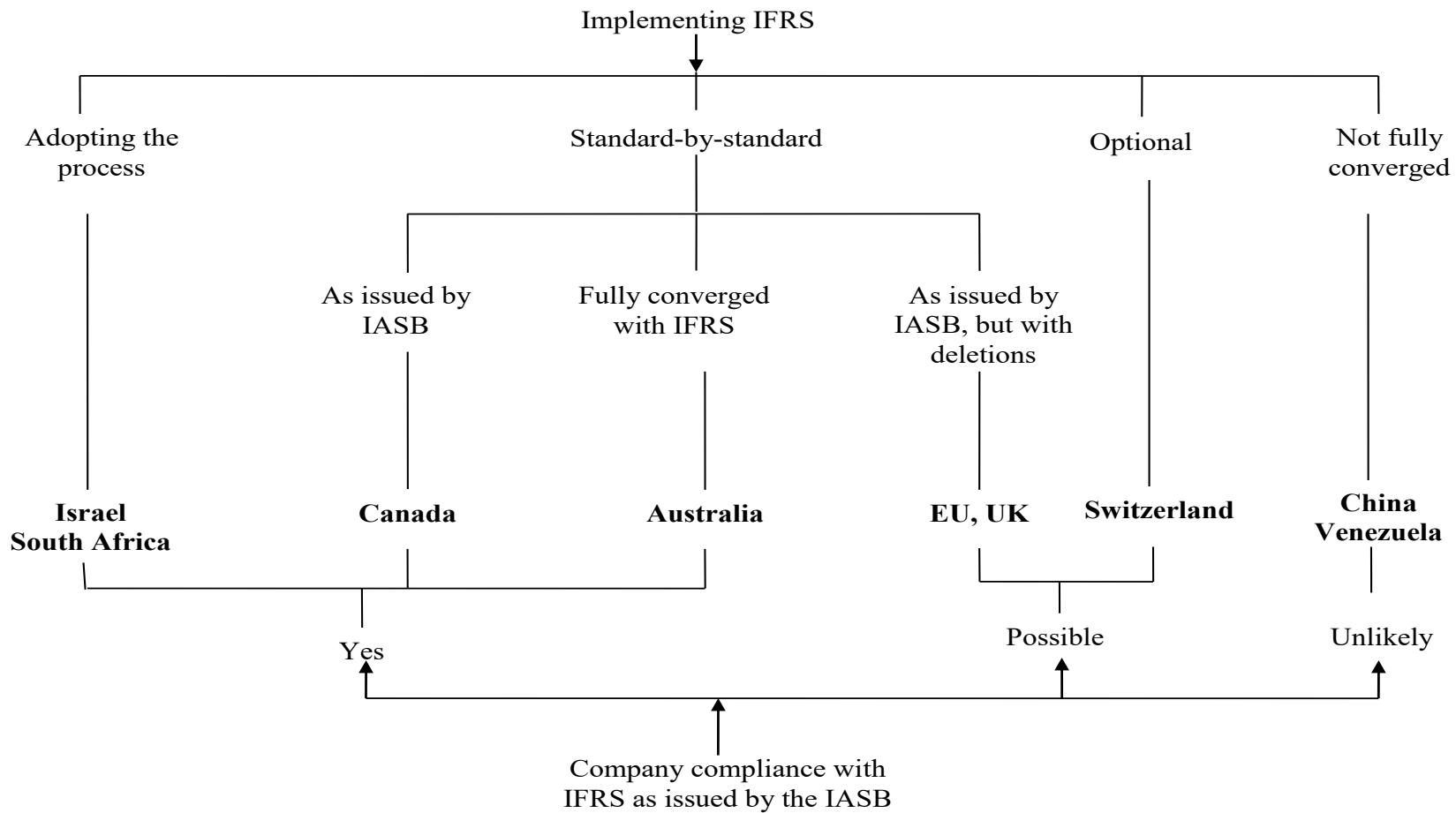
- Compulsory for **consolidated** statements of listed companies
- Optional for statutory, **individual** financial statements in:
 - Denmark, Ireland, Italy, Netherlands, Norway, UK
 - but not in:
 - Belgium, France, Germany (unless 2 sets), Spain, Sweden

Adoption or Convergence

- Harmonisation, standardisation, convergence, adoption
- Adoption of IFRS = replacement of national rules with IFRS
- This does not always mean “IFRS as issued by the IASB”
- EU has “endorsement” process:
 - IFRS 9 difference
 - delays of over one year (e.g. IFRSs 9 to 13)
- Australia has AASB equivalents
- For listed companies, China has approximately converged from 2006

Methods of Implementing IFRS

(consolidated statements of listed companies)



Brief discussion of academic article

- Nobes, C., and Zeff, S., (2016), “Have Canada, Japan and Switzerland adopted IFRS?”, *Australian Accounting Review*, Vol 26, Issue 3, pp.284-290.
 - *Australian Accounting Review* – Journal for academics, students and professionals. Articles shorter, less detailed.
 - Relates to first part of lecture: examines what different countries do about IFRS, and what that means

National rules survive for unlisted companies?

- **No:** Malta, Cyprus, South Africa
- **Not really:** Australia (although IFRS are called Australian standards; and there is also a reduced-disclosure version)
- **Yes, but converged with IFRS:** UK (gradually, and then by approximately adopting “IFRS for SMEs” in 2015)
- **Yes, and not converging much:**
 - China (except for listed)
 - France

What caused pre-IFRS international differences?

- Classifications show Germany and UK in different groups.
- Why? Financing, legal, tax systems. Or culture?
- Zysman (1983): three financing systems; Nobes (1988): two systems. Still affects most German groups?
- David and Brierley (1988): two legal systems. Connection with financing systems and with accounting practice. Still relevant for monitoring and enforcement.
- Lamb *et al.* (1988): two extremes of tax/reporting linkage. Nobes (1998) tax will dominate without a strong competing purpose. Still relevant even under IFRS.
- **Can all this still affect IFRS practice?**

Opportunities for international differences in IFRS practices: regulatory

1. Different versions of IFRS (e.g. EU-IFRS)
2. Translation difficulties and errors
3. Enforcement, compliance (e.g. common law v. code law countries)

1. Different versions of IFRS

- IFRS v. EU-endorsed IFRS
- Implementation date of a new standard
- Year ends
 - H_1 : International differences in practice exist among IFRS companies due to differences in the version of IFRS being used
 - $H_{1(a)}$: French banks exhibit less earnings volatility than British banks because of using less restrictive hedge accounting criteria allowed by EU version of IFRS

2. Different translations

- The following two slides show the official translations of IAS 36's term “impairment”, which means adjusting the asset (downwards) because of damage to assets

Language	Signifier	Literal translation
Swedish	<i>nedskrivning</i>	write-down
German (law)	<i>ausserplanmässige Abschreibung</i>	unscheduled write-off
German (IAS 36)	<i>Wertminderung</i>	fall in value
Danish	<i>vaerdiforringelse</i>	"
Norwegian	<i>verdifall</i>	"
French (EU, CAN)	<i>dépréciation</i>	"
Italian	<i>riduzione di valore</i>	"
Spanish (EU, ARG)	<i>deterioro del valor</i>	"
Polish	<i>utrata wartości</i>	"
Russian	<i>обесценение</i>	"
Finnish	<i>arvon alentuminen</i>	"

Language	Signifier	Literal translation
Arabic	إنخفاض قيمة الأصول	fall in value
Dutch	<i>bijzondere waardevermindering</i>	special fall in value
Portuguese (EU)	<i>imparidade</i>	inequality
Portuguese (Brazil)	<i>redução ao valor recuperável</i>	reduction in recoverable amount
Chinese	減值	fall in value (but para. 6: 'damage')
Japanese	減損	decreasing-losing
Korean	손상 (hangul 損傷)	damage

Language and “impairment”

Distinguish four issues:

1. Deterioration/damage (English dictionary; Korean IAS 36)
2. Actual fall in value (most translations of IAS 36)
3. Adjusting the asset (English IAS 36; Brazil; Swedish vaguely)
4. The debit

Opportunities for international differences in IFRS practices

Regulatory:

1. Different versions of IFRS (e.g. EU-IFRS)
2. Translation difficulties and errors
3. Enforcement, compliance

Application by companies:

4. Gaps in IFRS (e.g. oil/gas)

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- IAS 8, para. 10
 - But no detailed rules in **IFRS 6 (oil & gas)**, and no rules on other issues, e.g. art works
- H₃: For topics on which there are no specific rules in IFRS, German practice is different from UK practice.

Opportunities for international differences in IFRS practices

Regulatory:

1. Different versions of IFRS (e.g. EU-IFRS)
2. Translation difficulties and errors
3. Enforcement, compliance

Application:

4. Gaps in IFRS (e.g. oil/gas)
5. First-time adoption options

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- Higher PPE “cost” for UK groups than German groups

Opportunities for international differences in IFRS practices

Regulatory:

1. Different versions of IFRS (e.g. EU-IFRS)
2. Translation difficulties and errors
3. Enforcement, compliance

Application:

4. Gaps in IFRS (e.g. oil/gas)
5. First-time adoption options
6. Early adoption of changes to IFRS
7. Overt options (e.g. FIFO/weighted average)
8. Covert options (e.g. development costs)
9. Measurement estimations (e.g. fair value)

7. Overt options in IFRS

- 21 examples identified (see Table 9.2)

Research comparing with country traditions

H_4 : The choice of IFRS options by UK and German groups is different

$H_{4(a)}$: UK balance sheets use a financial position format whereas German balance sheets use a report format

Table 9.2 Examples of overt options in IFRS in 2019^a

IAS 1	No format requirements for statements of financial position or comprehensive income (paras 54 and 82).
IAS 1	Permission to show comprehensive income in two statements (para. 81A).
IAS 2	FIFO or weighted average for the determination of the cost of inventories (para. 25).
IAS 2	Marking to market allowed for inventories of commodity broker-traders (para. 3).
IAS 7	Direct or indirect basis for calculating operating cash flow (para. 21).
IAS 7	Choice of classification for interest and dividend flows (para. 31).
IAS 16	Cost or fair value measurement basis for classes of property, plant and equipment (para. 29).
IAS 20	Asset grants can be shown as a deduction from the asset or as deferred income (para. 24).
IAS 27	In parent statements, subsidiaries, joint ventures and associates can be shown at cost, using the equity method or as financial assets (para. 10).
IAS 38	Cost or fair value measurement for some types of intangible asset (para. 72).
IAS 40	Permission to classify a property held under an operating lease as an investment property (para. 6).
IAS 40	Entity-wide choice of cost or fair value as measurement basis for investment property (para. 30).
IFRS 3	For measurement of a non-controlling interest in an acquiree, a choice of fair value or the share of the acquiree's net assets (para. 19).
IFRS 9	Choice of fair value through OCI for equity instruments (para. 4.1.4).
IFRS 9	Choice of fair value through profit or loss for certain instruments (para. 4.1.5).
IFRS 9	Choice to designate a hedging relationship (para. 6.1.2).
IFRS 15	Estimating variable consideration as expected value or most likely amount (para. 53).
IFRS 15	Discounting or not revenue when customer pays in one year or less (para. 63).
IFRS 15	Expensing or capitalising costs on contracts of one year or less (para. 94).
IFRS 16	Lessee may treat short and low-value leases as operating leases (para. 5).
IFRS 16	Lessee may choose not to separate out the service component (para. 15).

Note: ^aparagraph numbers of extant options as at 1 March 2019.

8. Covert options (or vague criteria)

- 19 examples identified (see Table 9.3)
- Capitalisation of development costs raised Volkswagen's equity by 41% when changing to IFRS
- Impairment of assets – recognition
- IFRS “interpretations” are necessary – special committee (IFRIC) exists to decide and issue interpretations

H_5 : The interpretation of standards differs between UK and German groups.

Table 9.3 Examples of covert options or vague criteria in IFRS in 2019^a

IAS 1	Determination of whether a liability is current on the basis of the expected date of settlement or purpose of holding (para. 60).
IAS 8	The determination of materiality for various purposes (para. 5).
IAS 12	Recognition of a deferred tax asset for a loss carryforward only if future taxable profit is probable (para. 34).
IAS 12	Recognition of a deferred tax liability on unremitted profits from subsidiaries only if dividends are probable in the foreseeable future (para. 39).
IAS 21	Determination of functional currency based on a mixture of criteria (paras 9–12).
IAS 28	Identification of an associate on the basis of 'significant influence' (para. 6).
IAS 36	Identification of an indication of impairment based on a mixture of criteria (paras 12–14).
IAS 37	Recognition of a provision based on probability of outflow of resources (para. 14).
IAS 38	Capitalisation of development costs when all of six criteria are met (para. 57).
IAS 38	Amortisation of intangible assets only if useful life is assessed as finite (para. 88).
IAS 40	Use of cost basis, despite entity-wide choice of fair value, for an investment property whose fair value cannot be measured reliably (para. 53).
IAS 41	Use of cost basis for a biological asset whose fair value cannot be measured reliably (para. 30).
IFRS 3	Identifying the acquirer in a business combination presented as a merger of equals (para. 6).
IFRS 5	Treatment of assets as held-for-sale if expected to be sold within one year (para. 8).
IFRS 8	The determination of reportable segments based on a mixture of factors (para. 11).
IFRS 9	Assessment of criteria to allow designation at fair value (para. 4.1.5).
IFRS 9	Estimation of hedge effectiveness as a condition for use of hedge accounting (para. 6.4.1).
IFRS 10	Identification of a subsidiary on the basis of 'power over an investee' (para. 7).
IFRS 16	Lessors classify leases based on 'substantially all the risks and rewards' (para. 62).

Note: ^aparagraph numbers of extant options as at 1 March 2019.

9. Measurement estimations in IFRS

- 13 examples identified (See Table 9.4)
- German companies like large impairments; UK companies do not

Table 9.4 Measurement estimations (2019)

IAS 2	Net realisable value of inventories (paras 30 and 31).
IAS 12	Tax rate for deferred tax calculations based on the expected manner of settlement or recovery (para. 51).
IAS 16 (and IASs 38, 40)	Depreciation (or amortisation) based on estimates of useful life, residual value and pattern of consumption (paras 50, 51 and 60).
IAS 16 (and IASs 38, 40)	Fair value when selected as a measurement basis (paras 31–34).
IAS 19	Pension obligations based on estimates of mortality, final salary, etc. (para. 75).
IAS 36	Discounted cash flows or net realisable values for impairments (para. 18, etc.).
IAS 37	Best estimate of provisions based on percentage likelihoods of outflows (para. 40).
IFRS 9	Fair values for certain financial assets and liabilities (para. 5.2.1).
IAS 41	Fair values for biological assets (para. 12).
IFRS 2	Fair value of equity instruments (e.g. share options or shares in an unlisted company) granted to employees (para. 11).
IFRS 3	Allocation of cost of a business combination to assets and liabilities of acquiree based on fair values (para. 18).
IFRS 15	Estimating variable consideration (para. 50).
IFRS 16	Lease term depends on estimating whether optional periods will be exercised (para. 18).

Test by Kvaal/Nobes (2010): Data

- Index companies of 5 largest IFRS-using markets (Australia, France, Germany, Spain, UK) = 232 companies
- First full year of IFRS (2005/6)
- Hand-collected data on choices of 16 IFRS options
- Other variables: auditor, sector, SEC-registration, size

Hypotheses

- Null hypothesis of same practice in all countries
- 19 alternative hypotheses
- H_3 : French and Spanish companies are more inclined than others to show equity-accounted profits after finance items
- 84 tests: 69 rejects of null hypothesis at 1%; 7 at 5%; 8 not rejected

	Australia	UK	France	Spain	Germany
1a) income statement by function	59.3	47.2	54.8	4.0	76.5
1b) by nature	29.6	13.9	45.2	96.0	23.5
1c) neither	11.1	38.9	0.0	0.0	0.0
N (= non-financials)	27	72	31	25	17
2a) inclusion of a line for EBIT or op profit	51.9	97.2	100.0	96.0	100.0
N (= non-financials)	27	72	31	25	17
3a) equity acc included in operating	63.2	24.5	6.9	0.0	18.8
3b) immediately below	15.8	34.0	3.4	8.3	62.5
3c) below finance	21.1	41.5	89.7	91.7	18.8
N (= non-financials with equity accounting)	19	53	29	24	16
4b) showing net assets	100.0	81.9	0.0	0.0	0.0
N (= non-financials)	27	72	31	25	17
5Ab) liquidity increasing	0.0	100.0	100.0	96.3	85.0
N (= non-banks)	37	90	32	27	20
5Ba) liquidity decreasing	100.0	100.0	100.0	100.0	100.0
N (= banks)	7	8	3	5	3
6b) OCI statement	65.9	83.7	5.7	25.0	21.7
N (= all)	44	98	35	32	23
7b) indirect cash flows	0.0	98.0	100.0	87.5	100.0
N (= all)	44	98	35	32	23
8a) dividends received as operating	87.5	36.7	92.9	50.0	66.7
N (= companies showing dividends)	40	60	28	18	6

	Australia	UK	France	Spain	Germany
9a) interest paid as operating	90.9	68.4	88.6	38.7	61.9
N (= companies showing interest paid)	44	98	35	31	21
10b) some PPE at fair value	13.6	12.2	0.0	0.0	0.0
N (= all)	44	98	35	32	23
11b) investment property at fair value	42.9	73.1	0.0	0.0	0.0
N (= companies with investment properties)	28	26	7	14	15
12a) some fair value designation	29.6	12.5	32.3	12.0	5.9
N (= non-financials)	27	72	31	25	17
12a) some fair value designation	52.9	73.1	100.0	57.1	33.3
N (= financials)	17	26	4	7	6
13a) interest capitalization	75.8	47.5	40.0	94.7	22.2
N (= companies specifying borrow. costs)	33	59	25	19	18
14a) FIFO only	27.3	57.1	11.5	5.9	0.0
14b) weighted average only	59.1	30.6	57.7	88.2	71.4
N (= companies with inventory)	22	49	26	17	14
15a) actuarial gains/losses to OCI	72.7	84.4	20.0	12.5	47.6
15b) to income in full	18.2	3.3	5.7	37.5	0.0
15c) corridor	9.1	12.2	74.3	50.0	52.4
N (= companies with defined benefit plans)	33	90	35	16	21
16a) proportional consolidation	0.0	22.4	81.3	84.6	31.3
N (= companies with joint ventures)	27	67	32	26	16

Policy changes

- Kvaal and Nobes (in *European Accounting Review* 2012) show that there was little IFRS policy **change** from 2005 to 2008
- but that there was more for France/Spain than for Australia/UK
- See up-dates about this whole topic in Nobes (2013 in *ABR*), and Stadler/Nobes (2014 in *Abacus*)

Summary

- Countries have adopted IFRS in different ways, sometimes not fully
- Companies apply IFRS influenced by practices followed previously
- IFRS has been successful in that it has brought about major reduction in accounting differences, but some international differences remain
- Users of IFRS financial statements need to beware of differences
- Over time, expect variations to reduce