# The impacts of the implementation of International Accounting Standards

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***Abstract***
*This paper belongs to the category of literature review. In this descriptive article we take a brief look at the impacts of the implementation of International Accounting Standards. The continued globalization of business has led to the development of internationally applicable standards and codes of practice. The remarkable expansion of international trade and business, the international co-operation among countries and the breaking down of national barriers led to new challenges and new problems too. Problems in the analysis and comparison of financial reports and differences in auditing and taxation practices among countries made necessary the application of International Accounting Standards. Harmonization of this practice in order to get closer to a universal accounting language is affected by many factors such as: economic, financial, social, legal, cultural, political and others. Moreover, the level of preparedness for each country is significantly associated with many other factors. This process, as every new measure, had both positive and negative effects. So, this study highlights the advantages and disadvantages of adopting a uniform set of International Accounting Standards worldwide and also examines their volatility effects.*

Keywords: International Accounting Standards, Adoption, Positive and Negative Impacts.

## Introduction

Although accounting standards were important determinants of financial reporting quality, they differed significantly across countries. A commonly held belief was that such differences reduce the quality and the relevance of accounting information. Proponents of harmonized international standards claimed that if all firms follow the same set of accounting standards, external financial reports of firms will provide more uniform disclosures and more useful accounting information (Purvis et al, 1991) and , of course, these would not repress the idiosyncracies of each national accounting system. Besides this, accounting control would be easier. These suggestions contributed to the acceptance of International Accounting Standards in many parts of the world. So this process, has received considerable attention not only from accountants or banks but also from investors, regulators and academics.

## Theoretical Background

International Accounting Standards are issued by the International Accounting Standards Board, formerly known as International Accounting Standards Committee. The main objective of International Accounting Standards Board is to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make robust economic decisions (Epstein and Mirza, 2002).

Following the Lisbon summit, the effective date for the adoption of International Accounting Standards for listed firms that belong to member states of the European Union was 1 January 2005. From that date, all listed companies produce their accounts under International Accounting Standards rather than the various local rules that had been adopted previously.

## Effects of International Accounting Standards adoption

International harmonization of accounting standards did not exist in isolation but in a mosaic of complex sets of institutions, capital markets, stock markets etc. Next, we can see the issues arisen by the harmonization of accounting standards globally.

**Positive effects**

The development of International Accounting Standards was of very great benefit in bringing standardization to international investment. But this was not the most important point about the new international approach. The most important point was that by adopting the decision-making criteria and providing investors and creditors and others with the information they require for making forecasts and judgments about the future, the efficiency of markets is improved and the cost of capital falls. The markets represent a trade-off between risk and return. If accounting information is more reflective of economic reality, and more transparent, the risk in investment is reduced and the returned required is reduced also, to the benefit not only of the company but of society as a whole. When one considers that even a small improvement in the efficiency of the major capital markets will lead to an enormous increase in wealth; and when one considers that the establishment of decision orientated accounts in the many countries which do not yet have such accounts, it can be seen that the benefit to even the poorest members of society and the poorest countries will be very considerable indeed. It is difficult to think of any other activity which in the hands of relatively few people can bring such very great benefit to so many. Standard setting is an important activity and not just a technical one. In the past, accounts around the world have been based on a number of principles apart from decision-making – stewardship is one; another is the protection of creditors; another is the satisfying of the needs of the taxation authorities. Very frequently in a particular country the aims of financial statements are not clearly articulated, except perhaps in the case of the taxation authorities who know what they want, quite justifiably of course. But since taxation may have principles at variance with decision-making it is essential that the two approaches are split (Damant, 2003).

Following the benefits of International Accounting Standards adoption and the fair value of International Financial Reporting Standards, International Accounting Standards also appear to lead to higher annual stock returns and return on assets (Iatridis, 2007).

Despite the transition costs, International Accounting Standards implementation has favorably affected the overall financial performance and position of firms and is likely to lead to more value relevant accounting measures (Barth et al, 2005; Tendeloo and Vanstraelen, 2005; Hung and Subramanyam, 2007). Under International Financial Reporting Standards, key financial figures, such as profitability and growth, appear to be higher. Also, firms exhibit higher leverage measures, following the high International Accounting Standards financial reporting quality, which can reduce the potential uncertainty and risk that is attributed to a firm (Ball et al, 2003) and subsequently enhance the credibility and the borrowing bargain power of firms (Iatridis, 2007).

Also, International Financial Reporting Standards implementation helps making unbiased predictions about firms' future performance, standardizes the accounting practice and reduces information asymmetry and the scope for earnings manipulation, thereby enhancing the stock market efficiency (Iatridis, 2007).

Some other positive impacts are the next ones:

- Financial institutions make loans across borders and operate multinationally.
- Vendors want to evaluate the financial health of buzzers in other countries before they sell goods or services on credit.
- Credit rating agencies try to develop rating uniformly across borders.
- Many Small-Medium enterprises have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship.
- Venture capital firms providing funding to Small-Medium enterprises across borders.
- Many Small-Medium entities have outside investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they have interests in other Small-Medium enterprises.
- Global standards also improve consistency in audit quality and facilitate education and training (Bohusova, 2007).

The implementation of international accounting standards reduces the information asymmetry between informed and uninformed investors (Bushman and Smith, 2001). This smoothes the communication between managers and other related interested parties and as a result reduces the related agency costs that might otherwise arise (Bushman and Smith, 2001; Healy and Palepu, 2001). Lower information asymmetry also leads to lower costs in issuing equity capital (Glosten and Milgrom, 1985; Diamond and Verrechia, 1991) and debt (Clarkson et al, 1996; Sengupta, 1998; Botosan and Plumlee, 2002).

The practice of international accounting standards provides national and international decision makers with a relatively homogenous information product that is comparable and reliable. Also, this process is expected to improve the quality and credibility of accounting information and improve the flow of capital and investment, resulting in economic development (Zeghal and Mhedhbi, 2006).

According to Wolk, Francis and Tearney (1989), international accounting harmonization is beneficial for developing countries because it provides them with better-prepared standards as well as the best quality accounting framework and principles.

Multinational business seeks international harmonization so as to reduce the costs of, first, analyzing accounts of different countries and, second, of running different accounting systems in different countries. A third point of interest to the EU is to avoid any individual member state setting low standards of accounting disclosure so as to attract registration of companies attached to secrecy, at the expense of other EU members (Blake et al., 1998).

Elliott and Elliott (2002) suggest a number of arguments to support the use of common standards, including:

- Comparability: financial statements should allow a user to make predictions of future cash flow, make comparisons with other companies and evaluate management performance. In order to make inter-company comparisons, as performance, progress and trends, investment decision-makers must be supplied with relevant and reliable data that has been standardized. Comparisons would be valueless if companies were permitted to select accounting policies at random, or to “cherry pick” policies with the intension of disguising changes in performance and trends;
- Credibility: uniformity of subjective treatment is essential if financial reports are to disclose a true and fair view;
- Influence: the process of formulating standards should facilitate a constructive appraisal of the policies being proposed for individual reporting problems, thereby stimulating the further development of the conceptual framework; and
- Discipline: mandatory standards encourage a systematic ongoing regulation, that acts as a credible framework for those who rely on the annual accounts when making credit, loan and investment decisions.

According to Eccles and Holt (2001), by adopting this accounting framework, the EU has underlined its commitment to a fully-integrated European financial market. The International Accounting Standards serves additional functions, including the provision of a solid reporting infrastructure and clear standards that leave few options for “creative accounting” or misinterpretation. Being independently set, the standards provide a consistency of application that ensures a high quality audit process supported by appropriate sanctions.

Generally, benefits of global accounting standards for listed companies are obvious in the globalize financial market.

**Negative effects**

On the other hand, the more cynical commentators suggest that the standard setters have made their requirements deliberately difficult to implement (Moore, 2002).

The study of Ding et al (2007) shed light on two measures – absence and divergence – between domestic accounting standards and international accounting standards. The conclusions were two: 1) the level of absence is higher in countries with less developed equity market and with a higher ownership concentration and 2) divergence between domestic accounting standards and international accounting standards is positively associated with the economic development and the strength of the accounting profession but is constrained by the importance of equity markets (Ding et al, 2007). So, these meters are more applicable for some countries and less applicable for some others.

Some other negative impacts are:

- Good accounting and more disclosure add to Small-Medium enterprises burdens, rather than reduce them.
- Small-Medium entities are often concerned about the competitive harmfulness of greater transparency (Bohusova, 2007).

Especially for the banks:

- The criticism of accounting leveled after various derivatives scandals has been that the rules allow companies to run up large losses off balance sheet and the first that investors know of this is when companies fail or make large write-offs. Unsurprisingly, accounting standard setters tend to favor putting derivatives into the accounts at fair value. Since it then becomes difficult conceptually to draw the line between derivatives and other types of financial instrument, this leads to a logical conclusion that all financial instruments should be fair valued.
- Banks, who are heavy users of derivatives and even heavier users of financial instruments in general (indeed the vast majority of their balance sheet probably consists of financial instruments of one form or another) are faced with an unprecedented change to their financials if they adopt fair value accounting for everything. There is a severe risk that the way in which banks articulate their performance, analyze their results, manage their business and control their risk is changed overnight. Understandably, banks cannot see the reason for reporting financial instruments that they hold for the long term, such as loans, at fair value. Further, they have doubts about their ability to actually calculate the fair value of a number of these instruments. With small changes in values potentially having a large impact on profit, banks worry that their profit and loss accounts will become increasingly volatile leading to a knock on effect on capital adequacy. (Taylor, 2003).

Talaga and Ndubizu (1986) stressed that a country’s accounting principles must be adapted to its local environmental conditions. In fact, according to Perera (1989), the accounting information produced according to developed countries’ accounting system is not relevant to the decision models of less-developed countries. These arguments, have led some authors to strongly oppose the adoption of international accounting standards by developing countries (Hove, 1989 and Perera, 1989).

## Conclusion

Accounting harmonization processes repress important differences and idiosyncrasies in national systems of accounting (Gallhofer and Haslam, 2006, p. 917).The fact is that international standards replaced national standards on current practice. On the one hand, such rules are more difficult to delineate in a multi-cultural environment. On the other hand, this way will produce and indeed is already producing accounting process which will be of very great benefit to the world (Damant, 2003). The international demand for standardized regulatory systems and processes has many benefits and negatives too. Finally, all these challenges have provided new opportunities for researchers in the area of international accounting.

According to my opinion, the implementation of International Accounting Standards, extended the accounting homogeneity among different countries and, of course, the positive results are of great significance. But, as in each process, and in this have arisen many difficulties and generally aspects for discussion and further research.

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