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IFRS adoption: A costly change that keeps on costing

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ABSTRACT

This paper documents the results of a study exploring the transitionary and ongoing costs incurred by Australian companies from their use of IFRS. A longitudinal survey approach was adopted. Challenging the underlying logic of convergence, survey results highlighted that IFRS is costly for firms both in the lead up to adoption and thereafter. Specifically, the transition to IFRS imposed significant AIS, staff training and development, financial statement user education, and financial statement adjustment costs on many firms. Furthermore, many firms perceived that IFRS adoption has resulted in an ongoing increase of 20% or more on annual accounting and compliance costs.

1. Introduction

Australia's decision to adopt International Financial Reporting Standards (IFRS) for financial periods beginning on or after 1 January 2005 was part of a wave that has seen many countries replace their domestic accounting standards in favour of international solutions. The change followed a number of years of policy debate and consultation. Given the significance of the change, it is imperative that the decision to adopt IFRS is rigorously stress tested. Such assessments should consider both the potential benefits from IFRS adoption relating to the promotion of the quality of financial reporting globally and benefits to multinational corporations and other global capital market participants (e.g., Ahmed, Chalmers, & Khlif, 2013; Brown, 2011; Singleton-Green, 2015), and also the potential incremental costs imposed on report preparers. This study focuses on the latter.

The costs imposed on companies from IFRS use include those incurred on transition as companies navigate the gulf between IFRS and the domestic standards they replace. The costs of IFRS adoption may also be ongoing to the extent that, compared with prior domestic standards, IFRS are more complex, require a greater depth of disclosure, and/or are subject to greater ongoing amendment. Amongst others, the costs incurred by companies from their adoption and ongoing application of IFRS could be associated with internal staff time, external consultancy and audit support, and systems costs. Companies are also likely to incur opportunity costs from IFRS adoption as resources are redirected towards understanding and managing the transition to the new regime. The costs of IFRS adoption may be relatively more significant for smaller firms.

This study examines the financial burden imposed on Australian companies from the adoption of IFRS and seeks to understand and measure the transitionary and ongoing costs of the change. The clearly defined mandatory IFRS adoption date and strong investor protection make Australia a particularly suitable country to explore such costs (Lai, Li, Shan, & Taylor, 2013). Such a topic is worthy of consideration given that, despite the established understanding of the impact of IFRS adoption on different proxies for reporting quality (e.g., Ahmed et al., 2013; Brown, 2011; Pope & McLeay, 2011), other

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than a limited number of studies which have explored the transitionary costs of IFRS adoption and the impact on audit costs, relatively little research has explored both the transitionary and ongoing costs of IFRS adoption for report preparers. The analysis of the financial burden of IFRS compliance is also an important research topic given conjecture concerning the rules-based and complex nature of IFRS (e.g., Haswell, 2006; Haswell & Langfield-Smith, 2008; Haswell & McKinnon, 2003; Godfrey & Langfield-Smith, 2005; WüStemann & WüStemann, 2010) and growing IFRS disclosure overload angst amongst many stakeholder groups (e.g., EFRAG, 2012).

The researcher adopted a longitudinal survey method involving initial and follow-up surveys completed by Chief Financial Officers (CFOs) and other senior personnel representing Top 400, Australian Stock Exchange (ASX) listed, Australian companies. The initial survey was conducted in late 2005 through early 2006 as most firms were finalising their IFRS conversion projects. To allow time for the ongoing impacts of IFRS adoption to become apparent, the follow-up survey was conducted in late 2008 through early 2009. The sample contained Australia's largest and most internationally active firms whilst also including a diverse cross-section of firms and allowing for comparisons between different companies and the identification of common concerns.

The overall results of this study indicated that IFRS is costly to firms both in the lead up to adoption and thereafter. The majority of respondents to the initial survey agreed that IFRS adoption had required significant time and money being devoted to: systems upgrades; staff training and development; ensuring financial statement users were aware of the impacts of IFRS adoption; and ensuring comparative figures and opening balances were in compliance with IFRS. Almost all respondents to the initial survey supported that, given the onerous nature of IFRS, IFRS adoption would create additional financial reporting work in future years. Consistent with these predictions, most respondents to the follow-up survey agreed that the adoption of IFRS has resulted in ongoing increases in: staff training and development costs; fees paid to external auditors and other external specialists; and the work associated with the preparation of financial statements.

These results will be of relevance to a wide variety of parties. The results provide feedback to Australian regulatory parties involved in the decision to adopt IFRS in their assessment of the effectiveness of the policy to have provided positive outcomes for firms. The results provide a benchmark against which firms can compare and evaluate the efficiency by which they have managed the transitionary and ongoing costs of IFRS adoption. Firms and regulatory parities yet to commit IFRS adoption will also find the results of relevance as part of their respective assessments of the desirability of IFRS adoption, and the possible time and cost needed to make the transition to IFRS.

This paper is divided into five sections. Section two reviews the background to the Australian adoption of IFRS and the existing literature concerning the costs of IFRS adoption for companies. Section three outlines the research method employed and the sample selection procedure. The results of the analysis of survey responses are presented in section four. Finally, the overall conclusions from the study are presented in section five.

2. The costs of IFRS adoption

The decision of the Financial Reporting Council (Financial Reporting Council, FRC, 2002) to adopt IFRS[1] in Australia for financial reports beginning on or after 1st January 2005 was described in the business press as one of the largest changes in the history of the Australian accounting profession. In practical terms, the change represented a "monumental shift in financial reporting" (Jackling, De Lange, & Natoli, 2013: 263) and necessitated an overhaul to the way in which companies account for key transactions relating to intangible assets, share-based payments, and financial instruments (e.g., AASB, 2002; Chalmers, Clinch, & Godfrey, 2011; Ernst & Young, 2002; Goodwin, Ahmed, & Heaney, 2008; Jubb, 2005). These significant areas of change were despite Australia's prior efforts to address accounting standards diversity[2] and the relative alignment of traditional Australian accounting practices with IFRS and other Anglo-American accounting practices (e.g., Gray, 1988; Wines, 1989).

A number of studies have quantified the financial statement impact from the adoption of IFRS for Australian companies. Goodwin, Ahmed et al. (2008), for example, utilized AASB 1 *First-time Adoption of Australian Equivalents to IFRS* reconciliations to examine the impact of IFRS adoption for a sample of 1065 listed firms. The study revealed that IFRS adoption led to a significant increase in liabilities, and a significant reduction in equity and retained profits, although no significant impact on total assets or earnings was identified. The most frequently identified reconciling items included share-based payments, income tax, intangibles, and provisions. An alternative approach to quantifying the impacts of IFRS adoption on Australian company financial statements was employed by Chalmers et al. (2011). Based on a sample of 1205 firms and for the year 2005, this study compared key financial statement items between IFRS and AGAAP. Differences between IFRS and AGAAP were expressed as relative to AGAAP shareholders' equity. Overall, it was revealed that: 1. IFRS equity was, on average, 3.5 percent lower than under AGAAP; 2. the average net income difference was 1.5 percent of AGAAP shareholders' equity; and 3. total assets (liabilities) under IFRS were, on average, 0.4 (3.8) percent higher than under AGAAP. Median differences for all these items were, however, zero suggesting that the averages were affected by several large movements.

Bae, Tan, and Welker (2008) provided international context to the relative number changes encountered by Australian firms in transitioning to IFRS. Based on a survey of 21 key accounting items, Bae et al. (2008) identified four key areas of difference between former Australian and international treatments. This was less than the average of 8.5 differences for the 49 countries studied and well below the number of differences between international standards and the domestic standards of some countries including Finland (15), Greece (17), Luxembourg (18), Russia (16) and Spain (16).