

The advantage and disadvantages of ifrs essay sample

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The introduction

I was required to write an article about the potential benefits and negative impacts of adopting the IFRS, and use UK as an example. I was really new to IFRS, so I did lots of literary review to find out what is IFRS and advantages and disadvantages that companies used. According to the situation of lots of companies begun to convert their financial reporting standards from Generally Accepted Accounting Principles(GAAP) to International Financial Reporting Standards(IFRS), so the impact of IFRS became the focus of investors. I begin with a short description of IFRS and the history of EU and UK begun to adopt it, and then sum up huge information which i found form the internet, reports and books. I read it, edited it and integrated it. At the ' pro' side, I wrote the extraordinary success has been achieved in using a such comprehensive financial reporting. And on the ' con' side, i wrote the seriously problems which may be occurred in the process of adopting IFRS.

Summary

A various number of companies aournd the world have utilized IFRS as their basis for financial reporting. So there must be have lot of merits and drawbacks to apply it. At the ' pro' side, IFRS use one accounting language company-wide, it will be more consistently and understandable for the companies which adopted IFRS. Due to the transparency and consistency, it will help accountants mor easier to compare the finance information, and good for doing the decision making. In addition, it also can encourage multinational corporation. And on the ' con' side, it is obviously that the IFRS is a quite complex and costly, so cost may a big problem. And due to the different history and laws, IFRS need to follow the laws that there may to

some difference between different countries in some regulations. So it may lack of comparable.

The advantages and disadvantages of UK adopting IFRS

International Financial Reporting Standard(IFRS) are a series of accounting standards developed by the International Accounting Standard Board(IASB) which becomes the global standard for the preparation of public company financial statements(IFRS, 2005). The IFRS for SMEs used to meet the needs and competence of small and medium-sized companies and it accounts for over 95% of all entities around the world. Approximately 120 nations and reporting jurisdictions permit or require IFRS for domestic listed companies, although about 90 countries have fully conformed with IFRS as issued by the IASB and include a statement confirmation such accordance in audit reports. Moreover, European Union aimed to increase the international comparability of financial statement, they applied and standardized IFRS. And over 7000 listed companied adopted IFRS form 2005, so International Financial Reporting Standards (IFRSs) have been a part of financial reporting in the United Kingdom since 2005 when EC Regulation 1606/2002 (' the IAS Regulation') came into effect. 1. The benefits of UK adopting the IFRS

There are lots of benefit for UK to adopt the IFRS, I will analyze these benefit in the following part. 1. 1 Consistently and transparency

Sir David Tweedie, IASB chairman said: " As the world's capital markets integrate, the logic of a single set of accounting standards is evident.

A single set of international standards will enhance comparability of financial information and should make the allocation of capital across borders more

efficient. The development and acceptance of international standards should also reduce compliance costs for corporations and improve consistency in audit quality.” In UK , SMEs use one common global reporting language which can put the new and small investors in the same position with the professional investors, so it will help them making the reporting standard simple and have a high quality, which is impossible under the previous reporting standard. It is also very helpful and reduce the risk while trading due to the simple financial statement. For end users, they use a similar format for their financial statement and it is more easier and transparent to compare the statement each other. The gross margin, operating income and net income fall in the same positions.

The balance sheet, The statement of cash flows and the retained earning statement has the similar format as well. In addition, UK as a member of EU, they use a same financial reporting standards can improve relationship between investors and companies among member countries. IFRS also ensure the transparency and the efficiency of markets.(Meek and Saudagaran, 1990) IFRS will be influenced by the corporate ownership and governance of different countries. For example, UK relies on equity finance, so interests of these investors class dominate and financial reporting needs to meet the needs of users. Furthermore, the benefits of using IFRS will be materialize in the medium to long-term future.

1. 2 Flexible and Understandable

IFRS develop a unified set of accounting and reporting standard which require all companies follow the same guideline, so when one company of UK

understand these guidelines, it can assume that all companies in compliance with the IFRS follow the same guideline. In addition, The financial statement information of IFRS is more accurate, timely and comprehensive, so the information is more understandable for investors. However, IFRS uses a principles-based philosophy which has many ways to achieve a reasonable valuation. So companies will more easier to read and use the statement accord to their particular situation. 1. 3 Global comparability

By adopting IFRS, companies use same standards to present its financial statement and compare more easier to their competitors over all financial markets, regardless of the country of origin. There are more than 8000 listed companies in the EU adopted IFRS in the same year. So if one foreign company must use IFRS, the companies in UK need to corporate with the companies, they must use IFRS too. It is a global acceptance accounting framework. For all the companies which adopted IFRS in UK, they use same reporting standard under which can improve the comparability not only for investors, but also all stakeholders who use the financial statement.

Furthermore, for the end users of companies, they can access the financial statement in the internet to do the peer to peer comparison, they can compare the net income and calculates financial ratios for different companies. This also removes the trade barrier. 1. 4 Decision making

The new IFRS reflects on economic substance more than legal form which can helps the companies and other stakeholders to have true and fair view of the companies' transactions. In addition, IFRS is more reliable and credible to reflect the gains and losses so it can help investors and shareholders to

make decision. From the perspective of a more detailed analysis of IFRS, the investors and stakeholders can recognizing the loss immediately within the company. So they can make the decision timely when they discover the loss, it can increase the efficiency of contracting of companies and it also can strength the corporate governance. This timelier loss recognition of IFRS enables the companies review its value of asses and liabilities, earnings and equity, thereby reduce the risk.

1. 5 Multinational corporation and cost

A thousands of companies in the world has adopted IFRS, so it can encourage more companies access the financial market by having one financial reporting standard. Just one group of accounting standards will give us comparability and transparency which will promote the corporate of international. It is more easier cross-border investment with greater liquidity and inexpensive of capital. (Jermakowicz and Gornik-Tomaszewski2006). So the benefits of IFRS implementation are more apparent to corporate shareholders. Because higher information quality can reduce the risk of buying and owning shares to investor and the risk of lack of information which contribute to misunderstanding of the selection. It will also decrease time and charges of planing financial reports depend on different standards and regulations, thus it saves lots of capital within longtime. For example, it can save cost through tax implication, like Deferred tax which“ is no option to discount this and generally revaluations will require recognition of deferred tax where previously they did not.”(NEWUKGAAP, 2005).

However, before they enjoy the cost saving they can consider to use the money as a transitional costs. Chalmers and Godfrey(2004) said that “ some companies disclose certain information to maintain their reputation and credibility with their institutional investors”. For example, if a company have a good reputation for financial probity, they can charge their products for a higher price , hire more experienced employees and more easier to access the market. Meanwhile, Cornell and Sirri (1992) argue that “ increased IFRS disclosure is likely to result in a reduction in information asymmetry among shareholders which might in turn lead to an improvement in the market liquidity of a company’s shares, the lowering of bid-ask spreads and an increase in the volume of share transactions that take place.”

1. 6 Impact the structure of company

De Jong et al. (2006) explored that IFRS may be influence the capital structure of a company. He found when International Accounting Standard (IAS) 32 was adopted, the debt ratio of companies with preference shares increased 35%. In addition, over two-third of companies chose to buy back the shares or change the specifications of the shares to allow them to qualify as equity. So it will encourage companies to rebuild their capital structure when implement the IAS 32.

2. The potential negative impacts that UK may face.

As the mention of the previous part, IFRS bring lots of benefits for UK.

However, it is not ignored that due to the first time for UK to adopt IFRS, so there must be some negative influents occurs.

2. 1 The high costs of converting to IFRS

UK is based on common law, and now many companies move from UK GAAP to FRS 102 and it is also based on the IFRS for SMEs, but it is not the same as IFRS. For instance, the IFRS for SMEs prohibits revaluation of fixed assets or capitalization of borrowing or development costs. The Institute of Chartered Accountants in England and Wales (ICAEW, 2007) suggests that “ the costs associated with the IFRS implementation process comprises of: establishing an IFRS project team, training other staff such as IT staff, internal audit and management, training staff, obtaining external technical advice, taking tax advice, changing software and systems, communicating with third parties, incurring additional external audit costs, renegotiating debt covenants and obtaining other external data requirements.” From the process, we can see that convert to IFRS is quite complex and costly, so it may be a big disadvantage for SMEs as they will be impacted by the large transition costs and the high level of complexity of IFRS may not be absorbed by SMEs.

In addition, small businesses don't have many resource to support implementing the changes, a survey of the FTSE 350 by PriceWaterhouse Coopers (PWC) finds that they need to hire more professional accountants or other outside consultants to help them change(PWC, 2006). So these will be another financial burden for the companies. Meanwhile these costs depended on the nationality of the company, its size and its sector; for example, in the UK interviewees quoted IFRS costs of between £1 million and £50 million.(Alison F, Gwen H, Christine H and Monica V, 2013). However, Darenidou et al. (2006), Jermakowicz and Gornik-Tomaszewski (2006) and

Ernst & Young (2006) also found that the additional resources cost costed by companies are necessarily. 2. 2 Lack of comparability and inconsistency

Although there have over 8000 listed companies in the EU adopted in it the same years, there also have an argument about the lack of comparability and inconsistency. " Due to the strong national identity of IFRS reports, as the main effects of IFRS has been on how companies recognize, measure and disclose items. And the companies have adopted an approach which minimized the changes from previous national standards which reduced the ability to compare the financial statements across an industry."(Anna J, 2013) Due to the IFRS is totally new so it has not fully been adopted yet by all EU member countries. And compared to GAAP, IFRS has much less overall detail. For example, IFRS contains little industry-specific instruction which created gaps and inconsistencies in the IFRS reporting standard. So if a UK company needs to incorporate with a companies which is use GAAP. Due to lack of industry-specific instruction, the corporation may has negative influents. Olson(2009) said that " incomparability may raise as companies claim to have converted to IFRS but in reality have only selected the portion that best fit their needs." In addition, IFRS is more complicated than the national accounting standard which is used by UK, therefore, it may be a complex mechanism but it can't promote the performance of the companies. And companies don't believe IFRS can provide more detail information as GAAP. 2. 3 The impact of investors and accountants

There has a flexible rule of IFRS: companies can show only show what they need to show and follow their wish to use IFRS. This may lead to revenue or

profit manipulation. For investor, these information may be misleading. For example, some company change their method of inventory valuation which will bring more income into the profit and loss statement, so investors may see more profit than real, they may make the wrong choice. For accountants, they need to learn the new IFRS. Thus companies should invest huge money to support the accountants have a comprehensive training. 3. Conclusion

This report said that the positive and negative influence of adopting IFRS. However, the positive one is more important and more useful. And the evidents which I mentioned in the article prove IFRS is the best financial reporting standard and more and more companies should try to utilize it.

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