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The impact of the introduction of IFRS on corporate annual report and accounts in the UK

Finningham, Gary D.

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Gary D. Finningham

2010

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THESIS
2010

The Impact of the Introduction of IFRS on Corporate Annual Reports and Accounts in the UK

Gary D Finningham

A Thesis Submitted to the University of Dundee in Fulfilment of the Requirements for the Degree of Doctor of Philosophy, May 2010.

Dedication

For my mother Sheila, my father Derek, my sister Michelle and my partner Cleo. Thank you all for your love and support.

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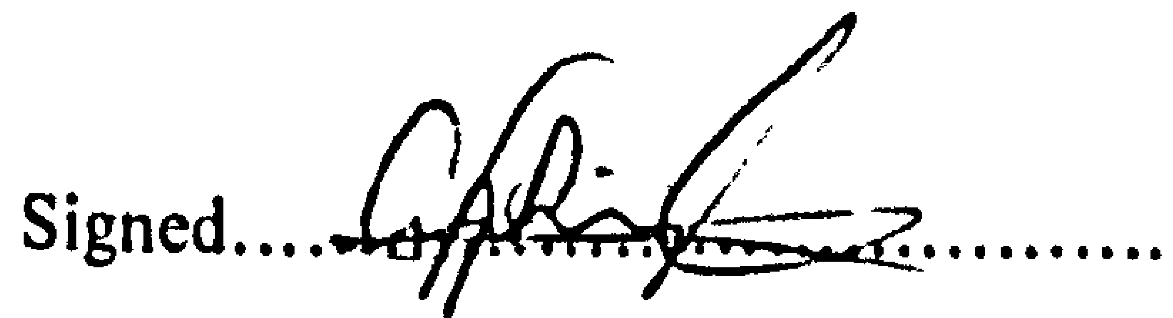
Finally, I would like to thank my mother Sheila, my father Derek, my sister Michelle and my partner Cleo whose love and support has been invaluable.

Declaration

I hereby declare that I am the author of this thesis, that the work of which this thesis is a record has been done by myself, and that it has not previously been accepted for a higher degree.



Signed.. Date..31.05.10......................

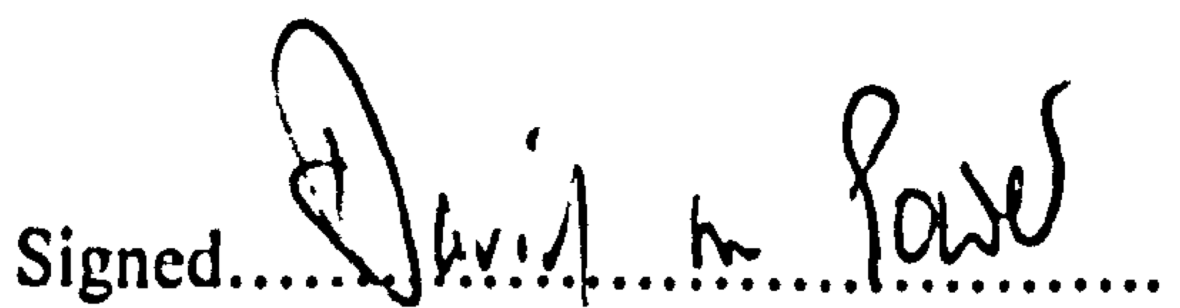
Mr G. D. Finningham

Certificate

We certify that G. D. Finningham has worked the equivalent of nine terms on this research, and that the conditions of the relevant ordinance and regulation have been fulfilled.

Signed.. Date..31..May..2010

Dr. T. M. Dunne



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Prof. D. M. Power

Abstract

From 1 January 2005, all EU-listed firms are required to prepare their consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) (EU, 2002). This requirement represents one of the most fundamental changes to affect financial reporting in recent times. This dissertation is an examination of the introduction and impact of IFRS on the annual report and accounts of UK companies in an attempt to investigate the decision-usefulness of the new IFRS disclosures. This examination is facilitated in three ways: (i) a content analysis is undertaken to investigate the magnitude and nature of the changes in IFRS-related disclosure presented in annual report and accounts produced prior to and following the introduction of IFRS; (ii) an analysis of the Reconciliation Statements produced upon first-time adoption of IFRS included in corporate annual reports to examine the impact on both profit and equity as a result of the transition from previous national GAAP to reporting in accordance with IFRS; and, (iii) an assessment of the new IFRS disclosures against the qualitative characteristics outlined in the IASB Decision-Usefulness framework. In other words, it is an investigation of whether the claims of the IASB about the usefulness of the mandated IFRS disclosures for decision-makers are supported in practice with the contents of corporate annual reports and accounts in the UK.

The results of the content analysis indicate that the implementation of IFRS had a significant impact on the content of the annual report and accounts of UK companies. The amount of disclosure in company annual reports increased significantly following the introduction of the new reporting regime. Furthermore, there was a large increase in the

physical size of the annual reports for the vast majority of the firms surveyed. The scale of the impact varied from standard to standard, however, the nature and magnitude of the information presented in UK-published annual reports has been fundamentally impacted by the introduction of IFRS. The Reconciliation Statement analysis results reveal that profit disclosed under UK GAAP increased by 105.85 per cent following the implementation of IFRS. In addition, the results show that the introduction of IFRS had a significant impact on reported equity; however, there was an almost even split between those which experienced a favourable impact following the transition and those disclosing a negative effect on the balance sheet post-IFRS adoption. The main IFRS standards which impacted reported results under previous national GAAP were IAS 10, IAS 12, IAS 19, IAS 40 and the IFRS 3/IAS 36/IAS 38 group of standards.

The assessment of the decision-usefulness of the new IFRS information reveals that the widespread variation in impact on reported results, the complexity of the supplementary narrative disclosures, absence of company-specific and forward-looking information, uncertainty about the long-term impact of the changeover and the lack of comparability between the Reconciliation Statements will likely have constrained the usefulness of the new disclosures for users and therefore their investment decisions. Thus, one of the aims of the standard setters does not seem to have been achieved as users of UK corporate annual reports were not supplied with more useful information about these companies compared to what was previously disclosed under UK GAAP.

Chapter 1

Introduction

Chapter 1 – Introduction

1.1 Preamble

The 1990s and early years of the twenty-first century have witnessed an unprecedented growth in the globalisation of business activity (Walton et al., 2003). Advances in information technology mean that improved communication has led to reductions in transaction costs and increased economies of scale for companies which operate in different locations; as a consequence, firms have grown not only in size, but also geographically (Godfrey and Chalmers, 2007). This period of development has also witnessed a continuous integration of the world's capital markets, enabling organisations to obtain listings on international stock markets and gain access to potentially valuable sources of capital (Larson, 1997; Haller, 2002). The globalisation of business, coupled with the internationalisation of capital markets, has led to a globalisation in the language of business, that is, accounting (Godfrey and Chalmers, 2007).

Until the 1990s, different accounting practices existed between various countries which constrained the comparability of financial statements between companies located in different regions (Dzinkowski, 2006). This lack of uniformity in accounting practices possibly created barriers for international investors and the international offering of securities (Doupnik and Salter, 1995; Eitemann et al., 1992). As the process of globalisation gathered pace, the benefits from harmonising the financial reporting requirements of different countries became more apparent. For example, it was argued that accounting harmonisation would provide more uniform disclosures by companies worldwide; it would enable stakeholders based in different countries to

use financial statements published by companies located in various jurisdictions using a common set of reporting standards (Street and Shaughnessy, 1998; Murphy, 2000).

One of the most fundamental and controversial developments in the attempt to achieve accounting harmonisation in recent years was the commitment of several countries, including the US, UK, Canada and Australia, to work towards the production and uniform adoption of a set international accounting standards (IAS). In 2002, these efforts culminated in the passing of European Union (EU) Regulation No. 1606/2002 requiring all publicly-traded EU incorporated companies to publish their consolidated financial statements in accordance with International Financial Reporting Standards (IFRS)[1] for accounting periods beginning on or after 1 January 2005 (EU, 2002). The corporate financial reporting practices of EU-listed firms may therefore have been affected by this change; the basis underpinning the preparation of the corporate annual reports became subject to a whole new set of reporting standards which may consequently impact upon their published earnings and reported financial positions.

This thesis examines the impact of the introduction of IFRS on corporate reporting disclosures by undertaking a content analysis of IFRS-related disclosures provided in corporate annual reports and an analysis of the IFRS Reconciliation Statements produced upon first-time adoption under the new reporting regime. To date, there has not been any large-scale systematic analysis of the impact of the new reporting standards on both disclosure practices and the financial statement numbers in the UK

[1] Throughout the current thesis, IFRS will be taken to include both International Accounting Standards (IAS) issued by the International Financial Reporting Standards Board's (IASB) predecessor, the International Accounting Standards Committee (IASC), and International Financial Reporting Standards when general reference is made to both. Otherwise IAS and IFRS will be used as appropriate to the context of the argument.

context; the present investigation offers an opportunity to remedy this deficiency. It therefore attempts to plug the gap in the existing literature at the current time.

The remainder of the introductory chapter is structured as follows. Section 1.2 outlines the key research questions that are investigated in the current study. The methodology and method utilised are also briefly discussed. A brief description of the structure of the dissertation concludes the chapter.

1.2 Scope of the Research

The primary objective of this study is to examine the impact of IFRS on corporate reporting disclosures in the UK in order to assess the decision-usefulness of the IFRS information for users. This objective is facilitated in three ways: (i) by an examination of the narrative IFRS disclosures included in corporate annual reports before and after the implementation of the new reporting regime; (ii) by an analysis of the Reconciliation Statements produced upon first-time adoption of IFRS included in corporate annual reports; and, (iii) by an assessment of both the narrative and numerical IFRS disclosures included in corporate annual reports against the qualitative characteristics outlined in the IASB Decision-Usefulness framework[2]. This investigation is undertaken in an attempt to determine whether the claims of the IASB about the usefulness of the new information are supported in practice by the contents of the annual reports analysed in the present study.

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[2] The IASB stated in its '*Framework for the Preparation and Presentation Financial Statements*' published in 1989, and subsequently reinforced in a Discussion Paper published in 2006, that the underlying objective of financial statements should be based on a decision-usefulness approach. Thus, the adoption of the decision-usefulness framework in the present study seems logical since it will allow the researcher to assess the impact of the introduction of IFRS on corporate annual reports against a fundamental objective that the IASB has purported to achieve. For further details on the decision-usefulness theoretical framework, see Chapter 3.

In attempting to examine the impact of IFRS on corporate reporting and the decision-usefulness of the IFRS-related information provided in annual reports, this study endeavours to add to the existing literature on accounting standard adoption, corporate reporting practices and the decision-usefulness of corporate information. The study seeks to achieve this by: (i) providing a detailed analysis of the particular impacts of IFRS on the disclosure practices of companies required to conform to the new reporting regime; (ii) examining the impact on both profit and equity as a result of the transition from previous national Generally Accepted Accounting Principles (GAAP) to reporting in compliance with IFRS for the first time; and, (iii) investigating the potential consequences of the new IFRS-related information in the context of decision-usefulness.

Much of the discussion in both the academic and financial press surrounding the introduction of IFRS prior its adoption in 2005 was based on: (i) simulations of what might happen to company financial statements (Kasanen et al., 1992; Teodori and Veneziani, 2005); (ii) anecdotal evidence from the experiences of a few early UK adopters (Accountancy Age, 2004; FT, 2005a); (iii) empirical studies documenting the practices and levels of compliance of early adopters in various European countries (Taylor and Jones, 1999; Street et al., 2000; Cairns, 2001; Street and Gray, 2001; Aisbitt and Walton, 2005); (iv) studies which have examined the differences and convergence between IFRS and US GAAP (Street and Gray, 1999; Street et al., 2000; Tarca, 2004); (v) consultancy reports published by firms advising companies on preparation for the transition (PwC, 2002a; KPMG Ireland, 2003); (vi) surveys which have sought the views of various stakeholders about the change to IFRS reporting (Fearnley and Hines, 2002; Fearnley et al., 2007); and, (vii) studies which have

investigated the value relevance of financial information produced under IFRS (Hung and Subramanyam, 2004; Bartov et al., 2005; Lin and Chen, 2005).

Preliminary evidence had suggested that changes to the financial statements of EU-listed companies would be substantial; for example, Vodafone reported that the adoption of IFRS in 2005 in its financial statements resulted in the restatement of a £1.9bn loss into a £4.5bn profit (FT, 2005b), while Astra Zeneca reported a $0.02 decrease in earning per share and a reduction of $48bn in net assets in their 2005 IFRS re-stated results (Accountancy, 2005a). Furthermore, BA announced that it would not be able to pay a dividend in 2005 due to its £1.4bn pension deficit reported under IFRS (FT, 2005c).

Early post-implementation studies of the impact of IFRS have focused on: (i) empirical studies examining the impact of the transition on company financial statements (Accountancy Age, 2005a; Accountancy, 2006a; Ormrod and Taylor, 2006); (ii) an assessment of the implementation experiences of IFRS-compliant companies (BDO, 2006; Ernst and Young, 2006; FRC, 2006; PwC, 2006a); and, (iii) surveys documenting the initial opinions of various stakeholders about the implementation of the new reporting regime (Financial Director, 2006; PwC, 2006b; BDO, 2007). Thus, there is little empirical evidence to date that examines the nature of the disclosures produced by companies following the implementation of IFRS. This is a particularly important issue as the basis underpinning the preparation of corporate annual reports as well as the components, formats and presentations of the financial statements will have changed following adoption.

In addition, although an examination of the IFRS Reconciliation Statements required by adopting companies as part of first-time adoption has been undertaken, this research has been assessed either in the context of their information effects and value relevance in the marketplace (Christensen et al., 2007; Horton and Serafeim, 2008) or based on the impact of IFRS on the balance sheet only (Aisbitt, 2006). Therefore, little research has been conducted to determine whether concerns raised about the possible financial impact of the transition to IFRS reporting are substantiated by its effect on both the reported profit and equity of adopting companies. Further, few attempts have been made to determine whether the IFRS standards which were subject to significant discussion by affected companies prior to the adoption of IFRS gave rise to sizeable adjustments in the financial statements following the changeover. Thus, the current study is an attempt to fill these gaps by providing a systematic study of the impact of the introduction of IFRS on both the disclosures and reported results included in corporate annual reports for a large sample of UK firms. The focus on the impact of IFRS in the UK provides the researcher with the opportunity to compare the adoption of the new regime against a well developed set of national standards given the high level of quality associated with UK GAAP (Haller, 2002); such a comparison will add weight to an assessment of the decision-usefulness of IFRS information disclosed by adopting companies. Further, focusing on the effect of IFRS adoption by UK companies offers a unique implementation context in comparison to many other EU countries; unlike other EU countries, the UK did not permit the use of IFRS for financial reporting or undertake significant convergence between UK GAAP and IFRS prior to mandatory adoption in 2005[3]. Finally, it is contended that undertaking

[3] For example, German and Austrian companies were permitted to apply IAS for consolidated financial statements in 1998 whilst large-scale convergence between national GAAP and IFRS was undertaken in the Netherlands between 1998 and 2003 (Horton and Serafeim, 2008).

this study for a large number of sample companies will facilitate general conclusions about the effect of the new reporting standards on corporate disclosure practices.

The current study is exploratory in nature and assumes an intermediate standpoint between the interpretive and functionalist paradigms identified by Burrell and Morgan (1979). The aim is to provide a descriptive account of both the IFRS-related disclosures and IFRS Reconciliation Statement numbers provided in corporate annual reports. This approach was undertaken because of the dearth of work in this research area and because such a paradigm is consistent with the world views of the researcher[4].

1.3 Structure of the Thesis

The dissertation is organised into eight chapters. Following the current introductory chapter, Chapter 2 provides a review of the literature concerning the issues to be examined in the present study. Specifically, it introduces the concept of accounting standard harmonisation and the debate concerning the introduction of a global set of accounting standards. The chapter outlines the IASB's attempt to harmonise international accounting practices through the development and subsequent adoption by the EU of its IFRS framework. Studies which have examined voluntary moves toward the adoption of IFRS prior to implementation in 2005 are discussed, while details of the new international standards are provided and include an outline of the IASB standard setting process and a discussion of problematic standards highlighted in the literature. Empirical investigations concerning the anticipated impact of the

---

[4] The thesis is part of a larger project funded by ICAS which examined the impact of the IFRS-adoption process. A number of parts in the larger study which focused on interviews about the change to international accounting standards are not included in the current thesis since they are not conducted by the author (Dunne et al., 2008).

introduction of the new reporting regime are also described. In addition, the role of the US in the harmonisation process is outlined and an overview of studies which have examined the adoption of IFRS in range of countries is provided. The introduction and potential impact of IFRS in the UK is examined given that the focus of the current thesis is on the impact of International GAAP on UK corporate disclosure practices. Early post-implementation studies of the impact of the new standards in the UK are also reviewed. Thus, Chapter 2 attempts to provide a comprehensive overview detailing the many stages of the development and attempts to harmonise international reporting practices through the introduction of IFRS.

The purpose of Chapter 3 is to discuss the theoretical framework adopted in the current investigation. This theoretical framework is based on the decision-usefulness literature. The chapter describes the decision usefulness objective for the information disclosed in financial statements. It defines what is meant by the term "decision-usefulness" and illustrates how the approach has been adopted by standard setters – initially in the UK and US and then more recently by the IASB. A discussion detailing previous studies that have employed the decision-usefulness approach in their research is offered, while criticisms of the theoretical framework are also outlined.

Chapter 4 outlines the research methodology adopted and describes the research methods underpinning the analysis undertaken in the current study. Assumptions about the nature of reality and the contribution of knowledge will directly impact on the choice of methodology (Burrell and Morgan, 1979). Indeed, the world views held by the researcher are likely to have implicit or explicit ramifications for the research questions developed, the data to be gathered and how findings are interpreted (Dunne,

2003). The purpose of this chapter is to discuss the various philosophical assumptions that may underpin any research activity as outlined in the model developed by Burrell and Morgan (1979)[5]. The ontological, epistemological and methodological assumptions that characterise the choice of methods adopted in the present investigation are discussed. The particular research objectives of the current study and the choice of appropriate methods of analysis are then outlined. The choice of an intermediate standpoint between the interpretive and functionalist paradigms is grounded in the ontological and epistemological assumptions of the researcher. The chapter explains the link between this approach and the research methods employed to examine the decision-usefulness of IFRS-related information; namely, an examination of whether the content of corporate annual reports were influenced by the introduction of the new reporting regime and whether the financial statement numbers were impacted by the changeover.

Chapter 5 examines the impact of the introduction of IFRS on disclosures in the annual reports and accounts of UK quoted companies. In particular, a content analysis survey is undertaken to investigate: (i) the IFRS-related disclosure presented in UK companies' annual reports prior to the introduction of IFRS; and, (ii) changes in the UK companies' reporting practices following the adoption of the new reporting regime. The chapter therefore examines whether the introduction of IFRS has had a material impact on the quantity of information included in the annual reports of UK companies. This examination is important as a key objective of the conversion to International GAAP was to provide more detailed and comparable disclosures. The study presents this analysis for the total level of disclosure and highlights the

[5] Alternative frameworks can and do exist, however it is beyond the scope of the present study to discuss the other types and legitimacy of each framework available to the researcher.

categories of information where companies have increased their disclosure devoted to IFRS-related information in response to the adoption of the new reporting standards. This analysis will also attempt to provide an insight into the type of companies that have responded to the changeover to International GAAP with an increase in IFRS-related disclosure and indicate which, if any, individual IFRS standards were subject to significant disclosure changes during the transition process.

Chapter 6 examines the Reconciliation Statements produced upon first-time adoption of IFRS included in the annual reports and accounts of UK quoted companies. In particular, this analysis examines the impact on both profit and equity as a result of the transition from reporting under UK GAAP to reporting in compliance with IFRS for the first time and determines which individual IFRS standards have contributed toward any impact identified. This chapter therefore examines whether the implementation of IFRS has had a material impact on the financial statement numbers reported by adopting companies in the UK. This analysis compliments the analysis of the narrative information provided in corporate annual reports and accounts at the time of IFRS adoption undertaken in Chapter 5; it will indicate whether the disclosure changes documented in Chapter 5 reflected any significant impact on the reported results of these firms following the changeover to the new regime. This analysis will also enable the researcher to identify whether the standards that were highlighted in Chapter 2 as problematic for adopting companies did indeed give rise to significant adjustments in financial statement numbers following the transition to the new reporting regime. The study presents an analysis of the percentage IFRS adjustments to total profit and total equity included in the Reconciliation Statements and applies an index of conservatism to assess whether there is material differences in profit and

equity reported under IFRS compared to the values reported according to previous UK GAAP. A comparison of the findings with those reported in Chapter 5 is included to identify whether the standards which were responsible for the largest disclosure increases in corporate annual reports during the adoption of IFRS correspond to those which caused the most financial impact on the financial statement numbers.

Chapter 7 investigates the decision-usefulness of the IFRS disclosures provided in UK corporate annual reports and accounts. More specifically, it provides an assessment of the IFRS disclosures reported in the content analysis survey in Chapter 5 and the Reconciliation Statement analysis conducted in Chapter 6 against the qualitative characteristics outlined in the IASB Decision-Usefulness framework discussed in Chapter 3. This assessment is undertaken in an attempt to determine whether the claims of the IASB about the usefulness of the new information are supported in practice by the contents of the annual reports analysed in the present investigation. In addition, this chapter reports the findings of an analysis of the additional comments captured during the content analysis survey undertaken in Chapter 5 to provide further insight into the implementation and impact of the changeover. Further, the interview findings from Dunne et al. (2008) are discussed; this analysis was conducted in tandem with the present investigation. It was undertaken as part of a larger project which examined the implementation of the new IFRS regime and may provide additional information about the perceived usefulness of the new disclosures.

Chapter 8 provides a summary of the main findings of the research undertaken and offers some policy implications about the introduction and impact of IFRS on UK

company annual reports. This chapter also highlights some limitations of the current study and explores potential areas of future research.

1.4 Conclusion

This chapter has sought to introduce the reader of the current dissertation to the research topic being investigated. The broad research area was outlined and the structure of the present study discussed. Such a discussion should provide a "road-map" for the remainder of the thesis so that any journey might be more easily travelled.

Chapter 2

Literature Review

Chapter 2 – Literature Review

2.1 Introduction

The rise of globalisation (Walton et al., 2003) and the continuous integration of the world's capital markets (Haller, 2002) have enabled organisations to obtain listings on several international stock markets and have facilitated access to potentially diverse sources of capital (Larson, 1997). Until recently, most stock markets required listed firms to prepare financial statements in accordance with local GAAP[6]; such a process was costly and time-consuming for companies with multiple listings on different exchanges and created uncertainty in the financial markets leading to "a sub-optimal resource allocation for both the firm and local markets" (El-Gazzar et al., 1999, p. 240).

Furthermore, the preparation of financial statements according to different requirements often produced widely varying results. For example, in order to list on the New York Stock Exchange (NYSE), the German firm Daimler-Benz produced a set of financial statements which complied with US GAAP; this process revealed $2.45bn in hidden reserves that were disallowed and resulted in a profit under German GAAP, becoming a loss under US accounting requirements (Radebaugh et al., 1995). As a consequence, some stock markets required the preparation of a Reconciliation Statement; for example, a Reconciliation Statement was mandated by the Securities and Exchange Commission (SEC) for overseas registrants on a US stock exchange

[6] Examples of stock markets that required financial statements to be prepared under domestic accounting rules included the New York Stock Exchange in the US and the London Stock Exchange in the UK (Haller, 2002).

(Haller, 2002)[7] and this requirement was cited as an important factor which inhibited companies that were considering whether or not to obtain a US listing (Cochrane, 1992)[8].

Coupled with the internationalisation of the world's capital markets, the comparability of company financial information across national boundaries became an important issue during the 1990s (Nobes and Parker, 2004). Indeed, Walton et al. (2003) highlight that:

> "If it is taken as a given that accounting rules and practices are influenced by the environment in which they operate, it is also expected that the internationalisation of the economic and cultural environment...will have an effect on accounting. Accounting has to address the new problems of how to communicate across national boundaries."
>
> (Walton et al., 2003, p. 8)

The existence of divergent accounting practices between various nations throughout the world constrained the ability of users to compare financial statements between companies situated in different countries (International Accountant, 2006). Given the rise of globalisation and the availability of instantaneous information in recent decades, this lack of harmony was a reminder of how quickly industry had changed and how "slow the accounting community has been to respond to these changes" (International Accountant, 2006, p. 1).

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[7] The SEC required foreign-listed companies to either: (i) prepare financial statements in accordance with US GAAP; or, (ii) provide a detailed reconciliation of earnings and book values from foreign GAAP to US GAAP in the Form 20-F (Jermakowicz and Gornik-Tomaszewski, 2006). This requirement was introduced by the SEC to protect US investors by ensuring that all foreign companies listed in the US provided comparable financial reporting (Meek and Thomas, 2003). Because reconciliation to US GAAP was costly, affected companies gave a high priority to removing reconciliation differences from their 20-F filing with the SEC (Walton et al., 2003).

[8] By the mid-1990s, Street and Bryant (2000) found that adjustments to reconcile IASs with US GAAP were required for an increasing number of items including deferred tax, property, plant and equipment, capitalisation of borrowing costs and goodwill. Further, they highlighted that the difference in the profit figure was as much as 20 per cent for a number of firms in 1996 and that several of these adjustments were material.

As investors have diversified their portfolios internationally and acquired securities of companies located in different countries, demand for a global set of reporting standards has grown; the benefits from harmonisation among financial reporting requirements have become more apparent (Haller, 2002)[9]. Section 2.2 discusses the concept of accounting standards harmonisation, outlining the possible benefits from achieving such harmonisation as well as the threats posed; indeed, the desirability of any harmonisation attempt is explored.

Section 2.3 outlines the IASB's attempt to achieve global accounting harmonisation through the formulation of IAS and includes a discussion of the EU's role in the adoption of IASs as well as a review of the voluntary adoption of IAS in selected countries by different companies. Section 2.4 provides details of the new international standards including an outline of the IASB standing setting process and the requirements of first-time adoption of IFRS. This section is concluded with a discussion of problematic standards highlighted in the literature and a brief outline of the fair value debate.

Section 2.5 reviews the literature concerning the anticipated impact of the introduction of IFRS and includes a discussion of the role of the US in the harmonisation process. Section 2.6 provides an overview of various studies which have assessed the adoption of IFRS in a range of countries. The present research involves a study of the impact of the introduction of IFRS in the UK and Section 2.7

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[9] McKinsey (2002) interviewed 200 institutional investors as part of their "Global Investor Opinion on Corporate Governance" survey and found that 90 per cent of the investor sample supported the use of a single set of global accounting standards.

outlines the regulatory system that governs financial reporting practices in the UK; it also discusses the anticipated effects of IFRS implementation in the UK. In addition, a review of various studies regarding the impact of IFRS post-implementation is provided in this section. Finally, Section 2.8 concludes the chapter.

2.2 The Global Harmonisation of Accounting Standards Debate

Doupnik and Salter (1995) defined harmonisation as,

> "...the reduction in differences in accounting practices across countries ultimately resulting in a set of international norms to be followed worldwide."
>
> (Doupnik and Salter, 1995, p. 41)

In other words, companies worldwide adopt the same accounting method for a particular accounting issue (Pierce and Weetman, 2000). However, a globally acceptable set of accounting standards does not currently exist and differences in accounting practices across countries can result in similar economic transactions being recorded differently (Bradshaw and Miller, 2007). This lack of comparability between global accounting practices complicates cross-border financial analysis and investment (Harris, 1998; Hawkins, 2000; Bradshaw et al., 2004). It is argued that the lack of uniform standards, and therefore the dearth of comparable accounting information, creates barriers for international investors as,

> "...unfamiliar foreign accounting principles and lack of disclosure can prevent investors from diversifying their portfolio internationally in an optimal manner."
>
> (Eitemann et al., 1992, p. 605)

Furthermore, disparity in national accounting standards has been found to act as a barrier to the international offering of securities (Doupnik and Salter, 1995)[10].

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[10] In addition, Rivera (1989) cited studies by Scott (1981) and Scott and Trobery (1980) who found that a group of accounting experts from different countries placed the lack of international accounting standards as sixth in a list of 88 problems in international accounting.

A number of commentators have argued that a common set of practices would provide more uniform disclosures by companies worldwide thereby eliminating many variations in accounting treatments between companies based in different countries (Murphy, 2000). In addition, greater comparability in financial reporting practices resulting from the use of a globally acceptable set of accounting standards would lead to reduced preparation costs and a lower cost of capital for companies (Choi and Meek, 2005). Several analytical and empirical studies have provided evidence that a potentially more transparent and higher-quality financial reporting regime would reduce adverse selection problems and, as a result, increase market liquidity and reduce a firm's cost of capital (Healy et al., 1999; Leuz and Verrecchia, 2000; Verrecchia, 2001; Lambert et al., 2007)[11]. Furthermore, uniform reporting rules would also allow companies with subsidiaries in different countries to prepare financial statements in accordance with a single set of accounting rules (Buchanan, 2003); the perceived consistency of financial reporting across jurisdictions and sectors may reduce the cost to investors of comparing companies' performances (Horton and Serafeim, 2008). This may reduce information asymmetry and enable capital markets to become more globally competitive; indeed, a key economic rationale in favour of accounting harmonisation is that differences in financial reporting practices prevent the flow of capital to its most efficient uses (Saudagaran and Meek, 1997)[12].

Inevitably, such broad and worldwide accounting harmonisation as that which might be achieved by the introduction of a uniform set of global standards has not escaped

[11] Although in an investigation of the economic benefits of adopting IFRS or US GAAP, Daske (2006) did not find evidence in support of the hypothesis that the adoption of international standards should decrease a company's cost of equity.

[12] For example, Bradshaw et al. (2004) provided evidence that unfamiliar accounting choices exacerbated home bias.

criticism. An obvious obstacle in any effort to harmonise accounting practices globally is the existence of different accounting systems in jurisdictions where contrasting objectives are given priority (La Porta et al., 1998). Indeed, it has been recognised that:

> "The accounting rules in each country have evolved over time and are a reflection of the needs and social, cultural and economic environment of that country. This balance of interests which has worked out over many years is set aside by the harmonisation process which must by definition be working towards a common set of rules in all major areas."
>
> (Walton et al., 2003, p. 10)

Indeed it has been argued that the social, cultural and economic influences that create differences in the objectives of accounting systems between different countries "will always exist" (Rivera, 1989, p. 322). Therefore, the probability of any attempt to harmonise worldwide accounting practices being successful may be low[13].

Several studies have investigated the properties of accounting information prepared across different regimes and in summary these studies indicate that similar accounting transactions are treated differently worldwide. For example, Hermann and Thomas (1995) investigated the level of accounting harmonisation by examining selected measurement practices in the annual reports of companies from several countries in the European Community (EC). Their findings revealed that the level of harmonisation was greater among "fairness-oriented" countries (e.g. UK, Ireland and France) compared to "legalistic countries" (e.g. Portugal and Germany) (Hermann and Thomas, 1995, p. 253). In addition, Ball et al. (2003) compared the timeliness of

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[13] Indeed, Goeltz (1991) noted that even though Canada and the US share common business and accounting traditions and are linked by a common market; they have been unable to agree on a common set of accounting principles and disclosure practices. This issue was highlighted in the two jurisdiction's treatment of oil and gas exploration costs at the time of the SFAS No. 19 controversy (Collins and Dent, 1979).

earnings in reporting bad news across several countries that have accounting systems based on common law sources. They found considerable variation in earnings among the sample countries and concluded that contrasting reporting incentives between countries limit the extent to which international accounting comparability can be achieved through harmonised accounting standards alone[14,15]. These findings have lead to the conclusion that global comparability will be dependent on factors other than accounting standards such as regulatory oversight or capital market pressures (Bradshaw and Miller, 2007); however, Gray and Vint (1995) and Bloom and Naciri (1989) suggest that it is doubtful that an externally enforced single regulatory system will be successful in every country. Indeed, it has been argued that:

> "If the predominant purposes of financial reporting vary by country it seems reasonable that the reporting should vary. Harmonisation is most useful when it concerns similar users who receive information from companies in different countries. It may be that relevant companies should follow two sets of rules: one for domestic and another for international consumption or one for parent statements and another for consolidated."
>
> (Nobes and Parker, 2004, p. 79)

Furthermore, the absence of uniform financial reporting worldwide has not hindered the significant development and growth of the world's capital markets over recent decades[16]. On the contrary, it has been highlighted that in the absence of a formal international accounting harmonisation process, the market may in fact compel members to supply the relevant information required (Meek and Gray, 1989).

[14] Subsequent studies have supported the conclusions of Ball et al. (2003). For example, Lang et al. (2006) found that 20-F earnings reconciliations produced by foreign firms listed in the US were not comparable to earnings reported by US firms.

[15] Bradshaw and Miller (2007) examined non-US firms who adopted US GAAP as their primary accounting standards to investigate the use of a single set of accounting principles across different cultural and institutional settings. They found that uniform accounting standards might lead to more comparable accounting practices and this conclusion contrasts with the views offered by Ball et al. (2003). However, they note that this outcome is dependent on effective regulatory oversight.

[16] In their study of 1,000 financial statements from public corporations based in 24 countries, Choi and Bavishi (1982) found in a comparison of foreign companies with their US-based counterparts that the major differences in accounting rules among the countries sampled were not as widespread as anticipated.

Furthermore, it has been argued that rational investors are able to "pierce the accounting veil and focus on economic results" and that the ability to predict future cash flows, considered to be the key source of investment value, using accounting and other data is more dependant on the effective use of this data as opposed to its perceived uniformity (Goeltz, 1991, p. 87)[17].

Although many arguments have been advanced both in support of and against the internationalisation of financial reporting, several organisations including the International Organization of Securities Commission (IOSCO)[18], the European Economic Community (ECC)[19] and the Organization for Economic Cooperation and Development (OECD)[20] have expended considerable resources in an attempt to improve the comparability of financial information across national boundaries (Murphy, 2000). In 1973, this coalition of efforts resulted in the formation of the IASC and Section 2.3 discusses how the IASC and its successor, the IASB, have attempted to harmonise global accounting practices by formulating an internationally-applicable set of accounting standards.

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[17] Goeltz (1991) highlighted that US academics generally concluded that markets did not respond to changes in reported earnings caused by cosmetic alterations in accounting practices with evidence to suggest that investors and analysts examined footnotes and other disclosure sources when comparing companies' financial statements.

[18] IOSCO is an international cooperative body of securities regulatory agencies whose objectives include "ensuring better regulation of security markets, and establish standards and an effective surveillance of international security transactions" (El-Gazzar et al, 1999, p. 240).

[19] The EEC was established by a treaty signed in 1957 by Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany (now Germany) and was the most significant of the three treaty organisations that were consolidated in 1967 to form the EC; known since the ratification [1993] of the Maastricht treaty as the EU (McCormick, 2002).

[20] The OECD consists of thirty member countries including the UK and US whose objectives include supporting economic growth and maintaining financial stability. A valuable contribution of the OECD is its surveys of accounting practices in member countries and its assessment of the diversity or conformity of such practices. Its Working Group on Accounting Standards supports efforts by regional, national, and international bodies promoting accounting harmonisation. In 1998, the OECD issued "Principles of Corporate Governance" that support the development of high-quality, internationally recognised standards that can serve to improve the comparability of information between countries. (OECD, 2008).

2.3 The IASB Attempt to Harmonise International Accounting Practices

In 1995, the stated objective of the IASC was to,

> "...work generally for the improvement and harmonisation of regulations, accounting standards, and procedures relating to the presentation of financial statements."
>
> (IASC, 1995, p. 29)

In pursuit of this objective, Whittington (2005) highlighted three main benefits that the IASC hoped to offer as a result of its creation:

> "A common set of accounting standards increases the comparability of companies based in different countries but traded in the same market. An additional benefit for trans-national companies and their auditors is that the preparation of group accounts, consolidating the accounts of companies based in different countries is made easier and more informative. Finally, there was a benefit to those countries that did not have an established set of national accounting standards. The adoption of international standards in such countries provided a ready-made set of standards which would meet the needs of domestic companies (or at least the larger ones) and have credibility in international capital markets."
>
> (Whittington, 2005, p. 128)

The IASC decided to re-constitute itself in May 2000 primarily in response to the growing pressure it faced to,

> "...become more independent of professional accounting bodies around the world, with the aim of working more closely with those who actually set local standards (i.e. the national standard setters) to reach agreed solutions."
>
> (Radebaugh et al., 2006, p. 172)

Formally restructured, the IASC was renamed the *International Accounting Standards Board.*

The early years of the IASC were devoted to the development and worldwide promotion of a set of international standards to be observed in the preparation of

financial statements (Roberts et al., 2005)[21]. The IASC issued 26 standards between 1973 and 1988 (Garrido et al., 2002), however the majority of these standards were very general in nature with an underlying emphasis on issues of presentation and disclosure as opposed to the more contentious subject of measurement (Nair and Frank, 1981). In addition, the early standards became subject to widespread criticism due to the numerous options available to users who applied them (Roberts et al., 2005; Street and Gray, 1999). The existence of alternative accounting treatments did not threaten the proliferation of accounting differences between nations as "prevailing practices could be accommodated" (Roberts et al., 2005, p. 26); for example, 8 of the initial 16 standards issued allowed alternative accounting treatments (Choi and Bavishi, 1982) and this flexibility was included to accommodate the range of treatments that existed in reporting standards which had already been adopted by developed countries (Roberts et al., 2005). Indeed, Evans and Taylor (1982) studied the accounting treatments employed by companies based in different countries for the period 1975-1988 and found that the international standards had minimal effect on the surveyed firms' disclosures; as in the majority of cases, companies continued to follow the same accounting treatment after the relevant international standard was issued as they did prior to its introduction.

In 1989, the IASC launched the 'Comparability Project'[22] in an attempt to reduce the flexibility afforded by the alternative accounting treatments available in existing IASC standards "so as to enhance the credibility and acceptability of IASs by the international investment community" (Street et al., 1999, p. 12). The completion of

[21] The IASC did not possess any powers of enforcement and so the members "agreed to support the standards and use their best efforts to ensure that published financial statements complied with the standards" (El-Gazzar, 1999, p. 240). The IASC members also attempted to gain support from governments, stock exchanges, and other relevant bodies (El-Gazzar, 1999).

[22] As defined in Exposure Draft (E) 32, *Comparability of Financial Statements* (IASC, 1989a).

the Comparability Project in 1993 resulted in the revision of 10 standards including the elimination of 21 alternative accounting treatments (Garrido et al., 2002); these revised standards became effective in 1995 (Street and Gray, 1999). However, when Street et al. (1999) investigated the extent to which a sample of major worldwide companies complied with IAS revised during the Comparability Project, their results revealed a significant level of non-compliance with the revised standards. Further, in an examination of the extent to which the reporting practices of 27 IASC members agreed with the revised standards, Roberts et al. (1996) found that although the general level of conformity with the new IAS standards was high, there were substantial differences among: (i) issues covered by the Comparability Project; and, (ii) between different countries. Indeed, the authors concluded that in many countries, company accounting practices would have to be considerably altered in certain areas in order to comply with the revised standards (Roberts et al., 1996).

A key turning point in the harmonisation process came in 1987 when the IASC and the IOSCO agreed to collaborate on the development of a core set of IAS (Haller, 2002)[23]. The agreement proposed that IAS would be observed in financial statements used for cross-border offerings and listings instead of national accounting rules (Roberts et al., 2005). In pursuit of this goal, IOSCO agreed in 1995 that the IASC would finalise a set of accounting standards for worldwide promulgation by 1999 in what is often referred to as the 'Core Standards Programme' (Roberts et al., 2005;

[23] The IASC often involved itself in joint projects with other accounting bodies. For example, the G4+1 group, consisting of four of the main standard setters in the world (US, UK, Canada and Australia) and the IASC, was formed to act as a think tank based on producing transparent, capital market-based financial reports (Street, 2006). The group succeeded in harmonising the accounting practices of its members during the 1990s and published 12 discussion papers on issues including recognition and measurement of financial instruments, hedge accounting, leases and share-based payments; however, progress towards harmonisation on a wider scale was slow (Street and Shaughnessy, 1998).

Fearnley et al., 2007). The IASC completed this programme in December 1998 and IOSCO reviewed its findings in 1999 (Radebaugh et al., 2006).

Pressure for the introduction of globally acceptable accounting standards escalated when the World Bank backed the campaign following the problems evidenced by the Asian economic crisis[24]; this crisis highlighted the lack of confidence evident in the accounting practices of those countries affected by currency problems in the Far East (Radebaugh et al., 2006). In 2000, IOSCO completed the assessment of 30 IASC standards initiated as part of the 'Core Standards Programme', together with their related interpretations (Garrido et al., 2002). In the same year, it recommended that its member bodies permit the preparation of financial statements using IAS for cross-border offerings and listings (Fearnley et al., 2007). Although reducing the cost and confusion inherent in the requirement to report under different reporting principles when listing on multiple stock markets, this recommendation also encouraged more companies to seek finance and stock market listings beyond national borders (El-Gazzar, 1999). This recommendation represented a pivotal development in the

[24] The Asian economic crisis was a period of financial crisis that crippled much of Asia beginning in 1997. The roots of the crisis extended from a fundamental change in the economics of the region, with many Asian countries, particularly Thailand, moving from being net exporters to net importers. As a result, many countries in the region acquired major capital inflows to support their currencies. However, questions were raised about the ability of these countries to repay their rising debt and this cumulated in the financial collapse of the Thai Baht in 1997 when the Thai Government decided to float the baht. Within days, a number of neighbouring Asian countries came under speculative attack by currency traders and capital markets forcing many Asian economies into meltdown (Eiteman et al., 2004; Fifield et al., 2006).

IASC's promulgation of international GAAP as a suitable programme of accounting standards for adoption in international stock markets[25].

2.3.1 The Intervention of the EU

The endorsement of the IAS programme by IOSCO was further boosted by the intervention of the EU. The EU and its predecessor organisation - the EC - have had a long standing interest in the harmonisation of accounting practices as,

> "...the free flow of comparable financial information resulting from the harmonisation of accounting is a necessary condition for achieving a common market in the European Union."
>
> (Canibano and Mora, 2000, p. 349)

Originally, the EC focused on the need to "create a level playing field for companies operating within its boundaries" (Cairns, 2004, p. 108) and attempted to achieve harmonisation of accounting practices throughout the region by means of company law directives which were integrated into the laws of the member states (Cairns, 2004). The EC published the Fourth Directive in 1978 which set the basic framework for the annual accounts of individual companies; the Seventh Directive was issued in 1983 and this established a common basis for the presentation of group accounts (Roberts et al., 2005). These directives obliged member states to require companies to provide "comparability and equivalence of financial information" (Haller, 2002, p. 155). However, the adoption of the EC directives was sporadic[26] and they were criticised for being too minimal and deemed insufficient with regard to achieving the

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[25] IOSCO, through its Technical Committee, endorsed its continuing support for IFRS and the work of the IASB in a recent statement and also reaffirmed its support for the development and use of IFRS in cross-border offerings and listings (Stenka and Ormrod, 2007). Further, the Technical Committee recommended that its members allow multinational issuers of securities to use IFRS in cross-border offerings and listings, supported by reconciliation, disclosure and interpretation where required, to tackle outstanding substantive issues at a national or regional level. The Technical Committee also expressed the hope that issuers would be permitted to use IFRS without reconciliation in the near future (IOSCO, 2005).

[26] For example, Denmark and the UK adopted the Fourth Directive in 1981; however, Austria did not adopt it until 1996 (Haller, 2002).

desired level of financial statement comparability between companies in different EU member states (Canibano and Mora, 2000)[27]. Haller (2002) argues that the directives *did not achieve sufficient harmonisation within the EU as differences in both the* content and results produced by the financial statements of companies situated in different member states have rendered it impossible to reliably compare and analyse financial statements on a cross-border basis "without taking national particularities into account and subsequently arranging reconciliation" (p. 159). Haller (2002) attributes this problem to the reluctance, at the time, of Member States to alter their national frameworks in order to achieve a suitable level of comparability.

During the mid-1990s, the focus of the EU's attention shifted to the needs of international capital markets and, in particular, large EU companies in those markets (Cairns, 2004). In 1995, the EC implemented a new strategy in support of the IASC standards programme allowing the replacement of national requirements with IAS by large companies on the condition that they continued to comply with the Fourth and Seventh Directives[28] (Cairns, 2004). In June 2000, it was proposed by the EU that all firms listed on an EU stock market should apply IAS when preparing their consolidated financial statements for accounting periods beginning on or after 1

[27] Joos and Lang (1994) investigated the effect of the two directives on firms in the UK and Germany. The authors examined their impact in these two countries because they represented two extremes of accounting systems in Europe given that the UK accounting model emphasises the provision of useful information to shareholders whilst the German model focuses on debtholders and serves both financial and tax reporting requirements. They postulated that UK firm earnings should better reflect underlying economic results and have higher correlation with share prices than those of German companies. Although they found that German firms have lower return on equity (ROE), earnings-to-price ratio (E/P) and book-to-market ratios compared to UK firms, they did not find evidence that UK earnings explained share prices and returns more than their German counterparts. They also failed to find evidence of convergence in ROE, E/P and book-to-market ratio following the implementation of directives, leading the authors to conclude that the directives may have provided greater form, rather than substance due to differing financial reporting incentives within Europe.
[28] See EU COM (95) 508 (1995): "*Accounting Harmonisation: A New Strategy Vis-à-Vis International Harmonisation*" for more information.

January 2005 (EC, 2000a)[29]. Significantly, the requirement to comply with IAS was not only instead of applying national GAAP, but also in place of the Fourth and Seventh Directives (Cairns, 2004). The proposal stated that the,

> "...adoption of uniform, high quality financial reporting rules in EU capital markets will enhance overall market efficiency, thereby reducing the cost of capital for companies."
>
> (EC, 2001, p. 2)

In June 2002, the proposal became a regulation (EU, 2002)[30] and the EC adopted all standards (IASs) and interpretations (Standing Interpretations Committee standards (SICs)) into EU Law, except IAS 32 and IAS 39 and related interpretations[31], in September 2003 (EC, 2003)[32]. Although the resolution obliges firms to apply IFRS, the EC must endorse the standards before they are mandated within the EU (Armstrong et al., 2008). Thus, the EC retains the power to reject any standard, or part of a standard, it believes does not meet its criteria for endorsement. The three primary criteria are: (i) the standard is not contrary to the EU's true and fair principle; (ii) the standard meets the criteria of understandability, relevance, reliability, and comparability; and, (iii) adopting the standard is in the European public interest (Armstrong et al., 2008)[33]. Nevertheless, this development was regarded as "a key

[29] An amendment allowed each Member State the option of permitting limited deferral until 2007. This applied to EU companies with only debt securities listed on a regulated market and those listed on markets outside the EU using other internationally accepted standards (Fearnley and Hines, 2002).
[30] See Regulation (EC) 1606/2002 for further information.
[31] In late 2004, the EU agreed to adopt a 'carved out' version of IAS 39 as the full standard was considered unacceptable to member states under EU Law. Following the publication of amendments to IAS 39 by the IASB in June 2005, the EU decided to reinsert provisions on the application of the fair value option to liabilities; many European banks and insurance companies objected to the IASB's requirement for derivatives to be measured at market value (Jermakowicz and Gornik-Tomaszewski, 2006). Armstrong et al. (2008) argued that these amendments to IAS 39, or modifications to any IASB standard, undermined the EU's goal of adopting global accounting standards.
[32] See Regulation (EC) No. 1725/2003 for further information.
[33] It has been highlighted that problems may arise with the third criterion which has been interpreted as ensuring EU companies are not put at a competitive disadvantage by imposing tougher financial reporting burdens on them than those required of their non-EU counterparts (Cairns, 2003). In practice, this could lead to any IFRS not being adopted if it is perceived to be tougher than its US GAAP (or similar) equivalent. As a result, the endorsement process may be subject to political interference and companies may be encouraged to lobby politicians rather than or in addition to the IASB.

step towards the evolution of a global set of accounting standards" considering the relative size and significance of the EU stock markets (Daske, 2005, p. 4).

The Committee of European Securities Regulators (CESR) issued a standard to facilitate a common approach to the enforcement of IFRS within the EU (CESR, 2003a). The standard consists of 21 high-level enforcement principles that Member States should adopt in enforcing IFRS. Furthermore, and linked to IFRS 1 *First-Time Adoption of International Financial Reporting Standards*, the CESR published "Recommendation for Additional Guidance Regarding the Transition to IFRS" in December 2003 (CESR, 2003b). The publication recommended that the transition process should be accompanied by a financial communication gradually preparing the markets for the impact of the transition. It also encouraged first-time adopters to explain the impact of adopting IFRS as soon as reasonably practicable. In addition, the International Audit and Assurance Standards Board (IAASB) issued further guidance on the audit of financial statements prepared in accordance with IFRS (IAASB, 2003).

The move towards uniform global accounting practices set forth by the introduction of IAS in the EU has encouraged standards setters in countries outside the EU to investigate their relevance for their own reporting purposes. For example, the Australian Government decided to adopt IFRS for the statutory accounts of all domestic companies from 2005 onwards in order "to ensure [that] their companies

remain competitive in the global market place" (Aisbitt and Walton, 2005, p. 14)[34]. In addition, New Zealand followed suit in 2007 while Canada has signified its intent to adopt IFRS by 2010. Further, the Arab Society of Certified Accountants, comprising 22 Arab nations, has signed a declaration supporting IFRS as the national set of accounting standards in all its member countries (Gujarathi, 2007). Currently, over 100 countries now use IFRS (KPMG, 2007). Section 2.3.2 will detail voluntary initiatives set forth by several countries toward the adoption of IAS prior to its mandatory implementation in 2005.

2.3.2 Voluntary Moves Toward the Adoption of IAS

The adoption of internationally accepted accounting standards began in several EU member states well in advance of the EU regulation being implemented (Daske, 2005). Beginning in the mid-1990s, there was a sharp growth in the number of companies voluntarily adopting IAS with an increase of 300 per cent over the time period 1996 to 2004; by 2004, 65 per cent of IAS adopters were based in the EU and Switzerland (Daske and Gebhardt, 2006). Although it has been documented that firms

[34] Nobes and Zeff (2008) criticised this "version" of adoption whereby the Australian Accounting Standards Board (AASB) used IFRS as the basis to create a new set of Australian accounting standards. The AASB initially made numerous amendments to IFRS to remove options, include extra disclosure requirements and add requirements for public sector entities. For example, IAS 31 contains an option to use proportionate consolidation, whilst the Australian equivalent AASB 131 *Interests in Joint Ventures* did not. Regardless of these differences, it could be claimed that compliance with Australian standards would also have achieved compliance with IFRS. However, this approach was abandoned in 2007 and Australian standards now correspond to the requirements of IFRS, with the only exception being amendments relating to public sector entities.

which change accounting standards incur large transaction costs[35], Haller (2002) argued that the requirement to raise sizeable amounts of capital and the associated demands of "decision-useful, globally comparable accounting information by the investment community" (p. 168) in addition to the need for companies "to benchmark themselves with their competitors" (p. 168) in an increasingly globalised business environment have seen a proactive move on the part of several large companies to voluntarily adopt IAS, or US GAAP, in place of national accounting requirements (Haller, 2002)[36,37]. In 1993, the German firm, Daimler-Benz became the first multinational company to list on the NYSE; it was therefore required to present financial statements according to the requirements of US GAAP (Haller, 2002). In an attempt to attract foreign capital, many global players joined an increasing number of companies in voluntarily adopting IASs several years before they became a mandatory EU requirement (Street et al., 1999)[38,39].

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[35] For example, De Jong et al. (2006) found that Dutch firms repurchased or altered the specification of preference shares to avoid large increases in debt ratios. The requirements of IAS 32 *Financial Instruments: Disclosure and Presentation* state that if preference shares lack unconditional rights to avoid cash payouts then they must be reclassified as debt. Dutch firms with preferred stock are required to pay preferred dividends when they have profits; as a result, their preference shares were reclassified as debt under IAS 32. Consequently, Dutch firms repurchased preference shares by issuing new common equity, using cash or issuing new debt to avoid debt ratio increases. De Jong et al. (2006) found that firms issuing common equity had high debt ratios even before repurchase, implying that due to its high cost, issuing equity was the last option considered.

[36] For example, Weibenberger et al. (2004) examined the motives behind the decision by certain German companies to adopt US GAAP or IFRS instead of German GAAP. The survey results indicated that this decision was driven by the expectation of gaining a standing in the capital markets, improved information supply and the internationalisation of investors. Indeed, Ashbaugh and Pincus (2001) found that the market value of those firms who used IAS increased following adoption, implying that firms might adopt IAS prior to a share issue.

[37] Leuz (2003) argues that firms attempting to raise funds would likely turn to US capital markets if given the choice. When examining firms listed in Germany's New Market, which permits US GAAP and IFRS, Leuz found that firms with higher sales growth, thereby implying greater financing requirements, were more likely to adopt US GAAP rather than IAS. He contended that this result corresponded to the findings of a KPMG (2000) survey, where respondents perceived IAS and US GAAP to be of equal quality, but IAS was less costly to implement, while US GAAP was considered a better choice when seeking access to capital markets. Therefore, firms choosing US GAAP must have considered the benefit of greater access to financing opportunities to be greater than the cost of adoption.

[38] Examples of companies who voluntarily adopted IAS prior to mandatory implementation included Fiat, Nestle and Nokia (Street et al., 1999).

Within certain EU countries, the "*de-facto* harmonisation process" (Haller, 2002, p. 168) initiated by multinational companies provoked a reaction by national institutions in an attempt to achieve an international "*de-jure* harmony" (Haller, 2002, p. 168). For example, several EU countries including Germany, Austria, France, Italy, and Belgium and Switzerland permitted, through regulations included in their national laws, the preparation of company financial statements under IAS in place of national rules (Van Tendeloo and Vanstraelen, 2005); US GAAP was also permitted in Germany and Austria (Haller, 2002). Alternatively, EU countries such as the Netherlands, Sweden, Finland and Spain attempted to incorporate internationally recognised standards, including IAS, within the development of their domestic accounting standards framework (Haller, 2002).

The 2000 IOSCO recommendation permitting the observance of IAS in the preparation of financial statements used for cross-border offerings and listings was implemented by most European Stock Exchanges[40]; this is not surprising given their sensitivity to the demands of international companies and an increasingly diversified investor community (Haller, 2002; Fearnley et al., 2007). However, several exchanges including the Spanish Stock Exchange, the Stockholm Stock Exchange and the Copenhagen Stock Exchange still required a national GAAP reconciliation thereby

[39] For example, Ashbaugh and Davis-Friday (2002) found that firms listed on the London Stock Exchange and which had adopted IAS or US GAAP increased the likelihood that they would become targets in mergers and acquisitions. Soderstrom and Sun (2007) contended that this might be interpreted in two ways. First, it might be that the perceived higher quality financial reporting from firms using IAS or US GAAP enabled outsiders to better identify them as possible takeover targets. Alternatively, but not mutually exclusively, it might be that firms seeking to be acquired adopted more transparent accounting standards. Nevertheless, both interpretations indicated that a more transparent accounting environment facilitated merger and acquisition activity (Soderstrom and Sun, 2007).

[40] Examples include the London Stock Exchange, the Frankfurt Stock Exchange and the Milan Stock Exchange (Haller, 2002).

questioning the underlying acceptance of IAS in such countries which "appear[ed] not yet willing to totally surrender their traditional national systems" (Haller, 2002, p. 174).

2.4 IFRS Standards

The EU regulation placed an obligation on EU-listed firms to prepare their consolidated financial statements prepared as of 1 January 2005 in accordance with IAS/IFRS and SIC/IFRIC[41] as issued by the IASB and endorsed by the EU. By 31 December 2005, the standards IAS 1 to IAS 41, IFRS 1 to IFRS 6, SIC 7 to SIC 32 and IFRIC 1 to IFRIC 5 were mandated throughout the EU for quoted companies (EC, 2008)[42,43]. Additional standards and interpretations were endorsed in 2006[44] and 2007[45], coupled with amendments to previously endorsed standards (EC, 2008)[46]. The current combination of IASs and IFRSs has generated 2,300 pages of text and 2,000 disclosure requirements which preparers need to interpret and implement (Ernst and Young, 2006). Further, these requirements represent twice the number of standards that were required under UK GAAP and four times those that had been required in France (Ernst and Young, 2006).

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[41] The Standards Interpretations Committee (SIC) was the predecessor to the IFRIC.

[42] Standards superseded or abolished were IAS 3 to 6, IAS 9, IAS 13 to 15, IAS 22, IAS 25, IAS 30, IFRIC 3, SIC 1 to SIC 3, SIC 8 and 9, SIC 11, SIC 14, SIC 16 to 20, SIC 22 to 24, SIC 26, SIC 28, SIC 30 and SIC 33 (EC, 2008).

[43] See Appendix 2.1 for a detailed list of all issued IFRS, IAS, IFIC and SIC.

[44] IFRS 7 and IFRIC 6 to 9 were endorsed in 2006 (EC, 2008).

[45] IFRS 8 and IFRIC 10 and 11 were endorsed in 2007 (EC, 2008).

[46] Furthermore, although endorsed in 2005, it was possible to apply some standards (IFRS 6), amendments to standards (on IAS 39) and interpretations (IFRIC 4 and 5) from 1 January 2006 (EC, 2008). Conversely, IFRS 7, IFRC 6 and amendments to some standards endorsed on 1 January 2006 could be applied to 2005 financial statements (EC, 2008).

2.4.1 IASB Standard Setting Process

The IASB develops IFRS in accordance with the procedures outlined in its governing constitution and this process involves public meetings and extensive input from various interested parties (IASB, 2006a). One such party is the European Financial Reporting Advisory Group (EFRAG) which is comprised of accounting experts from the EU; it provides the EC with advice on technical accounting issues (Armstrong et al., 2008). The EFRAG reviews any standard or group of standards issued by the IASB and decides whether the standard(s) should be recommended to the EC for endorsement in Europe.

Once it has considered the views of the EFRAG, the EC drafts a proposed regulation and seeks input on this regulation from the Accounting Regulatory Committee (ARC), a governmental organisation comprised of representatives from each EU member state (Armstrong et al., 2008). The ARC considers the technical merits of the standard(s) as noted in the EFRAG recommendation and also examines the implications of the standard(s) for the European public interest; if the ARC is satisfied with the proposed regulation and the EC decides to endorse the standard it then becomes applicable for all EU firms. If the ARC recommends that a standard should be rejected, the EC may seek further guidance from the EFRAG or forward their recommendation to the European Parliament to obtain a decision (Armstrong et al., 2008).

2.4.2 IFRS 1 – First-Time Adoption of International Financial Reporting Standards

The IASB issued IFRS 1 *First-Time Adoption of International Financial Reporting Standards* in June 2003 in an attempt to provide specific guidance to companies in various countries on the first-time application of IFRS. Effective for financial years

beginning on or after January 1 2004, although earlier adoption was encouraged, the objective of IFRS 1 was to achieve high-quality financial reporting among IFRS-reporting entities through information that: (i) provided transparency for users and was comparable over periods presented; (ii) provided a sound starting point for an entity's subsequent accounting under IFRS; and, (iii) could be gathered at a cost which did not exceed user benefits (Jermakowicz and Gornik-Tomaszewski, 2006).

IFRS 1 provides the framework applicable to entities preparing their financial statements in accordance with IFRS for the first time, stating the transitional provisions that companies must comply with (Jermakowicz and Gornik-Tomaszewski, 2006). In principle, the standard requires retrospective application of each IFRS effective at the reporting date of an entity's first IFRS compliant financial statements with certain limited exceptions[47]. It also involves the presentation of an opening balance sheet at the date of the transition to IFRS, the disclosure of one year of comparative information under IFRS and an explanation of how the transition impacted on the entity's reported financial position, financial performance and cash flows; this comparison should include a reconciliation of equity and profit or loss as prepared under the previous GAAP to IFRS and an explanation of the material adjustments made to the balance sheet, income statement and cash flow statement (Jermakowicz and Gornik-Tomaszewski, 2006). As a result, it has been argued that entities were given a "fresh start" since they had to redetermine their accounting policies under IFRS (Jermakowicz and Gornik-Tomaszewski, 2006, p. 170). In

[47] An entity will be prohibited from retrospective application on issues related to: (i) financial instruments; (ii) hedge accounting; and, (iii) estimates. Optional exemptions correspond to topics where the cost is greater than the benefit of full retrospective restatement (or restatement may be impossible) and include: (i) no restatement of business combinations; (ii) deemed cost (fair value or prior revaluations) for certain non-financial assets; (iii) cumulative actuarial gains and losses; (iv) cumulative translation differences; (v) compound financial instruments; and, (vi) assets and liabilities of subsidiaries, associates and joint ventures (Jermakowicz and Gornik-Tomaszewski, 2006).

addition, the opportunity to determine optimal outcomes might arise as a consequence of the limited optional exemptions available; such choices in the determination of IFRS accounting policies might significantly impact an entity's future results (Jermakowicz and Gornik-Tomaszewski, 2006).

2.4.3 Problematic Standards

Among the many new reporting requirements faced by EU companies, most concerns revolved around the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* (Fearnley and Hines, 2002; Aisbitt and Walton, 2005; PwC, 2006a; PwC, 2006c; PwC, 2006d; PwC, 2007a). The area of financial instruments has proved to be one of the most controversial and difficult issues that the IASB has had to provide guidance on (Dunne, 2003). The controversy caused by IAS 39 was highlighted by the difficulties that the EU experienced in endorsing the standard (Whittington, 2005).

Much of the debate surrounding the standard related to the fact that many companies had to account for, and disclose, details about their financial instruments for the first time. For example, Jermahowicz and Gornak-Tomaszewski (2006) found that 41 per cent of their sample companies reported on financial instruments for the first time in 2004; this standard accounted for the biggest proportion of new disclosures in their sample's financial statements. Under IAS 39, all derivatives need to be recognised on the balance sheet at fair value and, in most instances, the movements in fair values are recorded in the income statement (Elliot and Elliot, 2007). Although the aim of this was to improve the transparency of financial statements for users, it is argued that the change would have increased a company's income volatility (PwC, 2003). In addition,

IAS 39 placed restrictions on the use of hedge accounting and, hence, on the deferral of gains and losses on hedging instruments (Cairns, 2003). In order to qualify for hedge accounting, companies are required to put in place documentation at the start of the hedge and perform effectiveness testing at each reporting date; a number of commentators suggested that these requirements could have further increased volatility in reported earnings (PwC, 2003, PwC, 2007a)[48]. Overall, PwC (2007b) found that 81 per cent of companies surveyed changed their behaviour in relation to financial instruments policy and processes as a result of the new standard.

A second standard which was problematic was IAS 19 *Employee Benefits* (Cairns, 2004; KPMG, 2006; PwC, 2007a). A significant aspect of this standard was the requirement to recognise defined benefit pension scheme surpluses or deficits on the balance sheet (BDO, 2006); several studies have reported a negative adjustment to equity following the application of this standard indicating that many companies have disclosed pension deficits on the balance sheet under IFRS (Aisbitt, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; Stenka and Ormrod, 2007)[49]. In addition, IAS 19 allows a company to recognise only a portion of actuarial gains and losses in respect of defined benefit pension schemes as income or expense when certain thresholds are exceeded, the so-called 'corridor' approach, or to recognise all actuarial gains and losses as they occur, either in the income statement or the statement of other recognized income and expenses (SORIE) (Ernst and Young, 2006; Horton and Serafeim, 2008). Ernst and Young (2006) found that the majority of

[48] A BDO (2007) survey found that the difficulty of qualifying for hedge accounting under IFRS had affected the behaviour of some companies; for example, one company stated that it deliberately under-hedged in order to satisfy the requirements of IAS 39 whilst another continued to hedge but chose not to use hedge accounting.

[49] For example, Stenka and Ormrod (2007) found in their examination of the impact of IFRS adoption on UK group accounting that IAS 19 reduced reported equity by 13 per cent for the sample companies.

the companies sampled applied the 'corridor' approach to the recognition of actuarial gains and losses; although they noted that a sizeable portion had opted for immediate recognition of such gains and losses in the SORIE. Horton and Serafeim (2008) reported that the effect of IAS 19 was to reduce earnings for a sample of UK companies; however, this effect was dependant upon what UK GAAP requirements were previously followed and whether they took advantage of the 'corridor' approach[50].

A further controversial standard is IFRS 2 *Share-based Payment* (KPMG, 2005; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a, PwC, 2007a). IFRS 2 requires companies to recognise an expense in relation to share option schemes and to measure this expense at the fair value of the shares or options at grant date (Cairns et al., 2008); when IFRS 2 was initially issued in 2004, it was reported that the standard would reduce EU firms' profits by 10 per cent as a result of these new requirements. Indeed, Ernst and Young (2006) found that 90 per cent of companies reported charges to the income statement under this standard with respect to share-based payment plans on which very few of these companies disclosed valuation information in previous GAAP-compliant financial statements. This lack of prior disclosure regarding share-based compensation plans was particularly prevalent for UK companies; the Accounting Standards Board (ASB) issued Financial Reporting Standard (FRS) 20 *Share-Based Payment* in February 2004 which included requirements identical to IFRS 2, but did not become mandatory for listed companies until 1 January 2005 when by default it was superseded by IFRS 2 (Horton and Serafeim, 2008). However, accounting for employee share schemes under the previous Urgent Issue Task Force

[50] Prior to IAS 19, the majority of UK companies had taken advantage of the FRS 17 transitional option which entitled companies to continue reporting under the previous SSAP 24 within their main accounts (Horton and Serafeim, 2008).

(UITF) Abstract 17 differed significantly from FRS 20 and IFRS 2; it required a charge against profits based on intrinsic value at grant date which was often zero for UK share option schemes (Horton and Serafeim, 2008). Although some UK companies did adopt FRS 20 early, and therefore were probably not impacted by the changeover to IFRS, for most firms IFRS 2 increases the compensation expense as a result of the requirement to recognise the fair value of share-based payments as an expense over the period from the grant date to the vesting date and hence reduces reported profits (BDO, 2007; Horton and Serafeim, 2008).

A further key implication of the introduction of IFRS 2 is that companies are required to disclose what valuation models have been applied to determine the fair value of share-based scheme transactions and why they believe it is the appropriate model (BDO, 2006). Although the Black-Scholes Merton model (Black and Scholes, 1973; Merton, 1973) is specifically referred to in the standard, BDO (2006) noted that surveyed companies were attempting to use the method which they believe best suits the option plan being valued. For example, a quarter of the companies' surveyed used more than one model to their various option schemes including the Monte Carlo model (Boyle, 1977) and the Binomial Lattice Option pricing model (Cox et al., 1979) in addition to the Black-Scholes Merton model (BDO, 2006).

A fourth standard which has been the subject of discussion in the literature is IFRS 3 *Business Combinations* which, together with IAS 36 *Impairment of Assets*, requires that goodwill no longer be amortised through the profit and loss account but instead be subject to an annual impairment review (PwC, 2007a). This requirement has led to greater volatility in income statement numbers, particularly for certain sectors

(KPMG, 2005; BDO, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; PwC, 2006c; PwC, 2007a). For example, Ernst and Young (2006) found that of the companies analysed in their study, half reported impairment to goodwill while two thirds reported impairments to assets more generally. IFRS 3 also requires the fair value of the cost of the combination to be allocated to the various identifiable components, such as brands and customer lists (Beattie et al., 2008); however, an ICAEW (2007) study found that one third of the sampled companies did not provide a description of the components. Furthermore, a BDO (2007) survey noted criticism regarding the costs involved in valuing separately identified intangibles and questioned the reliability of the estimates of fair values placed on such intangible assets.

The implementation of IAS 12 *Income Taxes* has also caused problems for companies particularly for retail firms with respect to the reporting of deferred tax whereby significant liabilities arise in the balance sheet although these may never crystallise in practice (KPMG, 2005; PwC, 2006c; Haverals, 2007). IAS 12 requires the use of the 'temporary difference' approach when calculating the deferred tax liability which differs from the 'timing difference' approach that has historically been applied in the UK; this change, along with many other deferred tax adjustments, will likely impact the deferred tax charge and effective tax rate (Horton and Serafeim, 2008). IAS 40 *Investment Properties* has also had a significant impact on the income statements of UK real estate firms as it requires gains from changes in the fair value of investment properties to be credited to the income statement (BDO, 2006)[51]. A deferred tax implication of these write offs under IAS 12 required a provision to be made for

[51] Under UK GAAP, these movements were taken to the Statement of Recognised Gains and Losses (STRGL) (BDO, 2006).

temporary differences in tax; this was not previously required under UK GAAP and reduced shareholders equity (BDO, 2006).

Other problem standards that have been mentioned in the financial press include IAS 16 *Property, Plant and Equipment* (PwC, 2006c), IAS 18 *Revenue* (PwC, 2007a), IAS 17 *Leases* and IAS 38 *Intangible Assets* (Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; PwC, 2006c; PwC, 2007a). For example, IAS 17 has been documented as having a negative impact on reported profits (Horton and Serafeim, 2008). Although IAS 17 shares many common aspects with its previous UK GAAP counterpart SSAP 21, there are key differences which could have a pronounced impact. For example, certain leases historically classified as operating leases under UK GAAP may now be classified as finance leases under IAS 17. In addition, there are notable differences in relation to revenue recognition by lessors with SSAP 21 requiring the use of the net cash investment method whilst IAS 17 requires the application of the net investment method; the impact being a deferral of finance income compared with the recognition pattern under UK GAAP (Horton and Serafeim, 2008). Therefore, at the time of the changes to IFRS, several commentators in the financial press as well as in academic articles had highlighted that the move away from national GAAP would be problematic. However, they suggested that a fundamental issue which is implicit in many of the IFRS standards is the IASB's emphasis on fair value measurement.

2.4.4 The Fair Value Debate

The IASB's perceived preference for fair value as a measurement objective within its conceptual framework has been subject to much controversy. The adoption of IFRS

was predicted to lead to the recognition of more assets measured at fair value on the balance sheet because IFRS apply fair value more widely to financial and non-financial assets than under some other conventions including both UK and US GAAP (Aisbitt, 2006; Cairns et al., 2008; Whittington, 2008). Prior literature indicated that there were significant benefits with asset revaluations or fair value use (Sharpe and Walher, 1975; Standish and Ung, 1982; Aboody et al., 1999; Muller III et al., 2008); for example, Hitz (2007) documented evidence in support of the decision usefulness of fair value as a price from liquid markets. However, doubts were raised about whether the greater use of fair value in IFRS financial statements would provide more relevant information to users (Ball, 2006). Such doubts were particularly pronounced where markets were illiquid; the absence of liquid markets, which could be used as an independent source to verify fair value estimates, raised concerns about the reliability of fair value measurement (Christensen and Nikolaev, 2008). Furthermore, Watts (2006) criticised fair value for the lack of substance over form; unlike the accounting value, the true market value is established by a large number of investors with a wide range of information. The absence of readily available market prices raised additional questions about the usefulness of fair values; the use of 'mark to market' models to determine fair value was criticised because it presented an opportunity for manipulation given that managers can influence both the choice of model used and parameter estimates employed (Ball, 2006). Finally, the greater use of fair value in IFRS financial statements was expected to increase the level of volatility in reported earnings (Aisbitt, 2006).

Fair value measurement has been subject to much debate during the current global economic crisis where it has been blamed for contributing to the collapse of the

worldwide banking system (Accountancy Age, 2008a). Global calls for the suspension of fair value accounting were made in an attempt to ease the economic crisis given the significant volatility in worldwide financial markets (Accountancy Age, 2008a); clearly a resolution to the debate about the usefulness and indeed appropriateness of fair value does not appear forthcoming.

2.5 Issues Surrounding the Introduction of IFRS

Although the introduction of IFRS was anticipated to increase the comparability and transparency of global financial reporting practices (Murphy, 2000), the appropriateness of a move towards a worldwide accounting framework has been questioned amid concerns about the removal of local accounting standards "customized (sic.) towards the needs of a particular institutional framework" (Daske and Gebhardt, 2006, p. 462). Some commentators have noted that the amount of additional useful information provided by the move to IFRS depends both on the quality of the firm's previous domestic GAAP and on the firm's own disclosure strategy (Horton and Serafeim, 2008). With respect to the first point, it has been argued that the potential incremental transparency is higher for Continental European firms than for their UK counterparts; given the similarities between IFRS and UK GAAP, UK firms are expected to experience smaller capital market impacts when they switch to the international reporting requirements (Horton and Serafeim, 2008).

Although this may be true on average, the second point contends that there may be specific firms, or groups of firms, with a greater potential for incremental transparency given their previous reporting incentives (Horton and Serafeim, 2008). For example, Ball (2006) and Daske et al. (2007) have contended that all firms face

different reporting incentives regardless of their domestic GAAP; some firms may not want more transparency and are consequently unlikely to change their reporting policies following IFRS adoption[52]. Nevertheless, where an enforcement regime is strengthened and/or the level of public scrutiny is increased, these institutional factors may change firm reporting incentives (Horton and Serafeim, 2008). As a result, the potential for increased transparency among firms may be greater and the market consequences of this extra transparency for some UK firms may be more pronounced; especially since firms are mandated to comply with IFRS and disclose IFRS reconciliations irrespective of whether they consider the transition to be beneficial or not (Horton and Serafeim, 2008). Indeed, it has been argued that compliance with IFRS should provide investors with an opportunity to get a better understanding of those companies that have disclosed limited amounts of information prior to adoption of IFRS; the publishing of additional information might result in different valuations or elicit a greater scrutiny of the financial statements (Citigroup, 2005)[53].

In addition, concerns have been expressed about the expected quality of financial statements which result from applying IFRS as "higher quality financial reporting standards do not automatically lead to higher quality financial reports" (Daske and Gebhardt, 2006, p. 466), especially when enforcement mechanisms are weak and incentives to minimise disclosures exist (Ball et al., 2003)[54,55]. In an examination of

[52] Previous literature detailing the degree of harmonisation achieved following the introduction of EU accounting directives provides further evidence of varying degrees of success (Saudagaran and Meek, 1997).
[53] This is consistent with the findings of a PwC (2006b) survey which revealed that although fund managers did not expect the implementation of IFRS to involve any surprises, if there were any included in the year-end disclosures then they would anticipate a market reaction.
[54] Armstrong et al. (2008) contended that any variation in the implementation and enforcement of IFRS might result in an increase in opportunistic managerial discretion when applying IFRS.
[55] In a study of four East Asian countries, Ball et al. (2003) illustrated that higher quality financial reporting could not be guaranteed by the adoption of 'IAS-type' standards when law enforcement mechanisms and strong adverse reporting incentives existed.

the quality of the financial statements of Austrian, German and Swiss firms prepared using IAS or US GAAP, Daske and Gebhardt (2006) reported a significant increase in disclosure quality within the countries analysed regardless of whether firms voluntarily adopted IAS or US GAAP or were mandated to use such standards in response to the requirements of the stock market. However, a survey of FTSE Financial Directors (FDs) and UK-based fund managers found that although 64 per cent of fund managers claimed to be confident that the IFRS implementation process could create high quality enforceable standards, 59 per cent of FDs were not confident that this would be accomplished (Accountancy, 2006b).

Although approximately 7,000 listed European companies have been affected by the EU Regulation requiring adoption of IFRS from 2005, only 275 were actively using IAS for financial reporting in 2001 (Haller, 2002)[56]. Several studies have documented that companies did not voluntarily adopt IASs (Cairns, 2000; Street et al., 2000; Street and Gray, 2001)[57], that IAS reported results were associated with increased volatility in financial statement numbers (Street and Gray, 2002; Jermakowicz and Gornik-Tomaszewski, 2006)[58,59] and that non-compliance with IFRS was frequently not mentioned in a firm's audit report (Street and Bryant, 2000; Street et al., 2000).

[56] Indeed, Jermakowicz and Gornik-Tomaszewski, (2006) found that among the 74 firms surveyed that identified themselves as first-time adopters, only 15 of them would have adopted IFRS voluntarily if given the choice, while 52 stated explicitly that they would not have adopted the standards.

[57] For example, in their study of 279 firms that referred to the use of IFRS in their 1998 financial statements, Street and Gray (2001) found that the accounting policy disclosures of many of those sampled were inconsistent with IFRS.

[58] An analysis of 27 large European companies found an average earnings increase of 25 per cent with a high variability between companies; for example, ICI reported a 126 per cent gain whilst Danske Bank's earnings figure fell 12 per cent (Cooper et al., 2005). The study also reported a great deal of variability for the balance sheet figures.

[59] Although Jermakowicz and Gornik-Tomaszewski, (2006) indicated in their survey that reported results might have been significantly impacted by IFRS, only a few companies in the process of implementing IFRS, being those adopting IFRS for the first time, provided a dollar estimate of the expected impact of the transition on reported results. The amounts were found to be consistently larger, in relative terms, for early adopters than for first-time adopters; it may be that, anticipating the IAS regulation, first-time adopters were implementing accounting policy choices over time thereby minimising the differences between domestic GAAP and IFRS.

Taylor and Jones (1999) examined the financial statements of those companies that claimed to be applying international standards, in order to ascertain the location and nature of information about their compliance with IASs. Although a substantial majority of the companies studied referred to IASs in the notes to the accounts, mention of the standards was only evident in 50 per cent of the audit reports. Furthermore, they found that the largest group of companies applied a mixture of local and international standards and a considerable number of companies reported the use of *exceptions*[60] in applying IAS standards. This finding calls into question the level of comparability and transparency afforded by international standards prior to 2005 given the apparent ability of the sampled firms to pick and choose which standards they applied.

Several studies have highlighted the lack of implementation guidance and the absence of uniform interpretations forthcoming from the standard setters as key challenges in the transition process (Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006). For example, PwC bemoaned this lack of guidance on the transition process; they argued that some standards looked straightforward to implement but unexpected difficulties arose when they started to be applied in practice as differences emerged in comparison to previous practice (Accountancy, 2005b). Schmultz and Lopez (2001) argued that cultural differences between countries were detrimental to the uniform interpretation of IAS standards; these variations gave rise to substantial variations in reported results, thus thwarting the stated objective behind IAS harmonisation. Indeed, a large scale review of the

[60] Given that disclosures prepared in accordance with IAS were not a mandatory requirement in the year during which the Taylor and Jones study was undertaken, many of the sample companies were not applying the full requirements of individual standards. Instead, the companies surveyed highlighted where they had departed from the requirements stated within a relevant standard in the form of exceptions (Taylor and Jones, 1999).

financial statements for 200 companies across 16 countries undertaken by KPMG (2006) revealed that a company's country of domicile and its previous national GAAP were the key influences on the approaches taken by companies in applying IFRS; these factors were more important than the industrial sector to which the company belonged.

According to an EC (2005) survey of the countries in the European Economic Area (EEA), almost all of the 28 EEA members permitted IFRS for the consolidated financial statements of unlisted companies (EC, 2005). However, few countries were expected to require the application of IFRS by non-listed companies (Larson and Street, 2004) and more than 7,000,000 unlisted small and medium entities (SMEs) were expected to apply national standards; thus, a "two-standard system" initially developed (Larson and Street, 2004, p. 115) with large listed firms applying international standards whilst their SME counterparts continued to conform with national rules thereby hindering the extent to which financial statements were comparable across countries (International Accountant, 2005). Furthermore, it has been argued that IFRS are inappropriate for SMEs in that they are too complex and over demanding in terms of the quantity of disclosures required (Larson and Street, 2004)[61], [62].

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[61] The IASB issued a discussion paper, *Preliminary Views on Accounting Standards for Small and Medium-sized Entities*, in June 2004 proposing a set of standards specifically for SMEs (IASB, 2004). The proposed standards were expected to be less complicated and require fewer disclosures than IFRS (Accountancy Ireland, 2006). However, in April 2008, the European Parliament criticised the IASB's proposed IFRS for SMEs stating that the standard was too complicated and encouraged the EC to withdraw its commitment for the implementation and adoption of IFRS for SMEs, thereby preventing the parallel application of standards in the EU (Accountancy Ireland, 2008).

[62] A PwC survey found strong support for the application of common standards to all firms regardless of size with only 20 per cent of survey respondents in favour a separate set of standards for smaller companies (Accountancy, 2006c).

In addition to SMEs, it was argued that parent firms and/or their subsidiaries would be indirectly impacted by the implementation of IFRS (CESR, 2003; Jermakowicz and Gornik-Tomaszewski, 2006). Many EU-listed firms, particularly in Continental Europe, continued to prepare their parent and/or subsidiary accounts according to national accounting standards since these are used for taxation purposes, profit distribution decisions and financial services supervision; thus affected companies incurred the cost of running the two parallel accounting systems (Jermakowicz and Gornik-Tomaszewski, 2006). Furthermore, requiring consolidated statements to be prepared under IFRS whilst allowing individual accounts to be reported using domestic GAAP added complexity to accounting systems and acted as an impediment to the achievement of worldwide accounting harmonisation (Haller, 2002; Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006). The expected benefits of the move to International GAAP, including a lower cost of capital, may not have been realised because parent and/or subsidiary companies were still required to prepare individual financial statements based on local GAAP which differed from IFRS. Differences in tax systems and the underdevelopment of certain national capital markets were also being identified as barriers to harmonisation (Larson and Street, 2004).

2.5.1 The Role of the US in the Harmonisation Process

A notable exception to those countries that have adopted IFRS, or propose to in the future, is the US; its absence from the list of IFRS users has been cited as an impediment in the IASB's attempt to harmonise global reporting practices (PwC,

2002b)[63],[64]. In 2002, the Sarbanes-Oxley Act was passed in the US, in response to the expressed lack of confidence in accounting created by several corporate scandals, (in particular the collapse of Enron in 2001)[65], restructuring much of the US framework (Fearnley et al., 2007). The Act proposed that the quality of financial reporting could be improved by converging worldwide accounting practices; therefore it can be argued "probably nothing will be more important to global accounting convergence than IFRS" (Jermakowicz and Gornik-Tomaszewski, 2006, p. 170)[66]. During the same year, the IASB and the US FASB agreed to formalise their commitment to the narrowing of differences between International and US accounting standards (Fearnley et al., 2007). In a joint project, the two bodies set out to develop an improved, common conceptual framework that built on their existing frameworks (that is, the IASB's *Framework for the Preparation and Presentation of Financial Statements* and the FASB's *Statement of Financial Accounting Concepts*) and provided a sound foundation for developing future accounting standards (IASB, 2009). This project is being conducted in eight phases[67]; the first discussion document

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[63] The Financial Accounting Standards Board (FASB) is responsible for standard setting in the US (Elliot and Elliot, 2007).

[64] In a PwC (2002b) survey of 650 Chief Executive Officers across the EU, the need for further convergence, particularly with US GAAP was acknowledged (PwC, 2002b).

[65] The executives of Enron, as well as those of other companies involved in the many corporate scandals that occurred during the same period of time (such as WorldCom and Tyco), covered up or misrepresented a variety of questionable transactions, resulting in huge losses to stakeholders and a crisis in investor confidence. US Congress attempted to address this problem by passing the Sarbanes-Oxley Act, which aims to enhance corporate governance and strengthen corporate accountability (Sarbanes-Oxley, 2006).

[66] Indeed, the Enron scandal undermined the international standing of the US at a crucial moment in the IASB's development (Nobes and Zeff, 2008). The US stock markets became very unpopular for foreign registrants following the introduction of the Sarbanes-Oxley Act with London being the preferred choice for new issuers; for example, European issuers registered with the SEC fell from 379 in 2001 to 223 in 2006, whilst the number of UK registrants increased from 63 to 143 (Carnall, 2007). The New York Stock Exchange attempted to rectify this by adding impetus to their long-run campaign to allow the use of IFRS for SEC registrants (Nobes and Zeff, 2008).

[67] The eight phases scheduled to be completed are: (i) Objectives and Qualitative Characteristics; (ii) Elements and Recognition; (iii) Measurement; (iv) Reporting Entity; (v) Presentation and Disclosure; (vi) Purpose and Status; (vii) Application to Not-for-Profit Entities; and, (viii) Remaining Issues (Whittington, 2008). The boards agreed that each board, within the context of its current GAAP hierarchy, will finalise the common framework as parts are completed, and noted the completion of later parts may result amendments to earlier phases (IASB, 2009).

was published in July 2006 and represents the views of the two boards with respect to the first phase of the project; namely, the objective of financial reporting and the qualitative characteristics of financial reporting information (Crook, 2008). This first phase was deemed critical for two reasons: (i) a consensus regarding the objectives and desirable features of financial reports should be reached to provide legitimacy and momentum for the rest of the project; and, (ii) the objectives and qualitative characteristics will serve as a basis for assessing alternatives relating to recognition and measurement issues to be discussed in later phases of the project (Gore and Zimmerman, 2007). However, this discussion paper was subject to much controversy with particular criticisms directed at the exclusion of stewardship as one of the objectives of financial reporting and the adoption of the entity perspective when reporting company transactions (Gore and Zimmerman, 2007). Following consideration of the comments received on the discussion paper, the two boards published an Exposure Draft on the objective of financial reporting and the qualitative characteristics of financial reporting information in May 2008; this was broader in scope than the earlier discussion paper particularly with respect to the objective of financial reporting which now includes a consideration of the stewardship function of financial reporting (Crook, 2008)[68]. Nevertheless, the potential removal of the existing requirement for foreign companies with a listing on a US stock market to produce financial statements using both IFRS and US GAAP could produce substantial cost savings for US-listed non-US companies (Accountancy Age, 2005b)[69]. In late 2007, the SEC approved a rule change to end reconciliation to US GAAP for foreign

[68] A discussion paper setting out the two boards' preliminary views on the reporting entity concept was also published in May 2008 (Crook, 2007).
[69] EU domiciled firms currently reporting under full US-GAAP were allowed to move to IFRS reporting by 2007 at the latest (EC, 2002).

companies listed in the US thereby realising these potential cost savings for affected firms (Accountancy, 2007)[70].

Research has shown that the gap between IFRS and US GAAP is narrowing (Street et al., 2000), although recent studies have indicated that there are still considerable differences between the two regimes[71]; indeed, US GAAP concepts that have proved difficult to implement in the US have formed the basis for several of the more controversial aspects of IFRS (Gandy, 2005)[72,73]. However, it has been argued that the IASB was moving too quickly and too willingly towards US standards (Accountancy, 2005c). A number of commentators have suggested that US influences have dominated the IASB's restructuring programme such that the harmonisation of international accounting standards will "merely result in a *de-facto* US GAAP for the entire world" (International Accountant, 2006, p. 28). For example, this view has been particularly evident with respect to the introduction of IFRS 8 *Operating Segments* by the IASB. IFRS 8 was developed as part of the IASB/FASB joint convergence project and sought to align the IASB's standard on segmental reporting with the requirements of its US GAAP counterpart SFAS 131 (Accountancy Age, 2007). However, IFRS 8 has been subject to widespread criticism because it was thought to be too similar to

[70] Although a key development in the harmonisation process, this decision was met with some opposition from EU institutions because the SEC requires compliance with IFRS as issued by the IASB, which is considered politically unattractive to EU politicians and bureaucrats who support endorsed IFRS (Nobes and Zeff, 2008). Furthermore, if the SEC also allows IFRS for US registrants, this may undermine the EU's claim to be the best customer for the IASB's standards and the SEC may also attempt to influence the IASB's deliberations (Nobes and Zeff, 2008).

[71] An Ernst and Young study of the reconciliation information filed by 130 SEC foreign private issuers following first-time adoption of IFRS in 2005 identified nearly 200 IFRS to US GAAP differences and that the reported results of the sample companies were significantly impacted by these differences (Accountancy Ireland, 2007).

[72] For example, the origins of the IAS 39 derivatives standard can be found in its US equivalent, Financial Accounting Standard (FAS) 133, which created significant controversy when introduced in 1998 as a result of its requirement to mark all derivatives to market. This new requirement introduced an element of earnings volatility not previously encountered by US firms (Schipper, 2003; Ernst and Young, 2005).

[73] Furthermore, in 2004, the FASB published SFAS 123 (R) *Shared-Based Payment* which converges closely with the IASB's identically titled standard IFRS 2 (Silliman, 2005).

SFAS 131; issues highlighted have included its emphasis on the disclosure of information for internal management purposes (which was the approach adopted in SFAS 131) rather than external user decisions (which is the approach that had previously been followed in IAS 14). It is suggested that IFRS 8 will lead to a lack of comparability between companies' financial statements when applying the standard because management can choose the format and content of information disclosed (Accountancy Age, 2007). In the corporate world, resistance has grown to the joint project in light of such arguments about the influence of the US due to,

> "...the desire to preserve domestic business culture, the potential negative financial impacts and tax liability implications it could have and, in some cases, the outright fear of increased transparency."
>
> (International Accountant, 2006, p. 29)

In November 2008, the SEC set out a roadmap for the transition to IFRS by 2014 and outlined several milestones for the transition process; these include the SEC officially endorsing the move towards IFRS in 2011 with the option for certain industry leaders to implement the transition to IFRS earlier than 2014 if they wished (Accountancy Age, 2008b)[74],[75]. In publishing its IFRS roadmap, the SEC said that:

> "The use of IFRS in other jurisdictions may have begun to affect US investors' ability to evaluate investment alternatives as their level of investment in non-US companies has increased over time."
>
> (Accountancy Age, 2008d)

The roadmap represents a significant development in the IASBs attempt to achieve the harmonisation of IFRS and US GAAP and was seen as particular boost following

[74] Based on market capitalisation, companies ranked within the top 20 of their respective industry will be permitted to begin filing IFRS compliant financial statements for fiscal years ending after December 15, 2009; approximately 110 companies from 34 industries would be eligible (Accountancy Age, 2008d).

[75] A study by Deloitte revealed that, if permitted, 42 per cent of more than 200 US company finance professionals indicated that they would consider adopting IFRS earlier than 2014 (Accountancy Age, 2008c).

much criticism directed at the Board regarding its stance on fair value (Accountancy Age, 2008a).

2.6 International Studies on the Adoption of IFRS

A number of studies have assessed the adoption of IFRS and its impact in a range of countries both within the EU and beyond. Table 2.1 presents an overview of prior literature examining IFRS adoption worldwide. An analysis of this table reveals that a sizeable number of countries have adopted these standards and academics have investigated a range of issues relating to IFRS.

Although the EU regulation requiring the mandatory adoption of IFRS from 2005 affects only those listed firms within the EU, the literature detailed in Table 2.1 reveals that the use of IFRS has been examined in countries not directly affected by this regulation including the US, Australia and China, but which have been or will be impacted by the introduction of the IFRS regime as a result of the new EU regulation[76]. Much of this literature involved an investigation of the value relevance of financial information produced in accordance with IFRS (Hung and Subramanyan, 2004; Bartov et al., 2005; Lin and Chen, 2005; Schadewitz and Viera, 2005; Callao et al., 2007; Barth et al., 2008; Gjerde et al., 2008; Gordon et al., 2008). The findings of these studies are very mixed; some documented an improvement in the value relevance of financial information following a change to IFRS reporting (Bartov et al., 2005; Gordon et al., 2008; Barth et al., 2008) while others noted that the use of IFRS

[76] For example, Section 2.3.1 highlighted that Australia introduced the mandatory adoption of IFRS for domestic companies in 2005 following the EU regulation whilst Section 2.5.1 discussed the intent of the US to implement IFRS reporting by 2014.

Table 2.1 International Literature on the Adoption of IFRS

Reference	Country Analysed	Research Topic	Reported Findings
Hung and Subramanyan (2004)	Germany	Effects of IAS adoption on financial statements and their value relevance.	Total assets and book value of equity, as well as variability of book value and net income are significantly higher under IAS than German GAAP. IAS adjustments to book value (income) are generally value relevant (irrelevant).
Jermakowicz (2004)	Belgium	Impact of IFRS conversion on companies, their internal organisation and accounting and finance strategy.	Significant changes on both internal and external reporting activities and impact on reported equity and net income.
Bartov et al. (2005)	Germany	Comparative value relevance of earnings reported under German GAAP, US GAAP and IFRS.	US GAAP and IFRS are more value relevant than German GAAP.
Lin and Chen (2005)	China	Value relevance of IAS Reconciliation Statements for firms from A- and B – share markets.	Accounting numbers based on domestic accounting standards more value relevant than IAS.
Schadewitz and Viera (2005)	Finland	Value relevance and market responses of transition to IFRS.	Some (no) evidence of value relevance found in IFRS adjustments on earnings (shareholders equity). Evidence of only minor market responses on stock returns and no excess trading after the release of IFRS reconciliation adjustments.
Higgins and Jones (2006)	Australia	Survey of impact of adoption of IFRS on account preparers.	Many preparers were not well prepared for the transition and were sceptical about the claimed benefits of IFRS.
Callao et al. (2007)	Spain	Effect on the comparability and relevance of financial reporting.	Local comparability and no improvement in the relevance of financial reporting due to the wider gap created between book and market values when applying IFRS.

Lopes and Viana (2007)	Portugal	Analysis of disclosures of the impacts of the transition to IFRS.	High degree of variability among both the qualitative (narrative explanations of transition) and quantitative (reconciliation) disclosures. Portuguese standards more conservative than IFRS.
Armstrong et al. (2008)	18 European countries	Examination of the European Stock Market reaction to sixteen events associated with the adoption of IFRS.	Positive reaction for firms with lower quality pre-adoption information and with higher pre-adoption information asymmetry. Reaction is less positive for firms domiciled in code law countries.
Barth et al. (2008)	16 European countries plus Australia, China, Hong Kong, Singapore and South Africa.	Application of IAS associated with higher accounting quality.	Firms applying IAS generally evidence an improvement in accounting quality between pre- and post-adoption periods.
Gjerde et al. (2008)	Norway	Examination of value relevance of adopting IFRS on NGAAP restatements.	Find that reconciliation adjustments to IFRS are marginally value-relevant due to increased relevance of balance sheet and the normalised net operating income.
Gordon et al. (2008)	US	Comparison of US GAAP and IFRS earnings attributes.	US GAAP exhibits higher cash persistence and value relevance.
Nobes and Zeff (2008)	4 European countries and Australia.	Examination of what companies and auditors report on compliance with IFRS.	Even when companies were complying with IFRS, they were generally not saying so and only in a small number of cases were dual reports provided by auditors on full IFRS in addition to the mandated reference to national GAAP where the latter corresponds to full IFRS.

Note: This table provides details and the reported findings of prior literature which has examined the adoption of IFRS in a number of different countries.

decreased the stock market's response to information (Lin and Chen, 2005; Callao et al., 2007). Several studies have reported inconclusive evidence about this issue (Hung and Subramanyan, 2004; Schadewitz and Viera, 2005; Gjerde et al., 2008).

An assessment of the quality of financial information produced under IFRS has been undertaken in the literature (Barth et al., 2008) and the market reaction to any changes in accounting quality has also been studied (Armstrong et al., 2008); the findings reveal that IFRS generally improves accounting quality in a number of countries with the markets responding favourably to such improvements[77]. Other studies have found a lack of preparation among accounting preparers during the IFRS transition process (Higgins and Jones, 2006), that little or no guidance was supplied by companies regarding whether or not they had complied with IFRS in their financial reports (Nobes and Zeff, 2008), that IFRS adoption involved significant changes on both internal and external reporting activities (Jermakowicz, 2004) and that the transition to IFRS introduced increased variability in reported results (Jermakowicz, 2004; Lopes and Viana, 2007).

2.7 The Introduction of IFRS in the UK

The challenges faced by the implementation of IFRS no doubt differed between countries and depended on how much the international regime varied from existing national accounting systems (Aisbitt and Walton, 2005). In the UK, the ASB and IASB had worked closely in a move towards the convergence of UK GAAP with its IFRS counterpart. For example, in 2004, the ASB published a Discussion Paper *UK*

[77] For example, Barth et al. (2008) found that firms applying IAS from their sample of 21 countries generally exhibited less earnings management, more timely loss recognition, and a higher association of accounting amounts with share prices and returns than do matched sample firms applying non-US domestic standards.

Accounting Standards; A Strategy for Convergence with IFRS (ASB, 2004a) which set out proposals for the convergence of UK accounting standards with IFRS. These proposals included the introduction of new reporting standards which would bring UK reporting practices into line with the new IFRS requirements followed by a series of 'step changes' replacing existing UK standards with standards based on IFRS as prospective IASB projects were completed (ASB, 2004b)[78],[79]. However, despite these attempts to align UK accounting practices with those required under the new international regime, the introduction of IFRS represented a fundamental change in the financial reporting practices of affected companies in the UK. Indeed, as Aisbitt and Walton (2005) highlight,

> "...even UK-based companies face some significant changes in accounting policy that will affect the way financial transactions are recorded and reported and may, ultimately, influence wider business processes."
>
> (Aisbitt and Walton, 2005, p. 3)

Section 2.7.1 will detail the regulatory system which governs financial reporting practices in the UK while Section 2.7.2 will discuss the anticipated impact of the introduction of IFRS on affected companies in the UK.

2.7.1 The UK Regulatory System

In the UK, the financial reporting environment has three key sources of regulations governing the form and content of UK published annual reports: (i) company law; (ii) accounting standards; and, (iii) Stock Exchange requirements (Thomas, 2002).

[78] Since this proposal was published, the ASB has issued several standards which bring UK GAAP into line with IFRS including FRS 20 (IFRS 2), 'Share based payments', FRS 21 (IAS 10), 'Events after the balance sheet date', and FRS 22 (IAS 33), 'Earnings per share' (Elliot and Elliot, 2007).

[79] More recently, the ASB issued a Press Notice in 2006 seeking views on the future application of reporting requirements for UK companies (ASB, 2006a). Several proposals were outlined based on the feedback received; these included a proposal to require all UK public quoted and other publicly accountable companies to comply with IFRS regardless of turnover and whether they present group accounts or not. This would result in an additional 1,000 to 1,500 companies being required to report under IFRS (ASB, 2006b).

Prior to 1981, the legislative requirements concerning the form and content of published financial statements were not very demanding; directors and shareholders were responsible for making decisions in this regard. The implementation of the EC Fourth Directive in the UK via the Companies Act 1981 introduced considerable reform of the legislative demands governing UK published company accounts. This Act legalised a standard format for UK financial statements and formally introduced the principles of prudence, consistency, accruals and going concern to the financial reporting framework. The 1981 Act was followed by the Companies Act 1985 whose objective was to impose a legal standard with respect to the presentation of financial information in order to facilitate inter-company comparisons (Elliot and Elliot, 2004)[80]. The Company Law Review Steering Group published a report in July 2001 detailing the outcome of an extensive review of the existing legislation, which led to the recent introduction of the Companies Act 2006 (Company Law Review Steering Group, 2001). This Act is broad in nature and pays particular attention to topics beyond the scope of traditional financial statements including corporate governance disclosures and information about social and environmental matters such as the impact of business activities on the environment.

In the years prior to 1970, the professional bodies predominantly provided guidance on specific accounting issues, as no formal system governing accounting standard setting existed in the UK. In 1970, the Institute of Chartered Accountants in England and Wales (ICAEW) set up the Accounting Standards Steering Committee (ASSC). The name changed in 1976 to the Accounting Standards Committee (ASC); this

[80] The 1985 Act was amended and supplemented by the Companies Act 1989, which enforced the EC Seventh Directive regarding consolidated accounts and the EC Eighth Directive concerning the role of the audit (Elliot and Elliot, 2004).

Committee represented the six major professional accounting bodies on matters relating to the form and content of company financial statements[81]. The ASC issued accounting standards known as Statements of Standard Accounting Practice (SSAPs). The standard-setting procedure involved the ASC preparing a draft standard, which was subsequently adopted if all six professional bodies were in unanimous agreement; each of the professional accounting bodies then issued the adopted SSAP to its own members (Elliot and Elliot, 2004).

Despite producing 25 SSAPs, the ASC was criticised for a number of reasons including its lack of a conceptual framework and its reactive rather than proactive approach to standard setting (Solomons, 1989). As a consequence, a review of the standard setting process was undertaken by the Deering Committee, which was set up by the Consultation Committee of the Accounting Bodies (CCAB). This review process led to the formation of the Financial Reporting Council (FRC), which assumed overall responsibility for standard setting in the UK. One of the subsidiary bodies of the FRC is the ASB which replaced the ASC in 1990; the main role of the ASB is to develop Financial Reporting Standards (FRSs)[82].

[81] The six bodies included the ICAEW, the Institute of Chartered Accountants of Scotland (ICAS), the Institute of Chartered Accountants of Ireland (ICAI), the Chartered Association of Certified Accountants (ACCA), Chartered Institute of Management Accountants (CIMA) and the Chartered Institute of Public Finance and Accountancy (CIPFA).

[82] The other subsidiary bodies of the FRC are: (i) the Auditing Practices Board, whose responsibility is to provide standards and guidance for the performance of external audit and other activities undertaken by accountants and in relation to the independence, objectivity and integrity of external auditors and providers of assurance services; (ii) The Board of Actuarial Standards, which is responsible for setting actuarial standards; (iii) Professional Oversight Board, which provides independent oversight of the regulation of the auditing, accounting and actuarial professions by the professional bodies; (iv) the Financial Reporting Review Panel (FRRP), which seeks to ensure that financial information published by public and large private companies complies with relevant reporting requirements; and, (v) Accountancy and Actuarial Discipline Board, whose responsibility is to maintain and enhance the standards of conduct of the accountancy and actuarial professions to protect public interest (FRC, 2009).

Before the ASB issues an FRS, it publishes a Financial Reporting Exposure Draft (FRED), which is essentially a proposed standard that is open to public debate and solicit comments (Thomas, 2002). Lobbying forms an important part of the standard setting process; such activity can be conducted by means of formal or informal channels. Formal lobbying typically involves written submissions, position papers, and questionnaire responses either to the ASB itself or via membership of the standard setting board. By contrast, informal lobbying takes the form of, for example, luncheon discussions, telephone conversations and other means of word-of-mouth communications (Weetman et al., 1996; Weetman, 2001; Dunne, 2003).

In addition to Company Law and accounting standards regulations, UK domestic companies whose shares or other securities are listed on the London Stock Exchange are required to comply with the regulations issued by the UK Listing Authority (UKLA) (Fearnley and Hines, 2002). The Listing Rules include additional demands that are not yet in the statute or a standard; for example, additional disclosures about company directors and corporate governance practices (Elliot and Elliot, 2004).

2.7.2 The Anticipated Impact of IFRS

Approximately 1,650 UK companies will have been affected by the introduction of international GAAP (Accountancy Age, 2003) and many listed companies were preparing for the transition to IFRS over several years (Aisbitt and Walton, 2005). The pharmaceutical company, AstraZeneca, published the UK's first set of restated figures under IFRS for its 2003 financial year; they reported a $0.02 decrease in earnings per share and a reduction in net assets from $48m to $13.2m under the International GAAP and this information was verified by the company's auditors

(Accountancy, 2005a). The company was commended for preparing such statements despite the adverse impact that the transition had on the reported numbers. However, their foray into international reporting highlighted transitional problems with the regime regarding reported amounts; this news appeared to be a surprise to affected companies (Aisbitt and Walton, 2005) with suggestions that too many companies had not been pro-active in preparing for IFRS (Accountancy, 2005d)[83]. Indeed, Aisbitt and Walton (2005) examined the 2003 financial statements of the FTSE 100 companies and found the level of disclosures to be mixed, suggesting,

> "...a range in the degree to which companies are prepared for (or are willing to disclose regarding) the transition to IFRS."
>
> (Aisbitt and Walton, 2005, p. 1)[84]

Furthermore, a study undertaken by ICAEW found that by June 2005, only 36 per cent of listed companies had publicly quantified the impact of IFRS on their 2005 or 2004 reported results, despite being encouraged to do so by the Financial Services Authority (FSA) (Accountancy, 2005d)[85].

Many of the larger UK companies successfully implemented extensive IFRS transition programmes by investing substantial resources in the process (Accountancy, 2005d). A PwC survey found that most companies used existing finance staff to undertake IFRS transition work, with only 8 per cent making extensive use of subcontractors; just 2 per cent employed new people (Accountancy, 2006a). For example, the transition process in Barclays Bank involved the full-time deployment of

[83] An Accountancy Age survey of UK Financial Directors found that less than half of survey respondents thought the introduction of IFRS would be beneficial to businesses in the UK, due to the lack of preparedness amongst most companies and the lack of understanding among investors (Accountancy Age, 2005c).

[84] PwC (2006a) documented that larger companies and SEC registrants were further ahead in their preparations than their counterparts. They also noted that for the key project areas, financial services companies were marginally ahead compared to others.

[85] In April 2005, the FSA wrote to the Chief Executives of listed companies recommending that they communicate to the market the effect of the transition to IFRS (FSA, 2005).

250 people, five full rehearsal weekends and adjustments worth £6 trillion (FT, 2005d). However, smaller companies, including those at the bottom end of the FTSE 250, did not possess such resources and thus found themselves facing additional pressures when implementing IFRS; these organisations were often reliant on the costly efforts of independent consultants and auditors (Accountancy, 2005d). An Accountancy Age (2004) survey found that although 32 per cent of FTSE 100 companies regarded their preparation as 'excellent', the figure for FTSE 350 companies was only 9 per cent (Accountancy Age, 2005a).

Surprisingly, UK and Irish firms were found to be least supportive of the adoption of IAS, despite the significant degree of alignment which was said to exist between UK standards and their international counterparts (Haller, 2002)[86]. Prior to the introduction of International GAAP, Fearnley and Hines (2002) interviewed key players such as regulators, auditors and company directors to obtain their views on the implementation of IFRS in the UK. They found that although those interviewed accepted the notion of uniform worldwide standards, they did not believe that the implementation of IAS would increase the quality of financial reporting in the UK. They reported concerns about Europe being the,

> "...initial focus of a harmonisation initiative, the feasibility of establishing common standards where there may be differences in interpretation and the consequences of possible convergence with US GAAP."
>
> (Fearnley and Hines, 2002, p. 2)

In a follow up study by Fearnley et al. (2007) post implementation of the IFRS regime, the interviewees believed that the adoption of IFRS was a positive move; however, further doubts were expressed about the implementation process.

[86] It has been argued that UK and Irish companies believe their domestic accounting standards to be superior to the international regime (Haller, 2002).

A particular concern of several commentators in this area related to the future of the UK true and fair view override[87]. It was argued that the adoption of IFRS would weaken the safeguards against corporate scandals as auditors would no longer be required to determine whether a company's financial statements were 'true and fair' but whether they gave a 'fair presentation' consequently altering the layout of both company accounts and auditor reports (Accountancy, 2005e). There were further concerns that an attempt to align UK auditing standards with International GAAP required auditors to adopt an objectionable tick-box approach (Accountancy, 2005e). Other concerns acknowledged the complexity of the accounting model, a lack of consistency of interpretation and the future of financial reporting for smaller entities (Fearnley et al., 2007).

Further concerns have been raised regarding the potential volatility in reported results arising from the implementation of IFRS; early evidence suggested that the changes would be substantial (Aisbitt and Walton, 2005; Jermakowicz and Gornik-Tomaszewski, 2006)[88]. For example, Imperial Tobacco reported a 400 per cent increase in the value of its assets as a result of the move to IFRS (Ormrod and Taylor, 2006). Furthermore, Unilever's first IFRS-compliant results reflected a fall in revenue

[87] Prior to the recent introduction of the Companies Act 2006, UK companies were not bound by the 'true and fair view' test when preparing their financial statements under IFRS. However, the 2006 Act confirms the true and fair view requirement as the cornerstone for financial reporting in the UK under the new reporting regime (ICAS, 2007).

[88] Although providing valuable early indications on the impact of IFRS on reported figures, these findings may not be generalisable following mandatory adoption given that such results were focused on only those firms who voluntarily moved to IFRS reporting. It has been documented that mandatory reporters of IFRS may be impacted differently compared to voluntary adopters; for example, Daske et al. (2007) suggested that, unlike the first group who have been forced to comply, voluntary adopters by definition are more likely to make significant changes to their reporting practices as part of a wider strategy. In addition, there have been considerable changes to many IFRS requirements since these findings were published. For example, Horton and Serafeim (2008) note that there were 22 key changes post 2004 in the form of amendments to existing standards or the introduction of new ones; they found that the most significant of these changes corresponded to the six reconciliation items identified in their sample as the most frequent adjustments.

under IFRS of £679m whilst reporting a profit increase by the same amount (Accountancy Age, 2005d). The adoption of IFRS, and in particular IAS 19, contributed to a decision by Rentokil to restructure the company in order to ensure adequate reserves were available to pay a dividend (Accountancy Age, 2005e). Credit Suisse (2004) and Deloitte and Touche (2004) noted that this increased volatility in reported results might in turn affect the dividends that some firms were permitted to pay out under UK company law. Deloitte and Touche (2004) and Beattie et al. (2006) also suggested that the transition might impact on debt to equity ratios; as a result, some companies might have to renegotiate their borrowing covenants and possibly face lower credit ratings. The transition to IFRS cost Barclays £50m yet they claimed that their accounts were less transparent leading the bank to conclude that,

> "...people underestimated how much work was involved, how much it would cost and the complications of interpreting financial results that have arisen as a consequence."
>
> (Accountancy Age, 2005f, p. 1)

2.7.3 Post - Implementation Studies of the Impact of IFRS in the UK

Early evidence indicated that the IFRS conversion process had been successfully implemented (Ernst and Young, 2006) with compliance levels being described as "good" (FRC, 2006, p. 1). Further, no companies in the UK were reported as missing reporting deadlines and impacts on company share prices were minimal (Ormrod and Taylor, 2006)[89].

[89] Although a BDO (2007) study found that the preparation of the transition balance sheets and the issue of the first IFRS interim statements involved companies utilising significant resources. Further, they left the drafting of the first IFRS statements quite late and underestimated the complexity and volume of disclosures required leaving most companies to conclude that they would, with hindsight, have started the process earlier.

In an attempt to measure the consequences of the implementation of IFRS, Aisbitt (2006) examined the reconciliation of equity between UK GAAP and IFRS for those companies listed on the FTSE 100 and found that, although the overall effect on equity was immaterial, the effect of the transition on individual items could be significant. The standards which had the biggest impact on net equity were: IAS 19 *Employee Benefits* and IFRS 2 *Share-Based Payments* which was associated with a negative movement of 10.10 per cent; IAS 10 *Events after the Balance Sheet Date* with a 6.43 per cent positive effect; IAS 18 *Revenue* giving a 4.26 per cent negative variance; IAS 12 *Income Taxes* with a 3.42 per cent decrease in equity; IAS 16 *Property, Plant and Equipment* with an 3.18 per cent positive movement and IAS 32 *Financial Instruments; Disclosure and Presentation* and IAS 39 *Financial Instruments; Recognition and Measurement* with a 2.14 per cent increase. There were wide variations reported within these changes; for example, the group and goodwill adjustments (IAS 27/36/38/IFRS 3) had the highest standard deviation of 41.63 per cent.

Aisbitt (2006) also found that the standards which had the largest financial impact did not correspond to those that posed the biggest problems in terms of disclosure requirements; for example, the most problematic standards in terms of disclosure were those concerning the disclosure of financial instruments despite the fact that there were no major adjustments to the published figures relating to financial instruments. Disclosures on items including pensions, goodwill, share-based payments, deferred taxation, impairments, dividends, intangible assets and business combinations were also problematic for the sample companies. The two standards that appeared to impact

both the reported figures and disclosures were IAS 19 and IAS 39[90]. A further study by Ormrod and Taylor (2006) examined the interim financial statements of FTSE 100 non-financial companies and found that the overall impact of IFRS compared with UK GAAP was to increase reported profits by 39 per cent and decrease equity by 23 per cent (Ormrod and Taylor, 2006). Surprisingly, they revealed that a large proportion of these impacts were accounted for by a small number of standards, while the effect of the remaining standards was minimal.

Several studies have highlighted a significant increase in the physical size of financial statements prepared under IFRS (Accountancy Age, 2005a; Financial Director, 2006; FRC, 2006). On average, the size of financial statements has increased by 56 per cent and in several cases these documents have more than doubled in length (Accountancy, 2006a). In addition, a PwC survey found that 90 per cent of FTSE 100 companies and 75 per cent of FTSE 250 firms included considerably more additional notes in their 2005 interim statements in comparison to their 2004 counterparts (Accountancy Age, 2005a). Although a great deal of the additional information that was now included in the accounts of UK companies related to the first year of transition, much of this will probably remain in the future due to the need to include information relating to difficult areas such as valuations and impairment tests thus contributing to the increased size of IFRS reports (Accountancy, 2006a). However, a BDO (2007) study documented little interest from analysts regarding the conversion to IFRS with the

[90] Aisbitt (2006) also reported a sectorial bias; for example, the transition to IFRS had a negative impact on health care equity but had a positive effect on consumer goods.

implication that companies, and their costs of capital, might not be benefiting from the additional disclosures included in their annual reports and accounts.[91]

PwC (2006a) research has shown that 13 per cent of the companies reviewed made changes to the accounting policies reported in their year-end statements from those previously provided in their initial conversion announcements and interim reports[92]. Extensive judgement in selecting and applying IFRS was necessary (Ernst and Young, 2006) with investors and analysts finding comparability difficult due to the increased subjectivity inherent in the implementation of IFRS (Accountancy, 2006a). Furthermore, a tendency to use "boiler-plate" (FRC, 2006, p. 1) descriptions for accounting policy disclosures have been found, whereby explanations of accounting policies appeared to imitate those provided by the relevant IFRS standards, indicating no company-specific application (FRC, 2006).

As a result of these changes, some business decisions may have been impacted by the introduction of the new reporting regime. For example, IFRS may have influenced acquisition and merger decisions and share-based payment schemes in some companies, particularly among smaller firms (PwC, 2006e)[93] and may also have drawn management's attention to certain arrangements such as lease incentives and embedded derivatives which had previously not attracted a great deal of thought

[91] BDO (2007) expressed a level of surprise at this finding given the relative importance of the return on equity (ROE) measure to analysts and the significant equity differences documented between IFRS and the previous UK GAAP.

[92] Finance Directors surveyed by BDO (2007) reported concerns regarding the business relevance of some of the IFRS changes. As a result, they were reluctant to include these changes in their management accounts thus requiring further reconciliation and consolidation adjustments.

[93] In addition, a survey undertaken by Jermakowicz and Gornik-Tomaszewski (2006), which included UK firms, indicated that a large number of respondents have used (or intend to use) IFRS-based financial statements for internal decision-making and performance measurement processes in addition to external reporting. The authors note that this may lead to an integration of financial and management accounting practices or perhaps create an external reporting/internal accounting rule of management accounting as discussed by Johnson and Kaplan (1987).

(BDO, 2007). Finally, BDO (2006) found that nearly 70 per cent of companies chose to report their parent company financial statements in accordance to UK GAAP instead of IFRS; the impact on taxation and distributable reserves being the most likely reasons driving this decision.

The auditors' role during the implementation process has been questioned. BDO (2007) found that the companies themselves had borne the brunt – and the cost – of the IFRS learning process as they faced uncertainty over the final content of particular standards, experienced delays in agreeing accounting treatments with their auditors during the implementation process and were made to wait while audit firms attempted to reach a consensus on the approach to common issues. They also noted that audit firms often proposed literal, as opposed to practical interpretations and some exerted pressure for too much compliance; this questions how well prepared the auditors themselves were for the transition.

It was indicated earlier that the IASBs support for fair value measurement was subject to widespread criticism; several studies have examined the use of fair value options by UK companies following the adoption of IFRS. For example, Cairns et al. (2008) investigated the use of fair value measurement by 195 companies in the UK and Australia and found that fair value adoption had increased in expected mandatory areas such as IAS 39; however, in other areas where companies were presented with a measurement choice, they observed a strong preference for historical cost/modified historical cost over fair value. They found that only 3 per cent of UK companies used fair value with respect to property valuation and no companies revalued plant and equipment. Similarly, Christensen and Nikolaev (2008) found for a sample of UK and

German companies that historical cost dominated the choice of measurement; the only exception being with respect to investment property owned by companies which were predominantly based in the real estate industry. Almost no companies examined used fair value accounting for plant, equipment and intangible assets. The findings of these studies appear to indicate a lack of support for the fair value approach by adopting companies thus raising further doubts about the perceived usefulness of fair value as a measurement principle.

The introduction of IFRS was anticipated to be a purely accounting change that would not have any real impact on market valuations (Mazars, 2006)[94]. However, early evidence suggested that analysts and fund managers' investment decisions would be significantly impacted by the IFRS reported results (KPMG, 2004)[95]. Indeed, PwC (2006b) found that the perceptions of company values had changed as a result of IFRS adoption, even at the early stages of compliance and that investment decisions of more than half the fund managers surveyed had been impacted[96]. It was widely believed that these changes in perceptions were the consequence of the greater management information and transparency introduced by the mandatory IFRS coupled with improved consistency of reporting between jurisdictions and sectors (Horton and Serafeim, 2008). This evidence provided early indications that the mandatory IFRS numbers might convey new useful information that is relevant to

[94] For example, Horton and Serafeim (2008) found that the vast majority of their sample firms believed that investors' beliefs would not change following IFRS compliance given that IFRS had no effect on their firm's strategy, business performance, risk profile or free cash flows and only a minimal effect on debt.

[95] KPMG (2004) believed that the valuation of a company's shares would be influenced by the introduction of IFRS; however, the markets had not yet included the full effects within pricing.

[96] PwC (2006c) surveyed 187 UK fund managers to determine whether the implementation of IFRS influenced their investment decisions. They found that 22 per cent disinvested in a company and 17 per cent did not invest in a company upon receipt of the IFRS results. Horton and Serafeim (2008) argue that such findings are difficult to reconcile with the efficient markets hypothesis given that firms claimed IFRS would present an accounting change only with no impact on the underlying business economics.

firm valuation and several post-implementation studies have empirically investigated this assertion. For example, Horton and Serafeim (2008) investigated the IFRS reconciliation/transitional disclosures for a sample of firms in an attempt to evaluate the information effect and value relevance of the IFRS regime relative to the previous UK GAAP. Although they found no significant abnormal returns around the announcement, they did document evidence that the market responded to firms with a net income that was lower under IFRS compared to that under UK GAAP, incorporating the earnings adjustment into share prices. Furthermore, Christensen et al. (2007) also assessed whether the IFRS reconciliations provided new information to the market and whether firms opportunistically timed the disclosure of this information in an attempt to minimise its immediate price impact. They found that the market responded significantly to the announcements of the IFRS reconciliations, particularly to early announcements, thus implying that these disclosures provided new information. They also revealed that firms tended to make their disclosures early when analyst demand for their information was greater implying that this information was considered relevant for firm valuation. In conclusion, they indicated that the similarity between IFRS and UK GAAP was not as great as commentators had suggested[97].

2.8 Conclusion

Following the implementation of IFRS in 2005, the underlying usefulness of the financial statements produced under IFRS has been questioned given the apparent lack of confidence expressed by companies regarding the sufficiency, or even the

[97] They also found that announcement delays were significantly associated with poorer results reported under IFRS and suggest that perhaps managers were consciously aware of the price sensitivity of the new IFRS information and consequently delayed releasing bad news to the market (Christensen et al. 2007).

appropriateness, of IFRS disclosures for the purpose of communicating their performance to the market place; the widespread use of alternative non-IFRS measures (Ernst and Young, 2006)[98] and the practice of including additional columns or boxes on the financial statements to explain company results (Accountancy, 2006a) suggest that companies were less than enthusiastic about the move. Coupled with a reported significant increase in the level of complexity inherent in IFRS-compliant financial statements (Ernst and Young, 2006; FRC, 2006), these factors have contributed to an apparent level of dissatisfaction regarding the implementation of IFRS with claims that IFRS accounts are either "worse" or are "not much more helpful" than their UK predecessors (Financial Director, 2006, p. 1). Indeed, a PwC (2007b) survey revealed that only a fifth of FTSE 350 finance executives believed that IFRS had positively benefited the world's capital markets. Furthermore, 58 per cent of those surveyed did not believe that investors had understood the numbers produced under IFRS (PwC, 2007c).

This study examines the impact of the introduction of IFRS and will attempt to contribute to the growing literature about the relative success of the new reporting regime by assessing the usefulness of the information produced in the annual reports of UK companies under the new standards. The IASB states that the underlying objective of financial statements prepared under IFRS is to provide information that is useful for decision-making across a range of different users (IASB, 2001). This

[98] BDO (2007) reported that more non-GAAP measures, considered a vital part of many of the sample companies' communications with shareholders, were emerging under IFRS in an attempt to 'get back to UK GAAP'. This finding is similar to that reported by PwC (2007b); their analysis of non-GAAP measures disclosed in 2,800 European financial statements revealed that, rather than attempt to provide reported results in a more favourable light, these disclosures were included to provide consistency, were possible, with the measures provided under previous national GAAP.

decision usefulness approach will form the theoretical underpinning of the current study and Chapter 3 will discuss the approach adopted.

Chapter 3

Theoretical Framework: Decision-Usefulness

Chapter 3 - Theoretical Framework: Decision-Usefulness

3.1 Introduction

Several objectives have been attributed to the information provided in financial statements. Historically, the objective of financial statements was "to enable users to assess the stewardship of management" (Deegan, 2000, p. 141), or more specifically, to determine "whether the resources entrusted to management have been used for their intended or appropriate purposes" (p. 141). According to this perspective, therefore, the role of financial statements was to demonstrate that the resources entrusted to management were used in a proper manner (Mathews and Perera, 1996). Over time, the stakeholders affected by financial statements have grown to include not only shareholders and creditors, but also employees, suppliers, customers, government and society at large (Mathews and Perera, 1996). In other words, a wider group may expect companies to be accountable for their actions.

This leads to a further objective of financial reporting; that is the accountability objective which Gray et al. (1997) define as "the duty to provide an account or reckoning of those actions for which one is held responsible" (p. 38). In other words, the reporting entity should demonstrate accountability to those parties to which the entity is deemed accountable (Deegan, 2000). Given the wider accountability sought by various groups, this approach suggests that financial statements should change to accommodate the rights of the various stakeholders involved (Mathews and Perera, 1996). An alternative objective of financial statements, and one that was prominent for many decades as a generally accepted rationale of financial reporting, is to provide information that is useful for decision-making (Deegan, 2000). This decision-

usefulness approach has been the over-riding criterion of the IASB harmonisation attempt and will therefore form the theoretical underpinning of the current study.

This chapter will describe the decision-usefulness framework. It will define what is meant by the notion and illustrate how the approach has been adopted by standard setters – initially in the UK and in the US and more recently by the IASB. The chapter then describes studies that have employed the decision-usefulness approach in their research while criticisms of decision-usefulness are outlined towards the end of the chapter. Finally, a conclusion is supplied which summarises the discussion and points the way for Chapter 4.

3.2 Definition of Decision-Usefulness

The perception that financial reporting should attempt to assist users in decision-making can be traced back to 1955 when Chambers highlighted the "use of accounting statements as the basis for making decisions of practical consequence" (p. 17). He contended that the information supplied in financial statements "should be relevant to the kinds of decision the making of which it is expected to facilitate" (pp. 21-22). The usefulness of financial statement disclosures was also stressed by Sterling (1972) who argued that requirements such as objectivity and verifiability, although "desirable" (p. 198), were secondary to usefulness, which he described as "indispensable" (p. 198). He claimed that financial reports should attempt to,

> "...supply information for rational [decisions]...that are most likely to allow decision makers to achieve their goals."
>
> (Sterling, 1972, p. 198)

Glautier and Underdown (2001) describe the decision-usefulness approach as the provision of "sufficient information to help investors to make predictions about future performance" (p. 344). They contend that the approach involves the consideration of "long-term disclosure rather than short-term profitability issues" (p. 344) and highlight the advantages that improved long-term disclosures will bring. These include enhanced information quantity and quality thereby improving the efficiency of markets as well as their ability to value reporting entities. As a result, the information should allow decision-makers to make better decisions by providing them with stronger foundations on which to base their analyses (Glautier and Underdown, 2001).

According to Gray et al. (1996), the decision-usefulness approach can be split into two branches: (i) the decision-makers emphasis; and, (ii) the decision-models emphasis. The decision-makers emphasis argues that the decision-makers know best what information they want and therefore involves conducting research that attempts to ask decision-makers what information they desire (Gray et al., 1996); for example, a number of recent studies have questioned various stakeholder groups in an attempt to identify the types of environmental information they consider to be useful as part of their decision-making processes (e.g. Deegan and Rankin, 1997). The knowledge obtained from the identification of the information sought by stakeholders is used to "prescribe what information should be supplied to users of financial statements" (Gray et al., 1996; Mathews and Perera, 1996, p. 9). However, this approach has been criticised due to a lack of coherence given that different studies typically examine different types of information, with little correlation between them (Mathews and Perera, 1996; Deegan, 2000); this has been attributable to an apparent inability among

researchers to build on the insights of others and the difficulty of generalising information "wants" which vary between user groups and change over time (Gray et al., 1996, p. 495).

In contrast, the decision-models emphasis maintains that the concern for determining information "wants" is secondary to the concern with ascertaining information "needs" (Gray et al., 1996, p. 496). Proponents of the decision-models approach develop models "based upon the researchers' perceptions of what is necessary for efficient decision making" in order to prescribe the information which should be provided to financial statement users (Mathews and Perera, 1996, p. 9). However, this emphasis assumes that all stakeholder groups share the same information needs and, unlike the decision-makers emphasis, no attempt is made to ask the decision-makers themselves what information they require (Mathews and Perera, 1996; Deegan, 2000).

This "decision-usefulness" approach has fallen out of favour among academic theorists who have been researching accounting over recent years. The approach is rarely referred to in academic investigations of accounting in recent publications despite its long-established pedigree. Such an outcome is not surprising since most recent conceptualisations of accounting have either wanted to focus more on the range of different users for whom accounting information may be useful (Stakeholder Theory) or have wished to analyse the role of accounting in decisions where parties have varying amounts of power (Legitimacy Theory) or access to differential information (Agency Theory). Thus, recent investigations have adopted a more detailed framework which characterises how, for whom and in what circumstances information is useful (e.g. Lintott, 1996). This more recent approach is not adopted in

the current thesis since the research question simply sought to examine the impact of the introduction of IFRS on corporate annual report disclosures and financial statement numbers in an attempt to assess the decision-usefulness of the new disclosures for users. In other words, it is an investigation of whether the claims of standard setters about the usefulness of mandated IFRS disclosures for decision-makers as measured by the qualitative characteristics outlined in the IASB conceptual framework appeared to be supported in practice with the contents of financial reports produced by firms. No attempt was made to consider the range of users who might read the report, the potential of the report information to legitimise corporate activity or to reinforce power structures that might exist.[99] Such a decision to focus on decision-usefulness was thought appropriate because of the dearth of work in the area focusing on the usefulness of mandated IFRS disclosures included in annual reports and accounts following the introduction of the new regime.

3.3 Adoption of Decision-Usefulness by Standard Setters

Accounting standard setters around the world have generally employed the concept of decision-usefulness as a criterion for financial reporting; many conceptual frameworks seem to be decision-based. In the US, the Trueblood Committee was formed by the AICPA in 1971 and was charged with the development of the objectives of financial statements (Belkaoui, 2004). The Committee's work was presented in a report, the *Trueblood Report*, which stated that the basic objective of financial statements was to "provide information on which to base economic decisions." (Belkaoui, 2004, p. 169). The Committee's conclusions emphasised that financial statements should aid economic decision-making and stressed the usefulness

[99] All of these questions are valid and potentially important but were not tackled in the current thesis because: (i) of time pressure; and, (ii) they would probably need to be initially informed by the more basic question which is tackled in this dissertation.

of accounting information to the needs of outside users instead of only internal business managers (Belkaoui, 2004).

The conclusions of the Trueblood Report laid the groundwork for the development of the FASB's conceptual framework during the 1970s (Belkaoui, 2004). The FASB adopted the decision-usefulness emphasis of the report and stated in its *Statements of Financial Accounting Concepts No. 1* that the key objective of financial reporting is that it,

> "...should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence."
>
> (FASB, 1978, p. 5)

The statement details an extensive list of potential users, distinguishing between those with a direct interest such as owners, management, creditors and employees, and those with an indirect interest in the information provided in financial reporting including financial analysts and advisors, journalists, regulatory authorities and trade unions on the basis that they advise those within the direct user groups (FASB, 1978). However, as detailed in the stated objective above, the statement emphasises the overriding needs of the investor and creditor user groups.

The statement goes on to state that,

> "...financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash flows to the related enterprise."
>
> (FASB, 1978, p. 17)

The statement argues that users of financial statement information are generally interested in an enterprise's cash generating ability because "their decisions relate to

amounts, timing, and uncertainties of expected cash flows" (FASB, 1978, p. 14). Further, the statement explains why investors, creditors, employees, customers, and managers all share the common interest in an enterprise's ability to generate favourable cashflows and implies that other potential users of financial reporting share this interest (FASB, 1978). The FASB acknowledged that such far reaching conclusions might have implied an objective of financial reporting that ultimately resulted in companies being required to disclose cash flow, management forecast or current value information (Bonham et al., 2004)[100]. However, the board went on to clarify that,

> "...the objective focuses on the purpose for which information provided should be useful ... rather than the kinds of information that may be useful for that purpose."
>
> (FASB, 1978, p. 27)

In 1980, the FASB published its second concept statement – *Qualitative Characteristics of Accounting Information* – which details the characteristics which it believed made accounting information useful to its users (FASB, 1980). The statement views these characteristics as a "hierarchy of accounting qualities" which form the basis for the selection and evaluation of information to be included in financial reports (Bonham et al., 2004, p. 73). This hierarchy identifies understandability as being the key quality for accounting to be decision-useful as elaborated in the first concept statement which stated that financial reporting,

[100] A study by Chang and Most (1979) revealed that individual and institutional investors viewed long-term capital gains as the most important investment objective from their use of financial statements, and not short-term cash flows; this finding appeared to contradict the FASB's emphasis on such cash flows in their stated objective of financial reporting. However, as Bonham et al. (2004) noted, such investors may be more influenced by short-term expectations today therefore questioning the relevance of this finding in present times.

> "...should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence."
>
> (FASB, 1978, p. 5)

The hierarchy then identifies two further qualities which make accounting information useful for decision-making: relevance and reliability (FASB, 1980). The statement defines relevant accounting information as being information which is,

> "...capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations."
>
> (FASB, 1980, p. 5)

With respect to reliability, the three attributes of representational faithfulness, verifiability and neutrality are put forward. In particular, the statement asserts that the,

> "...reliability of a measure rests on the faithfulness with which it represents what it purports to represent, coupled with an assurance for the user, which comes through verification, that it has that representational quality."
>
> (FASB, 1980, p. 6)

Comparability is listed as an additional quality that financial information should possess in order to achieve relevance and reliability and involves the preparation of information on a consistent basis between periods and the ability to compare the same, or similar, information between either different companies or from the same enterprise for another period (Bonham et al., 2004). Finally, the statement postulated that all qualitative criteria previously discussed are bound by the requirements of materiality; only material information will have an impact on the decision-making process (Bonham et al., 2004). However, no guidelines were provided to help measure materiality; therefore, it is left to the preparers of financial statements to determine what information to provide which will require them to obtain an understanding of the

users of such information including their, likely conflicting, decision-making needs (Bonham et al., 2004).

The emphasis on the provision of useful information to readers of financial reports has also been embraced in Australia. The AASB's *Statement of Accounting Concepts No.1* states that the objective of financial reporting is the provision of information to users that is "useful for making and evaluating decisions about the allocation of scarce resources" (Deegan, 2000, p. 141).

In the UK, the ICAEW published *The Corporate Report* in 1975 which represented the first notable attempt by the accounting profession in Europe to develop a conceptual framework for financial reporting (Bonham et al., 2004). This discussion paper stated, as its basic philosophy, that financial statements should attempt to provide information relevant to the expected needs of their users (Belkaoui, 2004); in other words, financial statements should seek to satisfy the information needs of users (Elliot and Elliot, 2004). The report emphasised that reporting entities had an implicit responsibility to report publicly and that general purpose reports produced for general purpose use serve to fulfil this public accountability (Bonham et al., 2004). Users were defined as those which had a reasonable right to information about a reporting entity arising from the entity's public accountability (Bonham et al., 2004). This view of the function of financial statements reflected a change during the 1970s in society's beliefs that organisations were accountable to a number of different groups in the wider community rather than only to those who have an interest in the capital of the organisation, namely shareholders and creditors. It also suggested that the purpose of

annual reports was to provide each of these different user groups with information (Thomas, 2002)[101].

The Corporate Report played an influential role in the ASB's development of a conceptual framework for accounting during the 1990s (Thomas, 2002). In 1999, the ASB issued its *Statement of Principles for Financial Reporting,* which stated:

> "The objective of financial statements is to provide information about the reporting entity's financial performance and financial position that is useful to a wide range of users for assessing the stewardship of the entity's management and for making economic decisions."
>
> (ASB, 1999, p. 16)

The Statement went on to detail the seven groups who might use financial statements and their information needs. The user groups identified were: Investors, Lenders, Suppliers, Employees, Customers, Government and Other Agencies, and finally The General Public (ASB, 1999). However, the statement identified the investor group as the primary stakeholder category for whom financial statements are prepared. It states:

> "The objective of financial statements can usually be met by focusing on the needs of present and potential investors. Such investors need information about financial performance and financial position that is useful to them in evaluating the reporting entity's ability to generate cash and in assessing the entity's financial adaptability."
>
> (ASB, 1999, p. 7)

This objective is broadly in line with the contents of the FASB's framework including its emphasis on: (i) predicting future cash flows as the objective of financial reporting; and, (ii) selecting relevance and reliability as the two key characteristics of accounting information (ASB, 1999). However, the Statement stops short of claiming that

[101] The paper identified seven user groups as having a reasonable right to information, detailing the basis of the rights of each group and their information needs; these were: (i) the equity investor group; (ii) the loan creditor group; (iii) the employee group; (iv) the analyst-advisor group; (v) the business contact group; (vi) the government; and, (vii) the public (ICAEW, 1975).

financial reporting can fulfil all the information needs of the different user groups by noting that,

> "Financial statements do not provide *all* the information needed by users; they do, however, provide a frame of reference against which users can evaluate the more specific information they obtain from other sources."
>
> (ASB, 1999, p. 7)

The notion of decision-usefulness was endorsed by the IASC when it highlighted that IASs were to enhance the quality and comparability of company disclosures between countries in order to assist international users in their decision-making processes (Wilson et al., 2001).

3.3.1 Adoption of the Approach by the IASB

Broadly based on the equivalent document issued by the FASB in the US, the IASC published its *Framework for the Preparation and Presentation of Financial Statements* in September 1989[102]. The IASC's framework is divided into seven major sections[103], the first of which, the objective of financial statements, stated that the aim of financial statements was to,

> "...provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions."
>
> (IASC, 1989a, paras. 22 and 23)

The section lists investors, employees, lenders, suppliers and trade creditors, customers, governments and their agencies, and the public as the users of financial statements; however, the needs of all these groups cannot be met (Bonham et al., 2004). Therefore, the framework asserts that financial statements which satisfy the

[102] However, this document was not issued as an accounting standard and therefore the requirements of individual IASs supersede those of the *Framework* (IASC, 1989a).

[103] The seven sections are: (i) the objective of financial statements; (ii) underlying assumptions; (iii) qualitative characteristics of financial statements; (iv) the elements of financial statements; (v) recognition of the elements of financial statements; (vi) measurement of the elements of financial statements; and, (vii) concepts of capital and capital maintenance (IASC, 1989a).

needs of the investor group will also meet "most of the needs of other users that financial statements can satisfy" (IASC, 1989a, para. 11). The remainder of this section of the framework then explained why readers needed to know about concepts such as profitability, financial position, adaptability and cash generation; the frameworks of both the FASB and the UK's ASB's Statement of Principles provided a similar discussion of these issues.

The second section of the framework stipulates that in order that financial statements should be useful to users, several qualitative characteristics should be present and the constraints noted. These characteristics are understandability, relevance, reliability and comparability and Table 3.1 provides a description of each of these characteristics as outlined in the IASC framework.

Table 3.1 IASC Qualitative Characteristics of Financial Statements

Characteristic	Description
Understandability	Information provided in financial statements should be readily understandable by users who are assumed to have a reasonable knowledge of business and economic activities and accounting, and a willingness to study the information with reasonable diligence.
Relevance	Information is relevant where it influences the economic decisions of users by helping them to evaluate past, present or future events or confirming, or correcting, their past evaluation. The relevance of information is affected by its materiality – information is material if its omission or misstatement could influence the economic decisions of users. Materiality provides a threshold or cut-off point for the provision of information.

Reliability	Reliability of information is expressed in terms of freedom from error or bias: information represents what it purports to represent or could reasonably be expected to represent. Within this concept are issues of faithful representation, substance over form, neutrality, prudence and completeness: • *faithful representation*: a balance sheet and an income statement should represent faithfully the transactions and other events that result in assets, liabilities and equity of the entity which meet the recognition criteria; • *substance over form*: information is presented in accordance with its substance and economic reality and not merely its legal form; • *neutrality*: information has not been selected or presented in order to achieve a predetermined result or outcome; • *prudence*: there is a degree of caution in the exercise of judgements such that assets or income are not overstated and liabilities or expenses are not understated, however not permitting the deliberate understatement or overstatement of items; • *completeness*: information must be complete within the bounds of materiality and cost.
Comparability	Users must be able to compare the financial statements of an entity through time. Financial statements of different entities should also be comparable for the same period. Measurement and display of the financial effect of similar transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities.

Adapted from: IASC *Framework for the Preparation and Presentation of Financial Statements* (1989)

In addition, the IASC Framework outlines three constraints on relevant and reliable information: timeliness, balanced against benefits and costs and in selecting a balance of qualitative characteristics which are summarised in Table 3.2.

Table 3.2 Constraints on Relevant and Reliable Information

Constraint	Description
Timeliness	If there is undue delay in the reporting of information it may lose its relevance; management need to balance the relative merits of timely reporting and the provision of reliable information.
Balance between Benefit and Cost	The benefits derived from information should not exceed the cost of providing it. This constraint should be considered by standard-setters in particular, as well as preparers and users of financial statements.
Balance between Qualitative Characteristics	There should be an appropriate balance, or trade-off, between the qualitative characteristics in order to meet the objective of financial statements.

Adapted from: IASC *Framework for the Preparation and Presentation of Financial Statements* (1989)

The qualitative characteristics detailed in the IASC framework are taken directly from the FASB conceptual framework. Indeed, the conceptual frameworks of the IASC and FASB do not fundamentally differ; the IASC framework has been described as being merely "a synopsis of the FASB conceptual statements" representing a lost opportunity at the time for the IASC to "explore more fundamentally the questions posed by such an endeavour" (Bonham et al., 2004, p. 99).

In addition, the IASC framework has been criticised because it does not give adequate consideration to the "legal and business context in which accounting is practised and the constraints thereby placed on it" given the primary focus on the investor user group and the narrowing down of the objective of financial statements to the prediction of future cash flows (Bonham et al., 2004, p. 100). As Bonham et al. (2004) stated:

> "This objective is suspect in as much as it is either not always true, or only trivially true. If a shareholder takes the view that she wishes to invest in property, even if that property is never realised, the proponents of the 'future cash flow' objective would still claim the objective holds because at some point the investor would want to realise the investment, even if that point is several lifetimes away."
>
> (Bonham et al., 2004, p. 100)

Indeed, Bonham et al. (2004) argue that financial statements are not solely produced to predict cash flows for investment decisions; they note that financial statements also provide a variety of other information useful to different user groups such as the identification of profits available for dividend, a starting point for the assessment of taxation, and a reference point that can be used for conditions in contracts with lenders and other parties, among others.

The IASB adopted the IASC pronouncements when it replaced its predecessor on 1 April 2001 including the conceptual framework for international accounting and its focus on decision-usefulness (IASB, 2001). In June 2000, the EU proposed that all EU-listed firms should adopt IAS for consolidated financial statements from 1 January 2005 (EC, 2000a); the proposal became a regulation in June 2002 (EU, 2002) and this forms the basis for the current study. Therefore, the adoption of a decision-usefulness approach in the current study seems logical since it will allow the researcher to assess the impact on annual report disclosures following the application

of IASs and IFRSs against a fundamental objective that the IASB has sought to achieve through the application of international GAAP.

3.3.2 The IASB/FASB Conceptual Framework Project

The IASB published a Discussion Paper (*Preliminary views on an Improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information*) in July 2006 as part of a joint project between the IASB and the FASB in the US, which attempted to improve upon and achieve convergence between the two boards' existing conceptual frameworks (IASB, 2006b). The paper restated the existing frameworks' decision-usefulness based definition of the objective of financial statements, this being to,

> "...provide information that is useful to present and potential investors and creditors and others in making investment, credit and similar resource allocation decisions."
>
> (IASB, 2006b, p. 12)

It also reiterated the existing frameworks' emphasis on investors and creditors as the focus groups for establishing needs because they are assumed to make resource allocation decisions; the paper stated that these needs would be met by providing information to "assess the amounts, timing and uncertainty of the entity's future cash inflows and outflows" (IASB, 2006b, p. 12). The document also identified several characteristics of financial information, such as relevance, faithful representation, comparability (including consistency) and understandability, which make it decision-useful (IASB, 2006b); although broadly similar principles, there are substantial changes both in the form and language of the characteristics compared to the current framework (Whittington, 2008). The main change in form is the replacement of the previous hierarchy of qualitative characteristics with a sequential approach while the

key change in language is the replacement of reliability with faithful representation; the combined affect of these changes being the removal of the trade off between relevance and reliability included in the current framework (Whittington, 2008)[104].

The discussion paper was subject to considerable debate as concerns were raised with several of the decisions reached by the IASB and FASB; some of the most significant issues related to the exclusion of stewardship as one of the objectives of financial reporting (Gore and Zimmerman, 2007). The discussion paper suggested that it is not deemed necessary to specify management's stewardship obligation to present owners as a distinct objective as it was encompassed within the decision-usefulness objective of providing useful information for resource allocation decisions; this implied that management's stewardship was regarded as relevant only insofar as it related to resource allocation decisions (Ernst and Young, 2007; Whittington, 2008). However, over 86 per cent of comment letters received disagreed with this assertion and argued that stewardship should be retained as a separate objective of financial reporting; since only a small fraction of companies are publicly traded, the boards may be biased toward the needs of capital markets rather than to those of privately held business firms (Gore and Zimmerman, 2007; IASB, 2007).

Further concerns related to the placing of relevance as first in the proposed sequential approach for the qualitative characteristics on the basis that information that is irrelevant is useless; however, as Gore and Zimmerman (2007) argued,

[104] The current Framework recognises that there could potentially be a trade off between the characteristics of relevance and reliability; for example, the most relevant information might suffer from measurement error and the most reliable information might not be the most current (Gore and Zimmerman, 2007). This trade off was cited as a deterrent of fair value measurements because they were perceived as often being relevant but unreliable (Whittington, 2008); however, its removal has been noted as a signal for the possible future extension of fair value measurement (Walton, 2006).

> "...information which is relevant but so inaccurate as to be misleading may be even worse than useless; it might even be harmful to those who rely on it. Enron is just one example."
>
> (Gore and Zimmerman, 2007, p. 34)

Additional concerns related to the Boards' decision to propose a decision-usefulness objective of financial reporting rather than the more limited objective of financial statements; most objections to the expansion in scope were concerned that the boundaries of financial reporting had not been determined (IASB, 2007). For example, some questioned the inclusion of forecasts and descriptions about an entity's social and environmental impact within the boundaries of financial reporting while others were concerned about including information that may not be auditable (IASB, 2007). Further, Ernst and Young (2007) questioned whether the qualitative characteristics detailed in the discussion paper could be applied to the wider range of financial information encompassed in financial reporting especially given that they were developed in the context of financial statements. The assertion that the needs of all users will be meet by satisfying the need of the primary user group – investors and creditors – has also been questioned. Indeed, the proposed objective which focuses primarily on assessing an entity's ability to generate net cash inflows had been called into doubt as an adequate basis for other types of reporting such as the reporting of non-financial information (Ernst and Young, 2007; IASB, 2007).

The IASB and FASB considered the comments received on its discussion paper and, in May 2008, they issued an Exposure Draft on the objectives of financial reporting and qualitative characteristics of financial reporting information (FASB, 2008). The Boards concluded that the objective of financial reporting was,

> "... to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers."
>
> (FASB, 2008, p. 1)

This stated objective is broader than that initially proposed in the discussion paper issued in 2006; the previous definition was criticised for focusing to narrowly on resource allocation decisions, however, the revised objective expands the types of decisions encompassed to consider all decisions made by capital providers including resource allocation decisions and decisions made to protect and enhance their investment (Crook, 2008). Therefore, although the Exposure Draft continues to focus on decision-usefulness, the proposed objective now explicitly discusses how users use financial reports for stewardship purposes.

In addition, the Exposure Draft proposed that: (i) the fundamental qualitative characteristics that make information useful are relevance and faithful representation, (ii) the enhancing qualitative characteristics complimentary to the fundamental characteristics are comparability, verifiability, timeliness, and understandability; and, (iii) the pervasive constraints on financial reporting are materiality and cost (FASB, 2008). However, several concerns have been raised regarding the proposals contained in the Exposure draft, many of which reiterated issues highlighted during the original consultation process in 2006. These concerns included the failure of the Boards to adequately explain the difference between financial statements and financial reporting, the lack of justification for the replacement of reliability with faithful representation, the continued overemphasis on the provision of information to enable

users to forecast future cash flows[105] and, although improved, the lack of sufficient consideration given to the stewardship function within the stated objective of financial reporting[106] (IASB, 2008). The changes being proposed in the Exposure Draft will likely result in significant changes in the future development of financial reporting; however, it is clear that a consensus about what financial reporting information is useful, what decisions is it useful for and for whom is it useful has yet to be formalised.

3.4 Previous Studies Adopting the Decision-Usefulness Perspective

In addition to being the underlying objective of the IASB conceptual framework, a second reason for the adoption of the decision-usefulness framework in the present study is that the approach has been previously used in a wide range of empirical investigations throughout the substantive literature. Various groups of financial statement users have been surveyed by researchers emphasising the decision-usefulness perspective in order to determine the type of information considered useful. For example, a study of users in a decision-making setting was undertaken by Carsberg and Day (1984), who examined if and how investors used current cost accounting information when making their decisions.

Lee and Tweedie (1979) employed questionnaires to determine whether shareholders used and understood corporate financial reports. Although over 90 per cent of respondents used such reports, the level of understanding uncovered was often poor. An analysis of the usefulness of disaggregated accounting data for forecasting

[105] Indeed, the emphasis on cash flows was deemed unnecessary because many analysts and practitioners used valuation models based on accounting earnings and book values (IASB, 2008).
[106] Respondents argued that stewardship involved more than the protection and enhancement of the entity's resources; it also considers how the entity's management performed according to the risks taken in the past in order to forecast the future performance and position of the entity (IASB, 2008).

corporate performance has been studied by Barnea and Lakonishok (1980) while several assessments of whether share prices were impacted by financial statement information have also been conducted (for example, Beaver et al., 1980). The investor analyst group has been the focus of much of this research due to their expertise as users of financial statement information, together with the relative ease with which their views can be ascertained and the influential advice they offer given that institutional investors own a large percentage of, particularly UK, stock market securities (Mallin, 1999).

The findings of studies that have adopted this research approach have offered various insights. For example, they have highlighted the perceived importance of the information contained within the financial statements including the Profit and Loss Account and the Balance Sheet to investors for share valuation purposes (Arnold and Mozier, 1984)[107]. They have documented a demand by financial statement users for disclosures relating to segmental activities (Balakrishman et al., 1990). A study by Appleyard and Strong (1984) sought to determine whether the disclosure of current cost accounting data provided useful information to US and UK investors but found no evidence to support this hypothesis; this lack of enthusiasm for inflation-adjusted accounting information was also uncovered in a study by De Berg and Shriver (1987).

[107] For example, Arnold and Mozier (1984) subjected a sample of UK investment analysts to interview and questionnaire surveys and found that, from a list of 18 possible sources of information, the most influential sources were perceived to be a company's annual profit and loss account and balance sheet and its interim results. They also noted that, surprisingly, the next most valuable source was discussions held with the personnel of the appraised company; this was regarded as more important than other annual report information such as that contained in the chairman's statement and other sources such as the information delivered by the financial press.

In a recent publication, Beattie and Pratt (2001) adopted the decision-usefulness approach in their analysis of web-based business reporting. They examined users' views on the importance of a variety of features of web-based reports and elicited favourable responses on the usefulness of many of the features surveyed. Hodge (2003) examined investors' perceptions of earnings quality, auditor independence and the usefulness of audited financial information following SEC concerns that earnings quality and auditor independence had declined over time. He found that such concerns were valid as both perceived earnings quality and perceived auditor independence had declined; although the perceived relevance of audited information had increased (which was closely related to lower perceptions of earnings quality increasing the reliance on this information for decision-making), its reliability had declined. A more recent study by Woods and Marginson (2004) evaluated the usefulness of derivatives disclosures provided by UK banks following the introduction of FRS 13 in 1999; they found that the usefulness of derivative disclosure practices was limited for users when attempting to assess an institution's financial risk exposure.

Decision-usefulness studies have also been conducted beyond the UK and US. For example, Jones et al. (1995) investigated the decision-usefulness of cash flow statements produced by Australian companies following the publication of a cash flow accounting standard by AASB. Their findings revealed that the cash flow statement was important for both a wide variety of internal and external decisions and a wide range of users and demonstrated that operating cash flow was considered a better measure of business performance than operating profit. A study by Lin et al. (2001) examined the impact of the new system of business accounting that was introduced by the Chinese government in 1993; this represented a move away from the previous

rule-based accounting regulations that had characterised the adoption of accounting standards in China. Their results revealed that Chinese stakeholders believed that the new system had substantially improved the decision-usefulness of accounting information provided by Chinese companies. Furthermore, Graham et al. (2003) assessed the decision-usefulness of alternative joint venture methods for a sample of Canadian firms following the Enron scandal, which placed a particular focus on such activities. They concluded that the proportionate consolidation method provided greater predictive ability and greater relevance than the alternative equity method[108].

In summary, what all this research has in common is the (often unstated) view that financial statement information may be useful to a range of annual report users (especially investors) when they are making decisions. Thus, a range of users has been consulted and the different possible ways in which the information may be used studied. Some focus on whether the information is directly employed in the decision-making process while others consider whether the information is indirectly used because its publication is associated with some change in perception about the issuer of the news. While some types of information appear not to be used (e.g. inflation-adjusted financial statements) others are widely read – at least by the investor or analyst community.

3.4.1 Criticisms of the Approach

A number of criticisms have been highlighted about the application of the decision-usefulness approach. The difficulties associated with specifying the user groups to be

[108] Under the equity method, the venturer's net investment and net income or loss in the joint venture is shown as a single line item on the venturer's balance sheet and income statement. In contrast, under proportionate consolidation, the venturer's share of each of the joint ventures financial statement items is shown combined on a line-by-line basis with similar items in the venturer's financial statements thus eliminating the need for the equity method's single line items (Graham et al., 2003).

considered have been noted (Dey, 1999); financial statement users are regarded as being a "heterogeneous group with widely varying interests" (AAA, 1966, p. 20). Therefore, the perceived usefulness of financial statement information may vary given the involvement of different decisions and different decision-makers (AAA, 1966). Indeed, corporate financial reporting was subjected to widespread criticism in the 1970s, particularly due to an apparent inability to meet the assumed needs of a variety of decision-makers (Mathews and Perera, 1996). This criticism was primarily directed at the correspondence of financial reports to the needs of shareholders and it was believed that reports were generally ignored by this user group (Mathews and Perera, 1996).

A further related criticism of the decision-usefulness approach concerns the requirement to consider the conflicting needs of the different users given their different information requirements as previously mentioned; Cyert and Ijiri (1974) illustrated that financial statements are the product of mutual interactions between corporations, users of financial statements and the accounting profession and therefore the explicit needs of these groups should be taken into account. More specifically, a balance between the user's right to know, the corporation's right to remain silent and the accounting profession's ability to attest is required. Difficulties associated with obtaining the views of users about what information is needed have also been documented (Carsberg and Day, 1984). Furthermore, Edwards and Smith (1996) highlighted a difficulty in finding the appropriate balance between the usefulness of information and the cost of disclosure. They found in their study of the introduction of a segmental reporting standard in the UK that survey respondents withheld segmental information because of fears about competitive disadvantage, therefore compromising

the quality of the information that was disclosed. Puxty and Laughlin (1983) questioned the very nature of the decision-usefulness theory; they demonstrated that the provision of information that is useful to users might not necessarily lead to greater welfare improvements. They suggested that some balance between the needs of users and the control of organisations was needed to optimise the welfare implications of accounting information.[109]

3.5 Conclusion

This chapter discussed the decision-usefulness objective for the information disclosed in financial statements, which will form the theoretical underpinning of the current study. The approach was briefly defined and its adoption by standard setters worldwide was outlined. These standard setters included the IASB whose introduction of IFRS in the EU from 2005 is the focus of the present thesis. Therefore, given the scale of the change to the financial statements produced by those companies that have to conform to the new reporting regime, a focus on basic questions regarding the usefulness of the information disclosed seems appropriate[110]. A wide range of studies examining the decision-usefulness of different kinds of corporate information was discussed; however, the dearth of current research work on IFRS suggests that fundamental research is needed about the usefulness of financial statements prepared under International GAAP. Chapter 4 will discuss the methodology and method adopted in the current dissertation.

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[109] The authors instead propose an explanation of a criterion that will be predicted both upon user needs and the control needs of reporting organisations (Puxty and Laughlin, 1983).

[110] The researcher acknowledges that the usefulness of the information examined in the present investigation may differ for different user groups with conflicting needs. However, the focus of the current thesis, and consistent with the frameworks of the IASB and the IASB/FASB joint project, is on the usefulness of the information examined to the investor user group. Throughout the remainder of this thesis, reference to user groups will primarily relate to the implications for the investor decision-making class.

Chapter 4

Research Method and Methodology

Chapter 4 – Research Methodology and Methods

4.1 Introduction

Chapter 2 provided a detailed discussion of the main literature driving this dissertation, while the theoretical framework to be employed was outlined in Chapter 3. This chapter outlines the research methodology adopted, and describes the methods underpinning the analysis in this current study.

The choice of the most appropriate research methodology is reliant on the nature of the phenomenon being studied (Tomkins and Grove, 1983). More specifically, the assumptions held by the researcher regarding the nature of the phenomenon's reality (ontology) will influence how knowledge can be obtained about that phenomenon (epistemology), and this will in turn have an effect on the process through which research can be undertaken (Ryan et al., 2002). Indeed, the assumptions underlying how the researcher views the world are likely to impact (directly or indirectly) on the research questions developed, the data to be gathered and how findings are interpreted (Dunne, 2003).

In this chapter, a discussion of the various methodological frameworks is provided in an attempt to document the ontological, epistemological and methodological choices that influenced the selection of the methods adopted in the current research. Section 4.2 discusses the key philosophical assumptions that underpin any academic research activity. Section 4.3 outlines the research objectives of the study and the choice of appropriate methods of analysis. Section 4.4 describes the qualitative and quantitative research methods selected for the study, namely content analysis and a form of Reconciliation Statement analysis, while Section 4.5 concludes the chapter.

4.2 Philosophical Assumptions and Research Methodology

This section outlines the various philosophical assumptions that may underpin any research activity. Much of this section is focused on the model developed by Burrell and Morgan (1979).[111]

4.2.1 Assumptions regarding the Nature of Social Science

Burrell and Morgan (1979) identified four distinct, but related elements in their typology of social science research - assumptions that classify our research position: (i) ontology; (ii) epistemology; (iii) human nature; and, (iv) methodology.[112] Each of the assumptions can differ depending on the position which the researcher adopts. In Burrell and Morgan's (1979) taxonomy, they suggested that their assumptions about the nature of social science research vary along a continuum that ranged from a subjective approach to an objective approach. The terms "subjective" and "objective" are used by the authors as descriptive labels in order to "capture the points of commonality between the four analytical strands" (Burrell and Morgan, 1979, p. 8). The schematic diagram has been reproduced in Figure 4.1.

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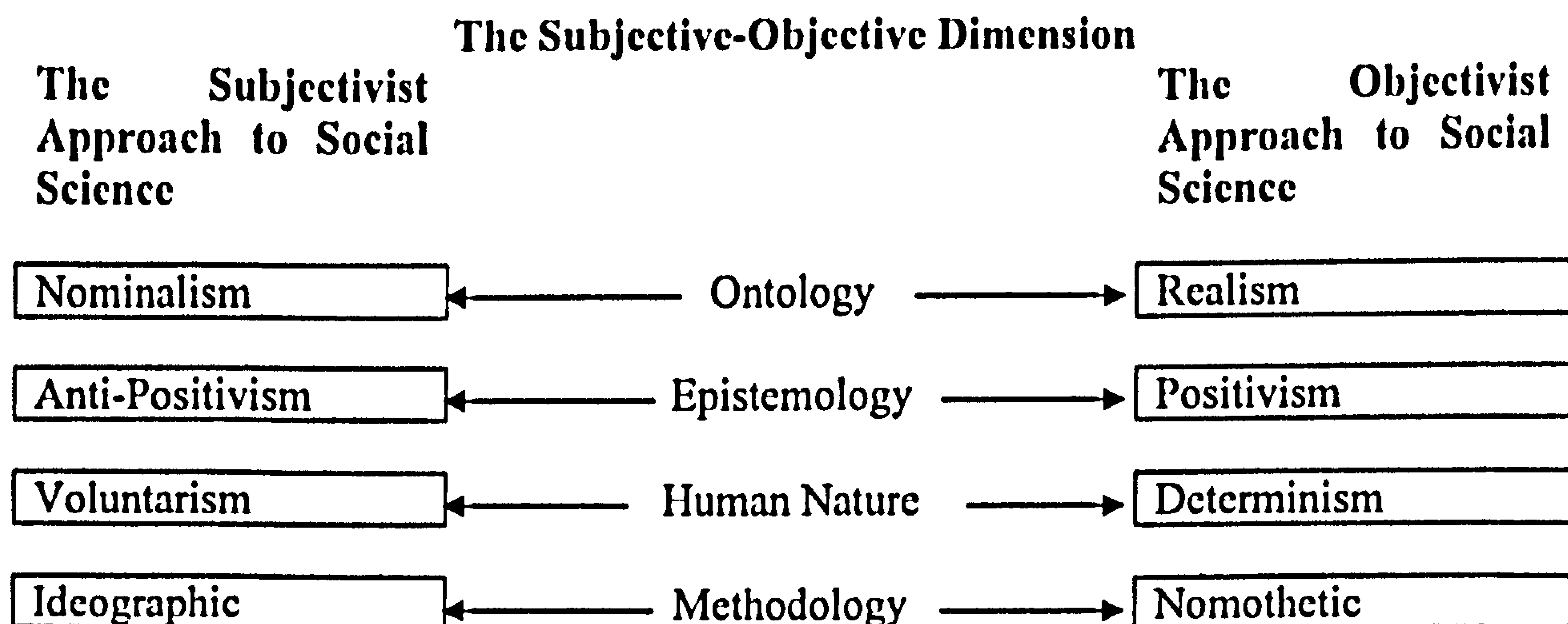
[111] Alternative frameworks can and do exist, however it is beyond the scope of the present study to discuss the other types and legitimacy of each framework available to the researcher, although the chapter does provide a brief overview of some of the most dominant alternatives (in Section 4.2.4).

[112] Creswell (1998) includes an additional "axiological" dimension. Axiological assumptions require an acknowledgment by the researcher that there are inherent biases in the research, which reflect the values of the researcher and the values of the research topic (Creswell, 1998). Tinker et al. (1982) contend that regardless of how rigorous and scientific research is believed to be, it is never value free.

Figure 4.1: Burrell and Morgan's (1979) Scheme for Analysing Assumptions about the Nature of Social Science



Reproduced from: Burrell and Morgan (1979)

Ontological assumptions consider the nature of reality or the "very essence of the phenomena under investigation", and vary from Nominalism at one end of the spectrum to Realism at the other end of the spectrum (Burrell and Morgan, 1979, p, 1). Nominalism views social reality as a relative concept and argues that there is no real structure to the world that is independent of the researcher (Burrell and Morgan, 1979). In other words, the 'reality' of the social world is not external to the individual; it exists only in an individual's consciousness (Ryan et al., 2002). Alternatively, a realist postulates that the world is comprised of "hard, tangible and relatively immutable structures", which exist independently of perception (Burrell and Morgan, 1979, p. 4). According to this view, the nature of 'reality' is considered to be 'objective' and is regarded as being independent of the individual researcher; the individual is seen as "being born into and living within a social world which has a reality of its own" (Burrell and Morgan, 1979, p. 4). The philosophy of realism within accounting arises from the assumption that objective economic reality can be

observed, measured and communicated (Godfrey et al., 2000). The choice of ontological assumptions will imply different epistemological approaches and specific research methodologies and methods, which in turn shape the research scenarios to be analysed and the hypotheses that are to be tested (Burrell and Morgan, 1979; Godfrey et al., 2000).[113]

Epistemological assumptions consider the nature of knowledge, or more specifically, is concerned about "how one might begin to understand the world and communicate this as knowledge" to others (Burrell and Morgan, 1979, p. 1). A positivist epistemology contends that knowledge can only be derived from observation, whereby the researcher attempts to explain and predict what occurs in the social world by "searching for regularities and casual relationships" between the events being investigated (Burrell and Morgan, 1979, p. 5). This is usually accomplished via the development and testing of hypotheses (Burrell and Morgan, 1979; Godfrey et al., 2000). The epistemology of anti-positivism regards the social world as "relativistic" whereby knowledge is something to be derived from personal experience (Burrell and Morgan, 1979, p. 5). Anti-positivists reject the notion of observer independence and that social science can "create objective knowledge of any kind" as one "can only 'understand' by occupying the frame of reference of the participant in action" (Burrell and Morgan, 1979, p. 5). In other words, an individual has to "understand from the inside rather than the outside" (Burrell and Morgan, 1979, p. 5).

Assumptions about human nature are concerned with the relationship between individuals and the society in which they live. Burrell and Morgan (1979) characterise

[113] Morgan (1988) presented a six fold classification of the social world, each being associated with different ways of viewing the world, as represented along a continuum starting from a strict objectivist viewpoint and ending in an extreme subjectivist position.

assumptions about human nature along the spectrum from determinism to voluntarism. Determinism regards human beings, and their activities, as being "products of their environment" and determined by the situation in which they are located (Burrell and Morgan, 1979, p. 2). At the other extreme, voluntarism assumes that individuals are "completely autonomous and free-willed", and thus govern and are responsible for their own actions (Burrell and Morgan, 1979, p. 6). These views on human nature taken in conjunction with the ontological and epistemological assumptions discussed previously will directly influence the choice of methodology (Burrell and Morgan, 1979).

Methodology involves the study of how knowledge about the world is acquired and considers how the entire research process is conceptualised (Burrell and Morgan, 1979; Creswell, 1998). Its function is to examine the methods used, or should be used, to produce knowledge about the world and to provide the reasons and justification for the selection of such methods (Burrell and Morgan, 1979). Ideographic methodologies, such as interviews and case studies, involve obtaining a direct understanding of a particular issue by "getting inside situations and involving oneself in the everyday flow of life"; they stress the importance of "letting one's subject unfold in its nature and characteristics during the process of investigation" (Burrell and Morgan, 1979, p. 6). Alternatively, nomothetic methodologies derive from the natural sciences whereby a hypothesis is tested after its formulation (Burrell and Morgan, 1979; Patton, 1990). Therefore, it is common that quantitative methods which search for answers are employed when using this approach (Burrell and Morgan, 1979).

4.2.2 Assumptions about the Nature of Society

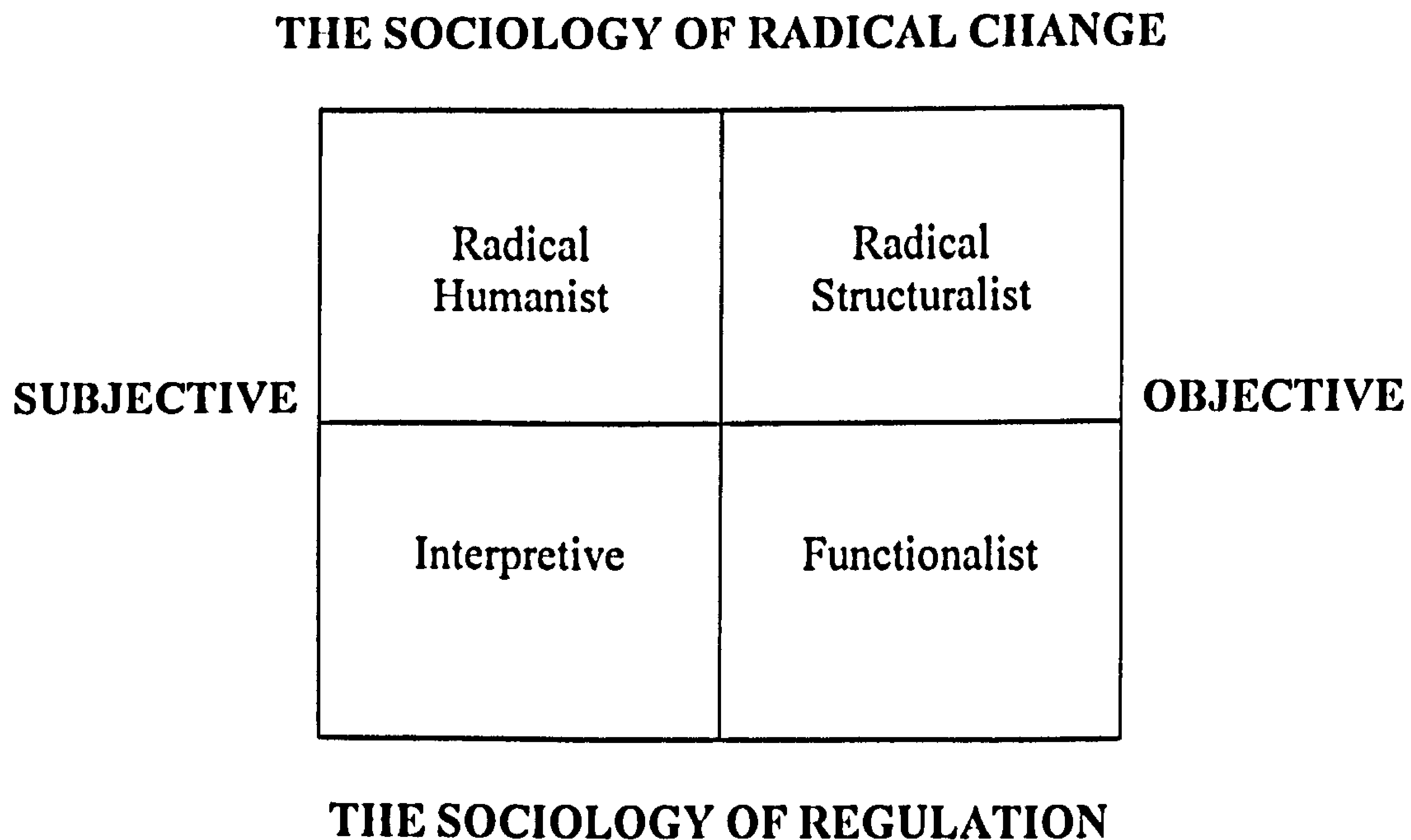
Burrell and Morgan (1979) suggest that the researcher must also make assumptions about the nature, or structure of society. Two extreme ends of a spectrum are advanced with respect to assumptions about the way society is structured: the sociology of regulation and the sociology of radical change. The first of these approaches seeks to provide explanations about how society is held together, emphasising its underlying stability and order (Burrell and Morgan, 1979; Ryan et al., 2002). It primarily emphasises the "need for regulation in human affairs" and attempts to "explain why society tends to hold together rather than fall apart" (Burrell and Morgan, 1979, p. 17). By contrast, the sociology of radical change attempts to explain the modes of domination and conflict, which are characteristic of society according to those who support this notion (Burrell and Morgan, 1979). It is concerned with seeking emancipation from the "structures which limit and stunt... [the] potential for development" (Burrell and Morgan, 1979, p. 17).

4.2.3 The Burrell and Morgan Classification Framework

Burrell and Morgan (1979) outline a useful framework to examine how the ontological assumptions concerning the nature of reality, influence the epistemological notions about the nature of knowledge, which in turn shape the research questions asked and the interpretation of resultant findings. Their analysis is based on a two-by-two matrix, which is reproduced in Figure 4.2; this results in: (i) the subjectivist-objectivist dimension (shown on the horizontal axis); and, (ii) the assumptions about the nature of society dimension (shown on the vertical axis). In combining the two dimensions, Burrell and Morgan (1979) propose four alternative

perspectives for the analysis of social phenomena, namely, functionalist, interpretive, radical humanist and radical structuralist paradigms.

Figure 4.2: Burrell and Morgan's (1979) Matrix for the Analysis of Social Theory



Reproduced from: Burrell and Morgan (1979)

The functionalist paradigm combines an objectivist view of the world with a concern for regulation and works under the ontological assumption of realism, with a positivist epistemology. It regards individual behaviour as deterministic and adopts the methodological assumption of nomotheticism. This approach seeks to provide explanations of the status quo and rational explanations of social affairs (Burrell and Morgan, 1979). Since the 1970s, this paradigm has tended to be the dominant approach adopted in accounting and finance research (Dunne, 2003). The interpretive paradigm assumes a subjective approach to social science underpinned by a nominalist ontology, an epistemological assumption of anti-positivism, a voluntarist

view of human nature and an ideographic methodology. Researchers in this paradigm try to comprehend the world as it is in an attempt to obtain a better understanding of individual behaviour (Burrell and Morgan, 1979). The assumptions about the nature of social science underpinning the radical structuralist paradigm are the same as those adopted by the functionalist approach, while the radical humanist paradigm shares the same assumptions concerning the nature of social science with those underpinning the interpretive perspective. However, the radical structuralist and radical humanist paradigms are underpinned by an assumption about society based on the sociology of radical change, which emphasises emancipation and significant change (Burrell and Morgan, 1979). The radical structuralist paradigm recognises inherent conflicts within society, which generate constant change through political and economic failure. Theorists in the radical humanist paradigm emphasise the importance of relaxing social constraints that restrict human development. They argue that individuals are governed by the current dominant ideologies with which they interact; these dominant ideologies separate them from their true selves (Burrell and Morgan, 1979). Burrell and Morgan (1979) argue that an individual cannot operate under more than one paradigm at the same time; they contend that by adhering to the assumptions underpinning any one paradigm, the assumptions of all of the other paradigms will be contradicted.

4.2.4 An Alternative to the Burrell and Morgan Framework

The Burrell and Morgan Framework is widely employed in the literature, however, its use has not been without criticism (Chua, 1986; Rosengren, 1993; Laughlin, 1995; Deetz, 1996; Clair, 1999). For example, Deetz (1996) argues that the framework has been used to reify research approaches, or as he explains,

> "...easily produce four classified things given object status, rather than providing two lines of differentiation that draw attention to important differences in research programs."
>
> (Deetz, 1996, p. 682)

In addition, Deetz claims that the framework dimensions obscure key differences in current research orientations and this leads to "poorly formed conflicts and discussions" (p. 682). Furthermore, Laughlin (1995) rejects the subjective-objective dimension presented within the Burrell and Morgan framework as being "too simplistic" (p. 66) and argues that it isolates "many, if not most, of the key domains for choice" (p. 66). Instead, he presents a three-dimensional framework labelled theory, methodology and change. He argues that choices with respect to "theory" involve forming a viewpoint about the nature of the world (corresponding to Burrell and Morgan's "ontology" assumption) and what represents knowledge whether relating to the past or present and how it is concerned with the current topic of investigation (relating to Burrell and Morgan's "epistemology"). "Methodology" choices involve decisions about an "amalgam of the nature and role of the observer in the discovery process" (p. 66) (consistent with Burrell and Morgan's "human nature" assumption) and the degree of "theoretical formality in defining the nature of discovery methods" (p. 66) (corresponding to Burrell and Morgan's "methodology") Finally, the decision about "change" involves assuming a position on whether the investigation is "intentionally geared to achieve change in the phenomena being investigated" (p. 66) (relating to Burrell and Morgan's "society" assumption). Laughlin (1995) therefore emphasises the need for choices on the research position to be adopted as "no one perspective can provide a complete picture of accounting reality" (p. 63) and that these choices can be, and should be, contestable.

Chua (1986) developed another alternative framework for the classification of the philosophical assumptions underpinning accounting research. This classification comprised three sets of beliefs. First, beliefs concerning the conception of knowledge are divided into two sets of epistemological and methodological assumptions. Second, beliefs about the nature of physical and social reality are characterised by three sets of assumptions; ontology, human interaction and rationality, and societal relations. Finally, assumptions are made regarding the relationship between knowledge (theory) and the empirical world (practice).

Chua (1986) noted that her classification differed from that of Burrell and Morgan (1979); the intended purpose of her framework was to evaluate the strengths and weaknesses of different perspectives in accounting. By contrast, she suggested that Burrell and Morgan's framework lacked critical evaluation. In addition, unlike Burrell and Morgan, Chua did not present mutually exclusive dichotomies and developed her framework in an attempt to identify current social perspectives; she did not claim that her framework offered a permanent classification of all social perspectives (Chua, 1986)[114].

4.3 Research Objectives and the Choice of Research Methods

The core objective of this study is an examination of the impact of IFRS on corporate reporting disclosures and financial statement numbers. More specifically, it contains an assessment of the decision-usefulness of the information required by the new reporting regime. This is achieved by an examination of IFRS-related disclosures included in corporate annual reports before and after the implementation of

[114] For example, Chua highlighted that assumptions regarding societal order and human rationality are considered context-dependant and can change over time; therefore, she only attempts to identify current emerging perspectives in research (Chua, 1986).

International GAAP as well as an assessment of the Reconciliation Statements required upon first-time adoption of the new reporting requirements. It is recognised that the disclosure of IFRS-related information may be motivated by a number of different reasons; however, the primary focus of this study is on the usefulness of these disclosures for decision-making purposes as outlined in Chapter 3.

The philosophical viewpoint of the researcher is based upon the research objectives previously discussed. With regard to the nature of reality, the researcher does not assume that there is a distinct structure of the world that exists independent of perception. Thus a nominalistic standpoint is adopted along the ontology spectrum. Social science is considered a subjective rather than objective area of study with knowledge regarded as something to be experienced as opposed to something that can be acquired. This study derives knowledge empirically from both the content analysis of IFRS-related disclosures and the analysis of IFRS Reconciliation Statements provided in corporate annual reports. Although content analysis requires that systematic counting procedures are undertaken which may be seen to contradict the subjectivist approach of the researcher, it is by way of subjective interpretation that the subsequent translation of the data collected will present meaningful findings. In addition, the analysis of IFRS Reconciliation Statements may be regarded an objective exercise given all adopting companies are required to produce a Reconciliation Statement following the transition to the new regime; however, no specific layout was outlined by the IASB for how these should be reported. Therefore, in order to facilitate a comparison of the Reconciliation Statements provided by reporting companies where the format and layout differed, subjective interpretation

will be required to enable subsequent translation of the data collected to be presented into meaningful findings.

Assumptions about human nature are characterised by Burrell and Morgan (1979) along a spectrum that ranges from voluntarism to determinism; however, Chua (1986) has expressed concerns about the fact that the researcher has to choose between the two viewpoints[115]. As such, she indicates that, whilst a choice between these assumptions should be made, one can also adopt an intermediate standpoint that allows for the influence of both sets of assumptions. The researcher assumes such an intermediate standpoint; although not completely determined by their environment, humans are also not completely free-willed and independent. Within the context of the current study, the financial statements of UK-listed companies are bound by the statutory requirements of IFRS; however, within many of these requirements are a number of choices which organisations can make. Therefore, the information disclosed by an organisation may be influenced by their selection from these choices.

The researcher believes that society is capable of social change, however, in order to identify where such change, if required, should be directed, the status quo needs to be understood in order to explain the decisions and conflicts within society. Therefore, a further compromise within the Burrell and Morgan classification is necessary to facilitate the researcher's views with respect to the assumptions regarding the nature of society.

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[115] For example, Chua noted that this did not reflect the position of Bhaskar (1979) who argued that although societies are prior to and different from individuals, they are continually reproduced and transformed by intentional human action. She also indicated that this did not encompass the position of Habermas (1978) who argued that individuals might act and shape meanings, however, they might still live within structures of domination in society (Chua, 1986).

The aim of the present study is to provide a descriptive account of IFRS-related disclosures; it is exploratory in nature as no effort is made to develop detailed hypotheses for subsequent testing. The philosophical assumptions of the author as previously outlined indicate the use of ideographic methodologies, where an attempt to explore and describe the view of annual report preparers is undertaken. The combination of a nominalist ontology, an anti-positivist epistemology, an intermediate standpoint on the assumptions about human nature, and the use of ideographic methodologies leads the researcher to locate himself within the interpretive paradigm as stipulated by Burrell and Morgan (1979). However, given the aims of the study and the employment of quantitative and qualitative research methods, such as the methods used in the present study, a further compromise is required within the Burrell and Morgan framework. As indicated earlier, the quantitative and qualitative research methods utilised in the present investigation may be regarded an objective exercise given that they involve systematic counting procedures and the data relates to the requirements of a mandatory reporting regime; however, the subsequent interpretation of this data into meaningful findings is a subjective process requiring judgement and perception. Therefore, re-emphasising the view of Chua (1986) regarding the choice of mutually exclusive dichotomies, the researcher assumes an intermediate standpoint between the interpretive and functionalist paradigms in order to satisfy the research objectives, consider the research methods employed and reflect the researchers underlying philosophical assumptions.

4.4 Research Methods

4.4.1 Qualitative Research Methods

Creswell (1998) described qualitative research as a form of inquiry that "explores a social or human problem" (p. 15). This type of research is characterised by a concern for meanings, patterns of behaviour and the way people understand things (Denscombe, 2003). Creswell (1998) added that the researcher,

> "...builds a complex, holistic picture, analyses words, reports detailed views of informants, and conducts the study in a natural setting."
>
> (Creswell, 1998, p. 15)

There are several advantages of qualitative analysis. A key strength of qualitative research is that the descriptions and theories are grounded in reality (Denscombe, 2003). In addition, there is a "richness and detail" to qualitative data and, to the extent that social existence involves uncertainty, accounts of that existence require tolerance with respect of ambiguities and contradictions, for which qualitative research is best equipped to provide (Denscombe, 2003, p. 280).

However, qualitative research does have its limitations. Qualitative data may be less representative thereby restricting its generalisability (Denscombe, 2003). Furthermore, during the process of coding and categorising this form of data, there is a possibility that the meaning of the data is lost or transformed when taking it from its source (Denscombe, 2003).

Given the aims of this research and the underlying philosophical assumptions of the researcher, the employment of a qualitative research method was considered to be

appropriate. This research study employs a qualitative form of content analysis in an attempt to satisfy the research objectives.

4.4.2 Content Analysis

A form of content analysis is employed as the research method in the present study. This method is used in an attempt to gather data on the disclosures relating to IFRS information provided in UK corporate annual reports. A brief outline of the content analysis method and its suitability in the current dissertation is provided in this section.[116]

Several definitions of content analysis have been provided in the substantive social science literature. Berelson (1952) originally defined content analysis as,

> "...a research technique for the objective, systematic and quantitative description of the manifest content of communication."
>
> (Berelson, 1952, p. 18)

More recently, Krippendorf (2004) described content analysis as,

> "...a research technique for making replicable and valid inferences from texts (or other meaningful matter) to the contexts of their use."
>
> (Krippendorf, 2004, p. 18)

Thus, content analysis is a method of classifying text (or content) of written communication into different groups (or categories) subject to chosen criteria (Weber, 1985). Therefore, a larger volume of disclosure for a specific category implies a degree of importance to users of the text or document. In addition, 'hidden' aspects within what is being communicated through written text may be captured by the technique (Denscombe, 1998, p. 168).

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[116] Chapter 5 provides details on the specific application of the technique in the current study.

The key strength of content analysis is that it enables a quantification of (a potentially large volume of) the contents of a text. The research tool is transparent and flexible across various kinds of unstructured information and, potentially, powerful for researchers (Denscombe, 1998, Bryman, 2004, Krippendorff, 2004). In addition, content analysis is an "unobtrusive technique" (Krippendorff, 2004, p. 40) as the documents subject to the analysis may be scrutinised in the absence of the communicator's knowledge (Jones and Shoemaker, 1994).

4.4.2.1 Stages in the Content Analysis Process

The content analysis process involves a number of stages (Carney, 1971; Kassarjian, 1977; Krippendorff, 2004). The research technique involves developing categories and subsequently counting the number of instances when these categories are used in a particular item of text (Silverman, 1993). This process can be divided into several stages as follows. First, an appropriate representative sample is required (Carney, 1971: Kassarjian, 1977; Krippendorff, 2004). The choice of such a sample needs to be explicit (Denscombe, 2003) and manageable (Kassarjian, 1977). In addition to the sample selection, a suitable sampling unit for analysis needs to be chosen (Krippendorff, 2004). The most popular sampling unit used in accounting analysis studies is the corporate annual report (Jones and Shoemaker, 1994; Gray et al., 1995b; Unerman, 2000).[117]

[117] Several reasons have been provided for the primary use of the annual report in accounting content analysis studies. For example, it has been argued that the annual report is the main form of corporate communication (Gray et al., 1995b; Adams and Harte, 1998) and it contains much written material that enables content analysis to be undertaken (Bowman and Haire, 1976). However, it has been acknowledged that "an incomplete picture of disclosure practices" may result from an exclusive focus on the annual report (Roberts, 1991, p. 63) and an examination of other documents has been conducted in some studies (For example, Guthrie and Parker, 1989 and Ince, 1997).

The second stage involves determining the coding unit, or unit of measurement, to be used for analysis. This coding unit can take the form of words, sentences, paragraphs, visual images and content of pictures (Kassarjian, 1977; Denscombe, 2003; Krippendorff, 2004). The selection of an appropriate coding unit is important as alternative measurement techniques may lead to different impressions of the relative importance of the material analysed (Unerman, 2000). Although no one technique has been shown to be superior to others, it has been suggested that any measurement error between the alternative measurement techniques is negligible (Hackston and Milne, 1996).[118]

Third, the development of relevant categories needs to be undertaken (Kassarjian, 1977; Krippendorff, 2004). This process involves a degree of subjectivity which is difficult to control and impossible to completely eliminate. However, establishing clearly defined categories at the outset aids the correct classification of the relevant disclosures (Kassarjian, 1977; Krippendorff, 2004).

The fourth stage involves a pilot study. This pilot is an attempt to test the robustness of the decision rules and research tool (Carney, 1971). Further, the pilot study will determine whether any adjustments to the decision rules are necessary.

Fifth, instances of defined disclosure are coded and then classified according to the pre-determined decision rules. Krippendorff (2004) identified a number of key elements for reliable coding and recording of data in content analysis. The researcher's experience of the type of data to be analysed is necessary and any

[118] Hackston and Milne (1996) found in their study that whether they counted sentences or calculated proportions of a page, there was little difference on the results of the subsequent analysis performed.

ambiguities should be avoided by presenting the decision rules in fundamentally basic terms. Further, to ensure a consistent classification of data into appropriate categories, the researcher undertaking the analysis should be provided with specific training.

Finally, it is argued that the collected data should be subjected to statistical or numerical analysis following its transfer to a computerised database. Thus, the process involves adhering to an approach via which essentially unstructured documents, such as annual reports, can be statistically analysed. This is achieved by creating clear and consistent measurement categories that can be applied to each document analysed and that can facilitate comparison between them (Unerman, 2000; Dunne, 2003). The final step following the summarisation of the numerical data is to examine the data with respect to its wider context in order to draw inferences from the analysis (Dunne, 2003).

4.4.2.2 Reliability and Validity

Consistent with the requirements when undertaking any form of qualitative research (Denscombe, 2003), content analysis must encompass two key characteristics if it is to be used as an effective research tool: the process must be reliable and valid (Holsti, 1969; Weber, 1985; Krippendorff, 2004). Reliability is a characteristic of content analysis that distinguishes the technique from other methods that attempt to explain the content of the communication (Kassarjian, 1977: Krippendorff, 2004). According to Krippendorf (2004), there are three types of reliability: stability, reproduceability, and accuracy.[119] Stability refers to the extent to which data are coded by the same coder in the same way over time (Milne and Adler, 1996; Beattie et al., 2001;

[119] Several different forms of calculations can be performed to measure the reliability of content analysis. Examples of reliability calculations include Scott's (1955) pi, Cohen's (1960) kappa and Krippendorff's (2004) α.

Krippendorff, 2004). Reproduceability, which is often referred to as inter-coder reliability, attempts to measure the extent to which coding results are produced when different coders are involved (Weber, 1985; Milne and Addler, 1996; Beattie et al., 2001; Krippendorff, 2004). The accuracy measure of reliability is the degree to which the coding performance adheres to either a pre-determined standard or to results from previous studies (Milne and Adler, 1996; Krippendorff, 2004). The development of clearly defined rules and procedures are necessary in order to minimise the possibility that the results are a reflection of the subjective bias of the researcher rather than the content of the documents being analysed (Kassarjian, 1977; Krippendorff, 2004).[120] Validity relates to the degree to which the results of a study mirror reality (Jones and Shoemaker, 1994). In order to improve validity, the development of a coding scheme that acts as a guide when undertaking content analysis is required (Potter and Levine-Donnerstein, 1999; Krippendorff, 2004). It is an attempt to make the coding procedure a systematic process by ensuring that it is consistent across all coders (Potter and Levine-Donnerstein, 1999; Krippendorff, 2004). Therefore, the problem of partial or biased analysis can be eliminated; only relevant data for the problem or hypothesis studied is captured and the findings are theoretically relevant and can be generalised (Kassarjian, 1977; Krippendorff, 2004).

4.4.2.3 The Utilisation of Content Analysis in Accounting and Finance

Content analysis has been widely used as a research method in several accounting and finance studies. However, the utilisation of content analysis techniques is most prevalent in the area of social and environmental reporting (Bowman and Haire, 1976; Ernst and Ernst, 1978; Ingram and Frazier, 1980; Neimark, 1983; Guthrie and

[120] The inclusion (or exclusion) of communications content or analysis categories must be undertaken in accordance with consistently applied rules to ensure a systematic and valid application of the technique (Kassarjian, 1977).

Mathews, 1985; Tinker and Neimark, 1987; Guthrie and Parker, 1989; Zeghal and Ahmed, 1990; Patten, 1992; Adams et al., 1995; Gray et al., 1995a, 1995b; Hackston and Milne, 1996; Neu et al., 1998; Milne and Adler, 1999; Unerman, 2000). Content analysis has frequently been employed to investigate financial analyst recommendations and reports (Govindarajan, 1980; Previts et al., 1994; Rogers and Grant, 1997). For example, Breton and Taffler (2001) examined the information set used by equity analysts in their stock recommendation decisions by undertaking a content analysis of their company reports. The authors found that, although company reports are a fundamental source of information, accounting information is not the only source used by the sample analysts when writing their documents. The firm's management and strategy as well as its trading environment were also considered important. The research technique has also been used as a method to examine organisational practices associated with the management and reporting of intellectual capital (Subharao and Zeghal, 1997; Guthrie et al., 1999; Brennan, 2001; Olsson, 2001). Narrative disclosures with respect to bankruptcy have been examined by Tennyson et al. (1990).

Several studies have investigated the content of financial accounting narrative, such as that presented in corporate annual reports (Neimark, 1983; Jones and Shoemaker, 1994; Smith and Taffler, 2000; Beattie et al., 2001; Beattie et al., 2002) while other articles have assessed the contents of documents relating to the accounting standard setting process (Kelly-Newton, 1980; Buckmaster and Hall, 1990, McKee et al., 1991; Guenther and Hussein, 1995). Recently, Dunne (2003) used the technique to examine the impact of a new derivatives accounting standard on UK corporate annual reports. Farrell and Cobbin (2000) analysed the content of the codes of ethics from 57 national

accounting associations, while Perry and Bodkin (2000) performed a content analysis of a sample of corporate web sites to identify the mix of promotional activities that they contained. The content analysis technique has also been employed in accounting education studies (Beattie and Collins, 2000; and Ferguson, 2002).

4.4.2.4 Limitations of the Content Analysis Method

An examination of the studies highlighted in the previous section indicates that there has been a rise in the usage of content analysis over time; there has also been an increase in the range of topics examined using this method. However, like all research methods, content analysis suffers from several limitations. It is widely recognised that the use of the content analysis technique involves a substantial element of subjectivity (Carney, 1971; Denscombe, 1998). Denscombe (1998) argues that the technique possesses an inherent tendency to "dislocate the units and their meaning from the context in which they were made" and also even from the writer's intentions (p. 222). Indeed, by placing greater reliance on the subtlety and intricacy of the meanings conveyed by the writer or inferred by the reader, the value of the technique diminishes when attempting to reveal the meaning of a text (Denscombe, 1998). Content analysis is frequently criticised with respect to the questions asked as much depends on the nature of the enquiry (Carney, 1971). A frequent difficulty is that a question involves the use of themes as units for counting; these can be difficult to identify uniformly, and can be easily distorted if broken down into their component parts (Carney, 1971). Furthermore, the focus in content analysis on measurement can easily and unintentionally result in an emphasis being placed on what is measurable rather than what is theoretically relevant (Bryman, 2004).

A further difficulty associated with the technique relates to the limitation of its scope; content analysis "can only be as good as the documents on which the practitioner works" (Bryman, 2004, p. 197). In addition, content analysis has been frequently acknowledged as being susceptible to researcher biases; these can have a significant impact on the decisions taken when collecting, analysing and interpreting data (Jones and Shoemaker, 1994). Indeed, such biases can be detrimental to a study's contribution to knowledge (Kolbe and Burnett, 1991). However, the existence of a suitable, reliable and accurate coding scheme to guide coders coupled with the involvement of multiple coders (where possible) may help to reduce these biases, and in turn, the inherent subjectivity involved in the use of the technique may be diminished.

4.4.2.5 Use of Content Analysis in the Present Study

Although content analysis is regarded primarily as a qualitative research method within the present investigation, it is acknowledged that some of the data collected during the process is quantitative in nature. In addition, content analysis is considered an objective process; however, a degree of subjectivity is involved when considering the choice of disclosure classification. However, the development and pre-testing of a rigorous set of decision rules will reduce this level of subjectivity. Further, this subjectivity is consistent with the philosophical assumptions of interpretive research.

The first stage of the current content analysis involves the selection of sample companies to be examined. The second stage requires the development of a suitable coding scheme. The key part of the research involves analysing company annual reports and obtaining thematic variables from this analysis. Statistical analysis will be

undertaken in an attempt to derive some meaning from the dataset. Chapter 5 provides a more detailed explanation about the application of the technique in the present study.

4.4.3 Quantitative Research Methods

Denscombe (2003) described the use of quantitative data as possessing an "aura of scientific respectability" because it "conveys a sense of solid, objective research" through its use of numbers and presentation in the form of graphs and tables (p. 236). He also noted that quantitative research does not necessarily involve the use of sophisticated statistical analysis; instead he argues that:

> "Provided the researcher has a vision of the pros and cons, and appreciates the limitations to what can be concluded on the basis of the data collected, good quantitative research need not require advanced statistical knowledge."
> (Denscombe, 2003, p. 236)

Indeed, relatively simple statistics can be more than adequate in quantitative research as they can form a sound basis for discussion and critique which Denscombe (2003) believes can provide "a solid foundation from which to progress the argument" (p.237).

There are several advantages of quantitative research. For example, quantitative data can be subjected to various forms of statistical tests and the subsequent analyses appear grounded in objective laws instead of researcher values (Denscombe, 2003). Quantitative data provides a sound basis for description and analysis and interpretations as well as findings are informed by measured quantities instead of impressions which can be checked by others for authenticity (Denscombe, 2003). Further, additional credibility with respect to interpretations made and confidence in

findings reported can be substantiated using statistical tests of significance (Denscombe, 2003).

However, there are notable limitations in the use of quantitative research. Quantitative data is only "as good as the methods used to collect them and the questions that are asked" and underlying research issues may be neglected due to an over emphasis on the techniques of analysis (Denscombe, 2003, p. 264). In addition, decisions made during the analysis may have implications for the findings reported; as a result, quantitative analysis may not be any more neutral or objective than qualitative research (Denscombe, 2003). For example, manipulating categories and the boundaries of grouped frequencies enable a data fix in order to report significance where alternative combinations of the data would not (Denscombe, 2003).

The employment of a quantitative form of analysis was considered appropriate given the underlying assumptions of the researcher. In an attempt to achieve the research objectives of the present study, a form of Reconciliation Statement analysis is utilised and the following section will describe this research method and include a discussion of its use in previous accounting and finance studies and outline its limitations as a research tool.

4.4.4 Reconciliation Statement Analysis

A form of Reconciliation Statement analysis is utilised as a research method in the current study. This method is used in an attempt to measure the differences in both net profit and net equity reported in the IFRS Reconciliation Statements provided in UK

corporate annual reports. A brief outline of this method, namely the Conservatism Index, and its suitability in the present dissertation is provided in this section[121].

4.4.4.1 The Conservatism Index

A key problem when undertaking a comparative study is to identify the criteria for comparison (Gray, 1980). This issue is further complicated when focusing on the reported financial results of companies based in separate countries where differing sets of national accounting principles are applied; or indeed, in the context of the present study, where companies within the same country move from reporting under national GAAP to preparing financial statements in accordance to a new international regime (Gray, 1980). Gray (1980) contends that if the impact of reported results between different accounting systems and practices is to be given perspective in an international context, then a "common yardstick for the purposes of evaluation is an essential prerequisite" to any such analysis (p. 65). He argues that the use of a ratio or index to determine the correlation between reported and adjusted results provides "a neutral indicator of measurement behaviour" of companies located in different jurisdictions or companies within the same country which have made a transition to a new accounting regime (p. 67). Gray (1980) postulates that if one takes the adjusted figure as the yardstick, it is possible to calculate the ratio of disclosed results to adjusted amounts as:

$$1 - \left(\frac{R_A - R_D}{R_A} \right) \qquad [4.1]$$

Where R_A = adjusted figure and R_D = disclosed figure[122].

[121] A detailed explanation about the application of this technique in the present investigation is provided in Chapter 6.

Gray (1980) terms the resulting ratio a 'conservatism' index arguing that,

> "...companies with a ratio of more than one would appear to employ accounting practices with outcomes which are relatively optimistic in relation to the yardstick, whereas companies with a ratio of less than one would appear to be relatively pessimistic or "conservative."
>
> (Gray, 1980, p. 67)[123]

Therefore, reported results measurement behaviour can be assessed by way of the continuum of conservatism (Gray, 1980)[124].

Some commentators argue that the term 'conservatism index' is misleading because accounting methods that result in lower profit or equity figures are not necessarily more conservative (Roberts et al., 2005). For example, although the revaluation of fixed assets is not considered as a conservative valuation rule, any such revaluation will give rise to higher depreciation charges and, as a result, lower profit figures. Indeed, Roberts et al. (2005) highlight that many other accounting rules involve a decision as to when revenues or costs should be recognised in the income statement as opposed to being concerned with the amount recognised. They cite development costs as an example as these can be charged to income in the period incurred or alternatively be capitalised and expensed over several periods. The pattern of earnings distribution therefore differs over time without impacting the total earnings of an entity over its lifetime; as a result, some period(s) will record lower earnings figures whilst other(s) will report higher amounts. Roberts et al. (2005) contend that the index

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[122] As it is not desirable to have an index that is negative simply because a company has made a loss, absolute profits are used as the denominator because it ignores the sign of the profit figure and treats all items as positive amounts (Roberts et al., 2005).

[123] Indeed, as Gray (1980) acknowledged, conservatism or 'prudence' is a basic principle of accounting in France, Germany and the UK and is explicitly incorporated in the IASB's Conceptual Framework.

[124] Two approaches to accounting conservatism can be identified in the literature. Basu (1997) defines conservatism as "accountants' tendency to require a higher degree of verification to recognize good news as gains than to recognize bad news as losses" (p. 7). Thus, conservatism involves a greater probability of timely accounting recognition of bad news than good news (Lopes and Viana, 2008). Feltham and Ohlson (1995) contend that, in the long term, conservatism is an expectation that reported net assets will be less than market value.

is better viewed as an index of how similar or dissimilar reported figures are and argue that the index should instead be referred to as a 'comparability index'. Indeed, Weetman et al. (1998) further support this re-appraisal by claiming it,

> "...places clearer emphasis on relative accounting treatment without requiring a judgement as to which is more or less conservative."
>
> (p. 192)[125,126]

4.4.4.2 The Utilisation of the Conservatism Index in Accounting Research

Several studies have used the conservatism index as a research method to examine differences in reported figures produced under various GAAP. For example, Weetman and Gray (1991) examined the differences in profits reported under US GAAP compared to those reported in accordance with UK, Swedish and Dutch GAAP. They found using the index of conservatism that UK GAAP, and to a lesser extent Dutch GAAP, were significantly less conservative than US GAAP whilst Swedish GAAP was determined to be more conservative than the US accounting regime[127]. Further, Weetman and Gray (1990) utilised the conservatism index in their study of the differences between UK and US accounting principles to determine their impact on reported earnings. They documented evidence of a systematically more conservative bias in earnings under US accounting principles with UK earnings up to 25 per cent higher on average than US amounts. They also found that the dominant effect on earnings related to the different treatment of goodwill between the two sets of

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[125] They also note that the comparability index indicates the measurement impact of accounting differences and can therefore be distinguished from alternative indicators of harmonisation such as H, I or C indices which quantify the occurrence of accounting differences (Weetman et al. 1998).

[126] Consistent with the original definition provided by Gray (1980), the index will be referred to as the 'conservatism index' in the present study. The author believes that referring to the index as the 'comparability index' would place an emphasis on the degree of harmonisation between reported figures and this is beyond the scope of the current dissertation.

[127] However, the authors note that there was insufficient evidence to determine a systematic pattern with regard to Swedish and Dutch firms (Weetman and Gray, 1991).

principles[128]. Norton (1995) utilised the conservatism index when undertaking a comparative analysis of the differences between Australian accounting practices and US GAAP. The results of this analysis offered minimal support for the hypothesis that US GAAP was more conservative with respect to reported profits; however, evidence was documented in support of the hypothesis for the reporting of shareholders equity.

Some studies have applied the conservatism index when comparing national GAAP with IFRS financial statements. For example, Bertoni and De Rosa (2006) measured the differences in net income, equity, ROE and partial items for a sample of Italian companies. As anticipated, they found that Italian GAAP was more conservative than IFRS although the results were not as significant as expected. Further, Tsalavoutas and Evans (2007) found for a sample of Greek companies, the restatement to IFRS resulted in a significant impact to equity and on gearing and liquidity ratios, however, the impact on net profit and ROE was inconclusive. More recently, Lopes and Viana (2008) applied the conservatism index in their measurement of the differences between Portuguese GAAP and IFRS on reported profits; they concluded that Portuguese standards were more conservative than IFRS. Other studies have examined the figures reported under various European accounting regimes (Emenyonu and Gray, 1992; Canibano and Mora, 2000)[129].

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[128] In a similar study, Weetman et al. (1998) found an increasing gap between reported profits under UK accounting principles and that restated under US GAAP between the period 1988 and 1994. The key differences identified being those relating to accounting for goodwill, provision for deferred tax and the accounting treatment of pension costs.

[129] For example, Emenyonu and Gray (1992) assessed the degree to which accounting measurement practices in France, Germany and the UK differed and attempted to quantify the overall effect of international accounting harmony across the three sample countries in the context of an EC harmonisation effort. They documented significant differences across all the practices examined between the three countries and found a wide and relatively low range of values indicating a relative lack of harmony across the three countries.

4.4.4.3 Limitations of the Conservatism Index

It is apparent from the studies discussed in the previous section that the conservatism index has been, and continues to be, frequently utilised in accounting research covering a range of countries and national as well as international accounting regimes. However, consistent with all research methods, several limitations of the conservatism index have been acknowledged. When applying the conservatism index, if the reported profit figure included is very low, the index will often be extremely high and this may be misleading because the change in profits is being compared to a very small denominator being the benchmark GAAP based profit (Roberts et al., 2005). A further problem highlighted relates to data availability as Reconciliation Statements are generally only produced by the largest and most international of companies and these may not be typical or representative of other smaller or less international companies (Roberts et al., 2005)[130]. Indeed, where alternative accounting methods can be adopted, such companies may not make the same choices as other companies. It is argued that no company will wish to produce two sets of accounts reporting very different results because users of accounts may view the figures, and perhaps also the company, with suspicion if it cannot determine its true results (Roberts et al., 2005). Consequently, companies which produce a Reconciliation Statement are likely, when given the choice, to adopt accounting methods which are compliant with both domestic and foreign GAAP, thus reducing the number of items included in the Reconciliation Statement and the size of the difference between the two sets of figures (Roberts et al., 2005).

[130] Although all EU-listed firms are required to prepare a Reconciliation Statement as part of the mandatory adoption of IFRS in the EU, and therefore significantly increasing the sample available for analysis in the EU, it may be argued that these statements may not be representative of non-listed EU firms (Jermakowicz and Gornik-Tomaszewski, 2006).

A further limitation of the technique concerns the narrow time period of analysis which may not allow for the timing differences involved between different accounting policies to be completely resolved (Norton, 1995). For example, the risk of making judgements based on annual results can be illustrated by the case of Daimler-Benz, the first German firm to list on the NYSE. On listing for the first time, the company's reported earnings fell from a profit of DM165m under German GAAP to a loss of DM1,1839m under US GAAP (Roberts et al., 2005). However, to view this company based on this one year was misleading because the difference was attributable to a one-off adjustment and the differences reported in subsequent years were much narrower (Roberts et al., 2005). The present investigation involves an examination of the impact of the conversion to IFRS on annual reports and accounts produced in the first year following adoption of the new regime; therefore, caution should be exercised when drawing conclusions from any significant changes reported given they may be transitory in nature and not necessarily reflective of the full impact of the new standards on the financial statements.

Furthermore, in their study of the differences between UK and US GAAP reported results, Weetman et al. (1998) highlight that the Form 20-F reconciliation considers this issue by requiring the results of the two previous years in addition to the current year results for comparison and they aggregate the data available over the three years provided in the Reconciliation Statements in an attempt to eliminate the potential influence of short-term reversals. However, they found that this aggregation offered little evidence of matching items being eliminated between different periods (Weetman et al., 1998). In addition, they noted that where a large adjusting item appears in one accounting period and no subsequent figure is reported for that item in

the other two years, aggregating profits over the three year period will effectively apply income smoothing to that item (Weetman et al., 1998). Further limitations of the index highlighted in the literature include a lack of control of industry-specific accounting distortions and the extent to which accounting policies applied by sampled companies mirror common practice or are a reflection of a 'typical' economic environment (Norton, 1995).

4.5 Conclusion

This chapter discussed the research methodology adopted in the current thesis based on the philosophical assumptions outlined in the model developed by Burrell and Morgan (1979). The combination of a nominalist ontology, an anti-positivist epistemology, an intermediate standpoint on the assumptions about human nature, and the use of ideographic methodologies led the researcher to assume an intermediate standpoint between the interpretive and functionalist paradigms in order to satisfy the research objectives, consider the research methods employed and reflect the researchers underlying philosophical assumptions.

In addition, the research methods adopted in the present investigation were discussed, namely content analysis and a form of Reconciliation Statement analysis. A description of these methods was provided and an overview of their use in the accounting and finance literature was outlined. Finally, limitations regarding their use as a research tool were discussed. Chapter 5 provides the results of the content analysis of IFRS-related disclosures included in UK corporate annual reports during the adoption of the new reporting regime and the findings of the analysis of the IFRS Reconciliation Statements produced upon first-time adoption follows in Chapter 6.

Chapter 5

A Content Analysis of IFRS Disclosures

Chapter 5 – A Content Analysis of IFRS Disclosures

5.1 Introduction

Chapter 2 detailed the extant literature relating to the introduction of IFRS in the EU, and more specifically its impact on companies in the UK. Chapter 3 outlined the theoretical underpinning of the present study, namely the decision-usefulness approach. Finally, Chapter 4 described the methodology and methods to be used in the current analysis; more specifically, the researcher assumes an intermediate standpoint between the interpretive and functionalist paradigms outlined by Burrell and Morgan (1979) given the research objectives, research methods employed and the researchers underlying philosophical assumptions. This chapter examines the impact on disclosures (other than in the Income Statement, Balance Sheet, Cash Flow Statement and Reconciliation Statement) in the annual report and accounts of UK quoted companies of the introduction of IFRS in 2005[131]. In particular, content analysis is undertaken to investigate the magnitude and nature of the changes in IFRS-related disclosure presented in the annual report and accounts produced in 2004 preceding the mandatory adoption of IFRS and the corresponding documents provided in 2005 following the conversion to International GAAP. This analysis is undertaken for the total level of disclosure, for different categories of information and is also performed for a wide range of firms in an attempt to present findings which are not restricted of any one type of company or sector.

[131] Thus, no attempt is made in the current chapter to study the impact of IFRS on the figures included in the Income Statement, Balance Sheet or Cash Flow Statement parts of the annual reports. Neither is there any attempt to analyse the Reconciliation Statements which companies had to produce when adopting IFRS for the first time; the analysis of the Reconciliation Statements is reported in Chapter 6. Rather, this chapter focuses on the Chairman's Statement, Operating and Financial Review, Directors' Report, Corporate Governance, Remuneration Report, Notes to the financial statements and other related documents to examine how these were influenced by the adoption of IFRS.

The chapter therefore examines whether the introduction of IFRS has had a material impact on the quantity of information included in the annual reports of UK companies (other than in the financial statements). This examination is important as the literature has indicated that the conversion to International GAAP would likely increase the level of disclosures required by adopting companies in the UK (Ernst and Young, 2006). Furthermore, the current analysis will highlight the categories of information where companies have increased the disclosure that they have devoted to IFRS issues in response to the adoption of the new reporting regime. The results of this chapter should also provide an insight into the type of companies that have responded to the changeover to IFRS reporting with an increase in IFRS-related disclosures.

The remainder of the chapter is organised as follows. Section 5.2 details the data and method of analysis used in the current dissertation. The results of the content analysis study are presented in Section 5.3. Finally, Section 5.4 offers some conclusions.

5.2 Data and Analysis

As Chapter 4 indicated, several accounting and finance research studies have used content analysis (Gray et al., 1995b; Beattie et al., 2002; Dunne et al., 2003). The framework developed by Dunne et al. (2003) has been utilised in the present study because it was deemed the most appropriate for the investigation being conducted[132]; there is a similarity between the research issue studied by Dunne et al. (2003) and the research question addressed in the current chapter of this thesis. In any content

[132] Dunne et al. (2003) examined the impact of FRS 13 on the financial statements of UK quoted companies. The authors undertook a content analysis study of the narrative disclosures within the annual report for the total level of disclosure, as well as for different categories of disclosure and for a wide range of firms. These will be examined as part of the current study and therefore it was deemed appropriate to utilise the framework developed by these authors to conduct the present analysis given the similarity of the investigations undertaken.

analysis, there are numerous stages where the researcher must make decisions regarding the choices available and the following sub-sections outline the decision-processes undertaken when employing the technique in this study.

5.2.1 Sample choice

The research aim is to assess the impact of the conversion to IFRS for a sample of UK companies implementing the new regime. The focus of the content analysis is on the non-financial statement sections of the annual reports[133]. The pre- and post-IFRS adoption annual reports were analysed in an attempt to understand the impact of the implementation of the new reporting regime. In other words, the last reports prepared under UK GAAP were compared with the first documents produced under IFRS.

All FTSE 100 firms were examined together with a sample of 'Other' listed firms randomly chosen from those listed firms out with the FTSE 100[134]. The sample initially consisted of 171 companies, 33 firms were excluded from this figure for reasons set out in Table 5.1 resulting in a final sample of 138. An analysis of Table 5.1 reveals that firms were excluded from the sample due to either: (i) a change in ownership status; or, (ii) the non-availability of data.

[133] The financial statement section of the annual report was not considered for the purposes of the content analysis survey because this section is a mandatory requirement under both IFRS and UK GAAP, where the content and layout is specified by the relevant standard within each framework. Therefore, all companies will be impacted by the same changes in disclosure, if any, within this section and so it was decided that this section would be excluded given it would not be expected to offer any further insights about the changes brought about by the new reporting regime between the companies surveyed.

[134] A listing of the sample companies is included in Appendix 5.1.

Table 5.1: Sample Details

Initial sample	171
Companies excluded:	
Data unavailable	14
Change in ownership status (mergers, de-listings, in administration, etc,)	19
Final content analysis sample	138

Note: This table provides basic information relating to the sample companies.

It is common practice in content analysis studies to use pre-samples when attempting to formulate the set of categories to be employed for analysing the main sample (Krippendorff, 2004). Preferably, such pre-samples should be gathered from the same population used for the main sample. However, as all the FTSE 100 companies whose annual reports were obtained are included in the study, an additional sample of FTSE Other companies (i.e. other than those included in the main sample) were sought for this purpose. This pre-sample served as a guide in the development of the categorisation to be employed in the content analysis process.

5.2.2 Sampling Unit

As Chapter 4 indicated, an important stage when undertaking any form of content analysis is deciding which documents are to be used for observing and collecting data (Krippendorff, 1980; Unerman, 2000). The annual report was used as the sampling unit for the present analysis because: (i) the accounting treatments and disclosures presented in the annual report are targeted by accounting regulations such as IFRS; and, (ii) it is regarded as the primary form of corporate communication given its use by various stakeholders as the single most important source of particular information and its widespread distribution (Adams and Harte, 1998; Unerman, 2000). Consequently, the perception of the organisation may be heavily influenced by this document (Hines, 1991). Tilt (1994) claimed that the importance of annual reports

was attributable to the high level of credibility they afford to the information provided within them. Therefore, the first annual report produced by each company in accordance with IFRS following the implementation of the new reporting regime, and the last report provided prior to the conversion to International GAAP were used for the current analysis.

5.2.3 Coding Unit

The coding unit is the method used to capture and measure each relevant disclosure (Krippendorff, 1980; Unerman, 2000). Previous content analysis studies have used a number of different coding units: number of words (Deegan and Rankin, 1996; Neu et al., 1998), number of sentences (Hackston and Milne, 1996; Tsang, 1998), proportion of a page (Gray et al., 1995b; O'Dwyer and Gray, 1998), and percentage of a document (Gray et al., 1995b). The debate regarding the preferred coding unit to be applied in content analysis was summarised by Milne and Ardler (1998); they contended that the most suitable coding unit was the proportion of a page devoted to a particular issue. They argued that this indicated the amount of space given to the topic and therefore the relative importance of that topic to those who produced the document (Milne and Ardler, 1998). This coding unit was therefore used in the current study[135]. Several difficulties have been highlighted when this measure is employed as the coding unit: typeface size, use of graphics and blank parts of a page (Unerman, 2000). However, information provided in the form of tables and graphics is considered by this coding unit; if information were measured in terms of words or sentences, measurement of disclosures of this nature would prove difficult. Additionally, a key assumption of content analysis is that the volume of disclosure

[135] To facilitate a relative measure – the percentage of the annual report devoted to IFRS-related disclosure – to be used, information concerning the number of pages in each annual report was also noted.

signifies the relative importance of a particular issue (Krippendorff, 1980; Unerman, 2000); therefore it would seem inappropriate to omit disclosures allocated to anything other than words and numbers.

5.2.4 Categories of Disclosure

Before the content analysis of the sample companies' annual reports could be undertaken, a detailed review of the literature was conducted (See Chapter 2). Several major areas of significance for firms implementing the new IFRS reporting regime became apparent as a result of this review. These gave rise to the following categorisations selected as the basic structure for the content analysis: (i) factual information; (ii) details about cost of implementation; (iii) information about the general impact of implementation; (iv) news about progress to date; (v) operational and strategic decisions taken by management; (vi) details about the implementation and impact of individual standards; and, (vii) general other. It was considered that these key issues would be the primary focus of any discussion of IFRS-related disclosures by companies in their reporting practice. Additionally, an eighth category was included to determine the total disclosures devoted to IFRS information presented by the sample firms. Appendix 5.2 sets out a full list of the decision rules used for the analysis with respect of the categorisations.

Further classifications were undertaken concerning the type of disclosure presented by the sample firms. The first supplementary classification related to the nature of disclosures provided – whether narrative or numerical. The second concerned whether disclosures were *auditable*; in other words, whether it would be possible to confirm the statements presented if given access to the organisation. The professional notion

of audit is different from this evaluation of auditability, however previous content analysis surveys have employed this classification (Gray et al., 1995b; Dunne et al., 2003). Third, a *news* categorisation which recorded whether a disclosure was *good, bad* or *neutral* from the viewpoint of the organisation was initially used, however this category, together with the auditable categorisation, were excluded from the subsequent analysis on the grounds that most of the information documented was found to be in compliance with the standards and thus auditable and neutral in its stance. Therefore, these categorisations were regarded as less relevant for the purposes of the current analysis. Finally, the location and page number of the disclosure within the annual report was recorded; any additional information was also noted in a memo field.

5.2.5 IFRS Data Coding

During the pre-analysis stage the researcher coded the pre-analysis sample of annual reports. Consideration of the results of this exercise prompted some refinement of the decision rules[136]. Adjustments to categorise disclosures that exhibited an overlap of content, or to clarify the coder's decisions, were necessary. For example, the pre-analysis stage identified several instances where information about particular subjects was closely related. One such instance was particularly evident with regard to discussions pertaining to financial instruments and their relevant standards: IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement.* The disclosure requirements for companies who use financial instruments are outlined in IAS 32 while the measurement and valuation requirements of such activities are detailed in IAS 39.

[136] One of the supervisors repeated this exercise for the pre-sample firms to ensure that the coding procedure was appropriate and that any refinements to the decision rules were justified.

From the pre-analysis disclosures, it became apparent that most of the pre-sample companies presented information required by these standards together; therefore, the researcher would have faced great difficulties attempting to allocate the information provided between the two standards. The decision was taken for the purposes of the content analysis to categorise this information together. In addition, disclosures relating to IFRS 7 *Financial Instruments: Disclosures* were presented by selected sample companies; applicable for annual periods beginning on or after 1 January 2007, this standard consolidates and expands on a number of existing disclosure requirements and adds some new disclosures in relation to financial instruments (PwC, 2007d). Therefore, the decision was made to add this standard to the other financial instruments standards for the content analysis.

Similarly, disclosures required by IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* were grouped together by several companies; thus, these standards were analysed together when such instances occurred. Further, the standards IAS 36 *Impairment of Assets*, IAS 38 *Intangible Assets* and IFRS 3 *Business Combinations* regulate intangible assets and goodwill among other elements of the financial statements and therefore this information was also grouped together.

All of the 276 (138 pre and post-IFRS) annual reports and accounts were coded in accordance with the detailed decision rules established during the pre-analysis phase. A clear A4 acetate template[137] split into one hundredths of a page (25 rows and 4 columns of equal height and width respectively) was used to measure disclosure quantities (see Appendix 5.3). The number of cells on the grid consumed by the

[137] A standard A4 margin was used in the template.

relevant disclosure constituted the volume of information recorded; any blank parts of a page were taken as part of the statement[138]. A specifically designed record sheet for each annual report (see Appendix 5.4) was then used to record the disclosures relating to each category detailed in the decision rules. An Excel spreadsheet was subsequently employed to transfer the data gathered from the completed record sheets which facilitated further analysis and aided statistical manipulation. This statistical analysis was performed using Minitab. Market listing and industry sector background data on the sample companies was obtained in order to conduct tests to identify any correlations between the information and the amount of IFRS-related disclosures[139].

5.3 Results

This section of Chapter 5 reports on the results of the content analysis of IFRS disclosures contained in corporate annual reports. The discussion of the results is divided into six sections: changes in the physical size of the annual reports (5.3.1); disclosure trends evident in the total sample (5.3.2); disclosure by market listing (5.3.3); disclosure by sector (5.3.4); analysis by nature of disclosure (5.3.5); analysis by location of disclosure (5.3.6); and a breakdown of the information provided by individual standard (5.3.7).

5.3.1 Changes in the Size of the Annual Report

As discussed in Chapter 2, a number of studies have recorded an increase in the physical size of financial statements produced under the IFRS reporting regime (Accountancy Age, 2005a; Financial Director, 2006; FRC, 2006). For example, a

[138] This follows the argument provided by Gray et al. (1995b) that blank parts were included as part of the design outline of a page and therefore were part of the communicative process.
[139] Market listing information was gathered from FTSE and the industry information was based on the Industry Classification Benchmark system (ICB).

study by Ernst and Young (2006) found an increase of up to 30 per cent in the length of post-IFRS adoption annual reports with an average of 65 pages. Appendix 5.5 details the total number of pages of both the pre- and post-IFRS annual reports for each of the sample firms with the mean number of pages and the average percentage difference also shown. Table 5.2 below outlines a summary of the information contained in Appendix 5.5 providing the total number of pages of both the pre- and post-IFRS annual reports split by market listing and for the total sample with the mean number of pages and the average percentage difference for this split and for the total also provided.

Table 5.2: Summary of Total Number of Pages Pre- and Post-IFRS

SE Listing	Number of Companies	Total Pages Pre	Total Pages Post	Mean Absolute Difference	Mean Percentage Difference	P-Value
FTSE 100	90	11709	14427	30.20	28.36	0.00
FTSE Other	48	2955	3829	18.21	31.14	0.00
Total	138	14664	18256	26.03	29.33	0.00

Note: This table provides summary details of the sample and the total number of pages analysed for this sample.

An analysis of Appendix 5.5 reveals that the majority of the sample firms exhibited a significant increase in the number of pages in their annual reports following the changeover to the new reporting regime. The summary provided in Table 5.2 shows that the mean increase in the absolute number of pages was 26.03 pages, and the average percentage increase in number of pages was 29.33 per cent. The company with the largest increase in number of pages following the conversion was Prudential with 114 extra pages included, although this figure did not represent the highest percentage change between the sample periods; that accolade went to British Sky Broadcasting Group with a percentage increase of 131.17 per cent compared with the figure for Prudential of 66.28 per cent.

Eleven of the 138 companies surveyed recorded a decrease in annual report size, with Whitebread showing the highest decrease in both the absolute difference in the number of pages (-27) and the percentage change (-21.26 per cent). An interesting point to note is that all eleven firms which exhibited a decrease in annual report size were FTSE 100 companies despite the assumption that these firms would be more likely to face extensive disclosure requirements as a result of the conversion to IFRS reporting; perhaps, they had already disclosed IFRS information before 2005 resulting in an increase in the size of their pre-IFRS report.

In addition, Table 5.2 reveals that, although the mean absolute difference in number of pages was greater for FTSE 100 firms (30.20) than their FTSE Other counterparts (18.21), the FTSE Other companies exhibited a larger percentage increase in number of pages (31.14 per cent) in comparison to the FTSE 100 companies (28.36 per cent). A t-test of the null hypothesis that these percentage differences in the length of the annual report were not statistically different from zero was rejected for all companies and for each type of firm; the p-values were all less than 0.05.

5.3.2 IFRS Disclosure by Category

Tables 5.3 and 5.4 detail the level of disclosure related to a discussion of IFRS-related activities provided by UK companies across the seven categories of disclosure. Disclosure was measured in two different ways: the number of absolute pages devoted to IFRS was counted and reported in Table 5.3, while the percentage of the annual report relating to IFRS expressed as a fraction of the overall size of the annual report was summarised in Table 5.4. Each table has two panels where the first presents the

mean values and the second displays the median figures. Columns two and three of both tables show the level of disclosure both before and after the introduction of IFRS respectively. The final columns in each table display the difference in disclosure quantity and the p-value, (which tests the null hypothesis that the average difference in disclosure is zero).

A number of points emerge when analysing these tables. First, the actual volume of IFRS-related disclosure information is relatively small prior to the adoption of the new reporting regime. The mean (median) number of pages was only 1.7600 (0.8350) pre-IFRS adoption; the mean (median) percentage of the annual report dedicated to this issue was 1.4590 per cent (0.8100 per cent) in the same period. Second, there is a significant increase in the total disclosure quantity after the implementation of IFRS. For example, Panel A of Table 5.3 reports a substantial rise from 1.7600 pre-IFRS adoption to 13.1780 post-adoption in the total mean number of pages disclosed. In addition, the mean percentage of the annual report increased from 1.4590 per cent to 9.8220 per cent over the IFRS transition period according to Table 5.4; indeed the average differences of 11.4180 in Table 5.3 and 8.3630 per cent in Table 5.4 were significant at the 5 per cent level given that the p-value is less than 0.05. Since the introduction of the new reporting regime, such increases in IFRS disclosures included in the annual reports of UK companies were anticipated. Chapter 2 indicated that the number of disclosure requirements necessary under IFRS was approximately double the amount previously required under UK GAAP (Ernst and Young, 2006); the extent of the disclosure increase is even more pronounced according to the results for the UK companies examined in the current analysis.

Table 5.3: Disclosure by Category – Number of Pages

Panel A – Means

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Factual information	0.3161	1.0090	0.6848	0.0000
Cost of implementation	0.0093	0.0164	0.0071	0.0320
General impact of implementation	0.1258	0.4097	0.2839	0.0000
Progress to date	0.0741	0.0264	-0.0477	0.0000
Operational & strategic decisions taken by management	0.0117	0.0067	-0.0050	0.5000
Implementation and impact of individual standards	1.2230	11.7080	10.4850	0.0000
General other	0.0000	0.0102	0.0641	-
TOTAL	1.7600	13.1780	11.4180	0.0000

Panel B – Medians

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Factual information	0.2150	0.8900	0.6750	0.0000
Cost of implementation	0.0000	0.0000	0.0000	0.0183
General impact of implementation	0.0600	0.2250	0.1650	0.0000
Progress to date	0.0500	0.0000	-0.0500	0.0000
Operational & strategic decisions taken by management	0.0000	0.0000	0.0000	0.9147
Implementation and impact of individual standards	0.3800	9.8950	9.5150	0.0000
General other	0.0000	0.0000	0.0000	-
TOTAL	0.8350	11.2200	10.3850	0.0000

Notes: This table shows the IFRS information measured in number of pages of the annual report provided by the sample companies by disclosure category. Panel A presents the mean figures and Panel B details the median amounts for this information across the seven disclosure categories. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

Third, although an increase in total quantities of disclosure was found irrespective of the measure used, this result disguises a degree of variation evident among the categories of disclosure. For example, the *Progress to date* and *Operational and strategic decisions* disclosure categories exhibited a decrease in disclosure quantity following the conversion to International GAAP. Such reductions were expected given that most operational and strategic level preparations would have been planned before the change in the reporting regime was implemented. Indeed, research has shown that many listed companies were preparing for the transition to IFRS several years prior to their adoption (Aisbitt and Walton, 2005). By contrast, the majority of

the total disclosure increases in both Table 5.3 and Table 5.4 related to the *Implementation and impact of individual standards* category. The mean number of pages in this category rose from 1.2230 to 11.7080 in the sample period. Such a significant increase is probably due to the requirement to prepare financial statements under a new set of standards as part of the transition to the IFRS reporting regime.

Table 5.4: Disclosure by Category – Percentage of Annual Report

Panel A – Means

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Factual information	0.2802	0.8413	0.5611	0.0000
Cost of implementation	0.0065	0.0126	0.0061	0.0140
General impact of implementation	0.1137	0.2885	0.1748	0.0000
Progress to date	0.0764	0.0193	-0.0571	0.0000
Operational & strategic decisions taken by management	0.0091	0.0036	-0.0055	0.2570
Implementation and impact of individual standards	0.9730	8.6500	7.6770	0.0000
General other	0.0000	0.0058	0.0058	-
TOTAL	1.4590	9.8220	8.3630	0.0000

Panel B – Medians

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Factual information	0.2083	0.7536	0.5453	0.0000
Cost of implementation	0.0000	0.0000	0.0000	0.0162
General impact of implementation	0.0678	0.1939	0.1261	0.0000
Progress to date	0.0541	0.0000	-0.0541	0.0000
Operational & strategic decisions taken by management	0.0000	0.0000	0.0000	0.9105
Implementation and impact of individual standards	0.3410	8.3190	7.9780	0.0000
General other	0.0000	0.0000	0.0000	-
TOTAL	0.8100	9.5960	8.7860	0.0000

Notes: This table shows the IFRS information measured as a percentage of the annual report provided by the sample companies by disclosure category. Panel A presents the mean figures and Panel B details the median amounts for this information across the seven disclosure categories. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

Similarly, a further point worth highlighting relates to the small increase in mean number of pages of 0.0071 in the *Cost of implementation* disclosure category. For the vast majority of sample firms who presented information within this disclosure category, the information related to the IFRS transition costs incurred from the use of

further auditor services; this was predominately disclosed within the notes to the accounts section of the annual report. Given the transitory nature of such implementation costs (Jermakowicz and Gornik-Tomaszewski, 2006), it is likely that these costs were only incurred, and therefore disclosed, in the first year of the conversion to IFRS reporting; disclosure increases under this category may therefore have been temporary in nature.

Fourth, as reported earlier, the median results in Panel B of Tables 5.3 and 5.4 confirm the mean findings of Panel A. However, the median total disclosure pre-IFRS adoption was only about 50 per cent of its mean-figure counterpart although the post-IFRS amounts were more similar. For example, the median absolute number of pages of total disclosure before the implementation was 0.8350 compared with the corresponding mean figure of 1.7600 while the relative (percentage of annual report) total disclosure figures were similar in size. This finding implies a degree of variability in disclosure across the sample companies before the implementation of IFRS, with a small number of companies driving up the mean values by publishing relatively large amounts of IFRS-related information. For example, there were several "big disclosure" companies prior to the adoption of IFRS; these included Scottish Power (18.79 pages) and Tate & Lyle (12.66 pages)[140]. In fact the five biggest disclosers accounted for over a quarter of all IFRS-related information published before the transition to International GAAP for the sample firms; these outliers may have been preparing early for the changeover to IFRS and disclosing this news in the notes to the pre-IFRS financial statements. In addition, the executives of these firms may have been advising shareholders of the likely consequences of IFRS adoption on

[140] See Appendix 5.5 for details of the total disclosure in number of pages of all sample companies prior to and after the introduction of IFRS.

subsequent annual reports. Perhaps this variability in disclosure was reduced following the conversion to IFRS since the mean and median figures more closely approximate one another.

Fifth, there is a noticeable increase in the *General impact of implementation* disclosure category during the sample period. The mean number of pages for this category of disclosure increased from a pre-IFRS figure of 0.1258 to a post-IFRS amount of 0.4097; the increase is statistically significant at the 5 per cent level since the p-value was less than 0.05. As Chapter 2 indicated, the transition to International GAAP was criticised by a number of researchers because implementation guidance was lacking and uniform interpretations were not forthcoming from standard setters (Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006); only a few companies were quantifying the effects of IFRS prior to adoption (Accountancy, 2005d). Such criticisms may explain the disclosure increase in this category post-adoption as companies were better able to quantify and discuss the impact of the transition to IFRS; prior to full adoption, they may not have been aware of the likely impacts of the implementation process on the financial statements.

Finally, the analysis in Table 5.4 supports the findings in Table 5.3. Therefore, the impact of IFRS was both large and statistically significant irrespective of whether disclosure is measured in absolute or relative terms. However, it is worth pointing out that the overall increase in the percentage of annual report devoted to IFRS disclosure is not as large as the rise in total number of pages devoted to IFRS. Therefore, although there was more information about IFRS in absolute number of pages after the changeover to International GAAP, there was not an equal or greater percentage

of the annual report devoted to this topic; thus some of the physical increase in the size of the annual report concerned issues other than those related to IFRS.

5.3.3 Disclosure by Market Listing

Previous content analysis studies (e.g. Dunne et al., 2003) have divided a UK sample of firms by market listing in order to ascertain whether any pattern exists in terms of the amount of disclosure present in relation to the markets where a share is quoted. These authors have hypothesised that disclosures will be larger and more detailed for the biggest firms included in the FTSE 100 list as these firms: (i) have the largest analyst following; (ii) have a greater preponderance of international investors; and, (iii) face pressure to divulge details about their activities in order to maintain their inclusion in the FTSE index. The current sample consists of 90 companies from the FTSE 100 and a random sample of 48 FTSE Other firms and Table 5.5 shows the total disclosure in number of pages across all seven disclosure categories for these two market groupings. An inspection of this table highlights a number of important findings.

First, the results produced following a disaggregation by market are consistent with the aggregate findings reported in Section 5.3.2. The introduction of IFRS was associated with an increase in the volume of IFRS-related information across the two market groupings. The number of pages devoted to IFRS-related information increased from a mean (median) of 2.3390 (1.2350) to 15.9900 (14.3900) for FTSE100 listed companies. For FTSE Other firms the number of pages rose from a mean (median) of 0.6740 (0.2700) to 7.9150 (7.2800) post-adoption. Second, the total

Table 5.5: Disclosure by Market Listing – Number of Pages

Panel A – Means

	FTSE 100				FTSE Other			
Type of Disclosure	**Pre IFRS**	**Post IFRS**	**Difference**	**P-Value**	**Pre IFRS**	**Post IFRS**	**Difference**	**P-Value**
Factual information	0.4069	1.0536	0.6467	0.0000	0.1458	0.9023	0.7565	0.0000
Cost of implementation	0.0139	0.0200	0.0061	0.1820	0.0008	0.0098	0.0090	0.0170
General impact of implementation	0.1557	0.5226	0.3669	0.0000	0.0698	0.1981	0.1283	0.0020
Progress to date	0.0844	0.0339	-0.0505	0.0000	0.0548	0.0123	-0.0425	0.0010
Operational & strategic decisions taken by management	0.0174	0.0099	-0.0075	0.5050	0.0008	0.0006	-0.0002	0.8420
Implementation and impact of individual standards	1.6600	14.3300	12.6700	0.0000	0.4017	6.7920	6.3903	0.0000
General other	0.0000	0.0157	0.0157	-	0.0000	0.0002	0.0002	-
TOTAL	2.3390	15.9900	13.6510	0.0000	0.6740	7.9150	7.2410	0.0000

Panel B – Medians

	FTSE 100				FTSE Other			
Type of Disclosure	**Pre IFRS**	**Post IFRS**	**Difference**	**P-Value**	**Pre IFRS**	**Post IFRS**	**Difference**	**P-Value**
Factual information	0.2900	0.9300	0.6400	0.0000	0.1100	0.8500	0.7400	0.0000
Cost of implementation	0.0000	0.0000	0.0000	0.0970	0.0000	0.0000	0.0000	0.0812
General impact of implementation	0.0850	0.3350	0.2500	0.0000	0.0350	0.1150	0.0800	0.0000
Progress to date	0.0700	0.0200	-0.0500	0.0000	0.0400	0.0000	-0.0400	0.0000
Operational & strategic decisions taken by management	0.0000	0.0000	0.0000	0.8976	0.0000	0.0000	0.0000	1.0000
Implementation and impact of individual standards	0.7300	12.9550	12.2250	0.0000	0.0950	5.9900	5.8950	0.0000
General other	0.0000	0.0000	0.0000	-	0.0000	0.0000	0.0000	-
TOTAL	1.2350	14.3900	13.1550	0.0000	0.2700	7.2800	7.0100	0.0000

Notes: This table presents the IFRS information measured in number of pages of the annual report by market listing. Panel A details the mean figures and Panel B shows the median amounts for this information across the seven disclosure categories. In both panels, the left hand side details the levels of disclosure provided by FTSE 100 companies, while the levels of disclosure presented by FTSE Other firms are shown on the right hand side. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

mean and median disclosure figures for FTSE 100 companies were significantly larger than those for FTSE Other firms pre- and post-implementation of IFRS. In addition, this finding is consistent with the conclusions of researchers such as Dunne et al. (2003) that firms in the FTSE 100 group tend to increase disclosures following the introduction of new reporting requirements such as those in FRS 13[141].

Third, consistent with the results presented for the total sample, the increase in disclosure between the different markets was not spread equally across the seven disclosure categories. As previously noted, disclosure quantity decreased in the *Progress to date* and *Operational and strategic decisions* categories for both FTSE 100 and FTSE Other groups. In addition, the *Implementation and impact of individual standards* category accounted for the vast majority of the total disclosure increases among both groups of firms; the mean difference in the number of pages of disclosure for the FTSE 100 companies was 12.6700 and for the FTSE Other firms was 6.3903 over the sample period.

Fourth, the total mean disclosures both before (0.0008) and after (0.0098) IFRS implementation for FTSE Other companies in the *Cost of implementation* disclosure category equate to approximately half the corresponding quantities for FTSE 100 companies (0.0139 and 0.0200). However, the literature has indicated that the average cost of producing financial statements under IFRS was greater for FTSE Other companies than their FTSE 100 counterparts; therefore, the difference in disclosure levels may mask the true impact of IFRS in terms of the implementation costs between the groupings (PwC, 2007c).

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[141] Specifically, Dunne et al. (2003) found that FTSE 100 firms increased their disclosure of derivative-related information more following FRS 13 than their FTSE Other or AIM counterparts.

Fifth, although both the mean and median results indicate an increase in disclosure, the FTSE 100 median total disclosure pre-IFRS adoption was just over half its corresponding mean quantity. For the FTSE Other sample firms, the median disclosure figure was only 40 per cent of the equivalent mean amount. These findings indicate that the variability in disclosure across the total sample was also apparent after disaggregating the sample companies by market listing. This variability in disclosure may have decreased given the similar mean and median amounts exhibited post-implementation.

Finally, an analysis based on the percentage of annual reports devoted to IFRS disclosures was also performed for each market (see Appendix 5.6). This analysis confirms that the impact of IFRS was significant irrespective of whether the results are measured using both the number of pages and the percentage of annual report across both UK markets.

5.3.4 Disclosure by Sector

A sectoral analysis was also undertaken for the sample of UK firms to determine if there were predominantly large (or small) disclosers in particular sectors. Chapter 2 had highlighted that firms in the financial sector – especially banks and insurance firms – might have been severely affected by some of the new IFRS standards (Ernst and Young, 2006; PwC, 2006a). A breakdown by industry could also determine if differences in disclosure levels were inherent between the different sectors for the various categories of disclosure being examined.

Table 5.6: Disclosure by Sector – Number of Pages

Panel A – Means

Sector	No.	Pre IFRS	Post IFRS	Difference	P-Value
Oil & Gas	4	2.0300	19.7100	17.6800	0.0200
Basic Materials	8	1.7080	14.9400	13.2320	0.0010
Industrials	25	0.8990	10.5380	9.6390	0.0000
Consumer Goods	15	3.5200	13.7400	10.2200	0.0000
Health Care	10	2.2370	11.7000	9.4630	0.0000
Consumer Services	32	1.4340	10.5250	9.0910	0.0000
Telecommunications	5	1.6080	13.8800	12.2720	0.0300
Utilities	8	3.5600	18.7100	15.1500	0.0010
Financials	26	1.4720	16.8800	15.4080	0.0000
Technology	5	0.5480	7.7800	7.2320	0.0090

Panel B – Medians

Sector	No.	Pre IFRS	Post IFRS	Difference	P-Value
Oil & Gas	4	0.8800	18.4700	17.5900	0.0304
Basic Materials	8	1.6850	13.0200	11.3350	0.0009
Industrials	25	0.6500	8.8900	8.2400	0.0000
Consumer Goods	15	1.2800	12.9400	11.6600	0.0003
Health Care	10	2.2200	13.3200	11.1000	0.0003
Consumer Services	32	0.7350	9.0100	8.2750	0.0000
Telecommunications	5	0.6700	14.9800	14.3100	0.0122
Utilities	8	1.3300	17.0700	15.7400	0.0039
Financials	26	0.7800	12.2200	11.4400	0.0000
Technology	5	0.3900	7.3200	6.9300	0.0122

Notes: This table shows the IFRS information measured in number of pages of the annual report provided by the sample companies by sector. Panel A presents the mean figures and Panel B details the median amounts for this information across the ten sector categories. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

In line with the results reported earlier, a visual inspection of Table 5.6 reveals that the introduction of IFRS was associated with an increase in the volume of IFRS-related disclosure across all sectors. For example, the number of pages devoted to this topic increased from a mean (median) of 2.0300 (0.8800) to 19.7100 (18.4700) for companies in the Oil & Gas industry. This pattern of disclosure was also evident for the Financials sector and among Utilities firms where the mean (median) difference was 15.4080 (11.4400) and 15.1500 (15.7400) pages respectively. Furthermore, no sizeable difference exists between the mean and median figures across the two base dates. For example, the mean increase in the number of pages for the Technology sector was 7.2320 while its median counterpart was 6.9300. This indicates that the

outlier effect previously reported, whereby a select few of the sample firms accounted for a sizeable proportion of the change in an individual case, does not affect all of the sector-based results.

5.3.5 Nature of Disclosure

A dissagregation of the data between narrative and numerical disclosure is provided in Table 5.7[142]. The results suggest that the largest increase in the total number of pages of IFRS disclosure is evident with the narrative information. For example, the total mean difference for narrative disclosure is 8.9530, whereas the corresponding figure for numerical information is 2.4898. The majority of the numerical disclosures provided by the sample companies related to the financial impact of the adoption of particular IFRS standards; for example, Reed Elsevier reported that:

> "The charge under IFRS 2 in 2004 is £48m/€71m higher than the £11m/€16m charge under previous GAAP."
>
> (Reed Elsevier Annual Reports and Financial Statements 2005, p. 99)

Similarly, Sab Miller reported that:

> "The application of IAS 32 and IAS 39 has resulted in increases in total assets of US$6 million and total liabilities of US$1 million, giving an increase in net assets of US$5 million as at 1 April 2005."
>
> (SABMiller plc Annual Report 2006)

[142] As previously highlighted, the numerical disclosure does not include information contained within the financial statements.

Table 5.7: Narrative versus Numerical – Number of Pages

Panel A – Means

Type of Disclosure	Narrative Pre IFRS	Narrative Post IFRS	Narrative Difference	Narrative P-Value	Numerical Pre IFRS	Numerical Post IFRS	Numerical Difference	Numerical P-Value
Factual information	0.3137	1.0009	0.6872	0.0000	0.0024	0.0000	-0.0024	-
Cost of implementation	0.0080	0.0048	-0.0032	0.2300	0.0023	0.0116	0.0093	0.0000
General impact of implementation	0.0806	0.1684	0.0878	0.0000	0.0449	0.2413	0.1964	0.0000
Progress to date	0.0743	0.0264	-0.0479	0.0000	0.0000	0.0000	0.0000	-
Operational & strategic decisions taken by management	0.0117	0.0062	-0.0055	0.4630	0.0000	0.0004	0.0004	-
Implementation and impact of individual standards	1.0760	9.3040	8.2280	0.0000	0.1466	2.4280	2.2814	0.0000
General other	0.0005	0.0058	0.0053	0.0340	0.0000	0.0043	0.0043	-
TOTAL	1.5640	10.5170	8.9530	0.0000	0.1962	2.6860	2.4898	0.0000

Panel B – Medians

Type of Disclosure	Narrative Pre IFRS	Narrative Post IFRS	Narrative Difference	Narrative P-Value	Numerical Pre IFRS	Numerical Post IFRS	Numerical Difference	Numerical P-Value
Factual information	0.2100	0.8900	0.6800	0.0000	0.0000	0.0000	0.0000	-
Cost of implementation	0.0000	0.0000	0.0000	0.6916	0.0000	0.0000	0.0000	0.0002
General impact of implementation	0.0450	0.1050	0.0600	0.0000	0.0000	0.0650	0.0650	0.0000
Progress to date	0.0500	0.0000	-0.0500	0.0000	0.0000	0.0000	0.0000	-
Operational & strategic decisions taken by management	0.0000	0.0000	0.0000	0.8345	0.0000	0.0000	0.0000	-
Implementation and impact of individual standards	0.3350	7.3500	7.0150	0.0000	0.0000	1.5050	1.5050	0.0000
General other	0.0000	0.0000	0.0000	0.4021	0.0000	0.0000	0.0000	-
TOTAL	0.7800	8.5350	7.7550	0.0000	0.0000	1.6850	1.6850	0.0000

Notes: This table presents the results based in number of pages of IFRS-related information of the disaggregation of IFRS information between narrative and numerical disclosure form. Panel A details the mean figures and Panel B shows the median amounts for this information across the seven disclosure categories. In both panels, the left hand side details the levels of disclosure provided in narrative form, while the levels of disclosure presented in numerical form are shown on the right hand side. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

In addition, a number of sample firms also reported the total financial impact of the changeover on reported results; for example, British American Tobacco stated that:

> "The effect on the profit for the year to 31 December 2004 was an increase of £1,733 million to £2,957 million. This was principally due to £1,262 million in respect of disposal of subsidiaries, £918 million of which was recognised outside of the income statement under UK GAAP and £344 million of which arose from applying IFRS to the transactions. In addition, goodwill is not amortised under IFRS, which added £491 million to the profit."
> (British American Tobacco Directors' Report and Accounts 2005, p. 23)

Further, Hays reported that the impact of the introduction of IFRS,

> "...led to a reduction in operating profit from continuing operations before goodwill amortisation for the year to 30 June 2005 of £(0.9) million."
> (Hays plc Annual Report and Accounts 2006, p. 17)

This finding was in line with prior expectations from the literature since much of the information given related to an explanation of the changes brought about by the transition to the IFRS reporting regime. Presumably, more of the numerical disclosure would have been contained in the Reconciliation Statement that companies had to produce in the first year of their IFRS disclosures; an analysis of the IFRS Reconciliation Statements produced by the sample of companies is undertaken in Chapter 6. Similar results were produced when using the percentage of the annual report devoted to IFRS information as illustrated in Appendix 5.7.

5.3.6 Location of Disclosure

A breakdown of the IFRS disclosures provided by the sample firms according to its location in the annual report was performed to highlight where companies were disclosing IFRS-related information within both the pre- and post-adoption annual reports and to facilitate a comparison in disclosure location between the sample periods. The following categorisations were used for the purpose of determining

location: Chairman's Statement (CH STAT), Financial Director's Review (FD REV), Chief Executive's Review (CE REV), the Operating and Financial Review or equivalent (OFR), Directors' Report (DIR RPT) Corporate Governance (CG), Remuneration Report (RR), Notes to the Accounts including the accounting policies (NTTA)[143], IFRS section (IFRS)[144] and Other (OTHER). Table 5.8 details the total disclosure in terms of the number of pages in the annual report devoted to such disclosures across all ten location disclosure categories.

An inspection of Table 5.8 reveals an increase in disclosure between the sample periods across the ten categories of location. However, the rises for three out of the ten categories (CH STAT, FD REV, CE REV) are not statistically significant given that their p-values are more than 0.05. By far the largest increase in disclosure is attributable to the NTTA section, which contributes 7.4707 to the total disclosure increase of 11.4180. The NTTA category was expected to show a significant rise in disclosure after the implementation of the new reporting regime since these disclosures are required under IFRS in comparison to the pre-adoption NTTA which were prepared under the previous UK GAAP.

The second largest increase in IFRS-related disclosure was in the IFRS location category; the mean rose from a pre-adoption figure of 0.9400 to a post-conversion amount of 3.7000. In light of the change to a new reporting regime, almost the entire sample of companies provided an explanation of the changes and impact of preparing

[143] The NTTA section excludes the Auditor's Report as this was not examined in the current analysis.
[144] The information gathered in the IFRS section related to an explanation of the impact of the change to IFRS reporting and the notes provided explaining the impacts contained within the Reconciliation Statements. In the vast majority of cases, this information was provided as a note in the Notes to the Accounts section, but was analysed separately for the purposes of the current study.

Table 5.8: Disclosure by Location – Number of Pages

Panel A – Means

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Chairman's Statement	0.0135	0.0193	0.0058	0.2570
Financial Director's Review	0.0360	0.0370	0.0010	0.9770
Chief Executives Review	0.0080	0.0123	0.0043	0.4780
Operating & Financial Review	0.5470	1.1200	0.5730	0.0250
Directors' Report	0.0360	0.1770	0.1410	0.0000
Corporate Governance	0.0176	0.0328	0.0152	0.0110
Remuneration Report	0.0180	0.0341	0.0161	0.0180
Notes to the Accounts	0.1170	7.5900	7.4730	0.0000
IFRS	0.9400	3.7000	2.7600	0.0000
Other	0.0280	0.4570	0.4290	0.0000
TOTAL	1.7600	13.1780	11.4180	0.0000

Panel B – Medians

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Chairman's Statement	0.0000	0.0000	0.0000	0.1392
Financial Director's Review	0.0000	0.0000	0.0000	0.6911
Chief Executives Review	0.0000	0.0000	0.0000	0.5363
Operating & Financial Review	0.2650	0.3900	0.1250	0.0338
Directors' Report	0.0000	0.1200	0.1200	0.0000
Corporate Governance	0.0000	0.0000	0.0000	0.0659
Remuneration Report	0.0000	0.0000	0.0000	0.0658
Notes to the Accounts	0.0000	6.5250	6.5250	0.0000
IFRS	0.0000	3.0000	3.0000	0.0000
Other	0.0000	0.1850	0.1850	0.0000
TOTAL	0.8350	11.2200	10.3850	0.0000

Notes: This table shows the IFRS information measured in number of pages of the annual report provided by the sample companies by location. Panel A presents the mean figures and Panel B details the median amounts for this information across the ten disclosure categories of location. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

financial statements under IFRS for the first time. Further, the requirement to produce a Reconciliation Statement in the first year of IFRS implementation adds to the increase in disclosure within this location category as the vast majority of the sample companies presented an explanation of the differences contained within the Reconciliation Statement. A similar explanation can be afforded for the increase in the OFR category where IFRS disclosures more than doubled from 0.5470 to 1.1200. The information provided within this part of the annual report following the conversion to International GAAP was based on the results produced by the IFRS

reported financial statements and included explanatory details about the impact of the new IFRS reported figures. For example, the 2005 Annual Report of Amvescap stated that:

> "The transition to IFRS resulted in the reduction of total shareholder's funds from the U.K. GAAP figure at January 1, 2004 of $208.1 million. This reduction is due primarily to the redenomination of goodwill and management contract intangible assets into the currency of the underlying acquired entities."
>
> (Amvescap 2005 Annual Report, p. 12)

However, the percentage of the annual report devoted to IFRS disclosures in the OFR section (as illustrated in Appendix 5.8) shows a statistically insignificant increase from 0.5060 to 0.604. Therefore, the relative increase in IFRS disclosure is not a true reflection of the absolute disclosure increase within the OFR as reported earlier, suggesting instances whereby the size of the OFR section within the annual report may not have actually changed during the sample period despite the increase in IFRS disclosures prior to and subsequent to the adoption of International GAAP.

The majority of the increase in IFRS disclosure within the DIR RPT concerns the change within the Directors' Responsibility Statement. This statement altered from a presentation with reference to UK GAAP pre-IFRS adoption to being provided on the basis of IFRS following the changeover[145]. For example, Severn Trent disclosed in the Directors' responsibilities section of the Directors' Report that:

> "The directors' have chosen to prepare the financial statements for the group in accordance with International Financial Reporting Standards (IFRS)..."
>
> (Severn Trent Annual Report and Accounts 2006, p. 33)

They then further note that:

[145] The Directors' Responsibility Statement was included within the DIR RPT category in instances where it was presented separately from the Directors' Report.

> "In the case of IFRS financial statements, International Accounting Standard 1 requires that the financial statements present fairly for each financial year the company's financial position, financial performance and cash flows."
> (Severn Trent Annual Report and Accounts 2006, p. 33)

The changes in percentage of annual report devoted to a discussion of IFRS-related issues between the sample periods exhibited a similar trend as the results reported above for the number of pages of disclosure as illustrated in Appendix 5.8, although only four out of the ten categories are statistically significant.

5.3.7 Disclosure by Standard

From the results previously discussed, the largest increase in information between the seven disclosure classifications following the changeover to IFRS was experienced within the *Implementation and impact of individual standards* category. During the content analysis survey, disclosures relating to each IFRS standard were recorded. Table 5.9 displays the number of pages of disclosure pertaining to information relating to the implementation and impact of individual standards.

An examination of Table 5.9 shows that there was a significant increase in total disclosures relating to the implementation and impact of individual standards during the transition to the new reporting regime for the sample firms. The total mean (median) number of pages devoted to a discussion of individual IFRS standards increased from 1.2197 (0.3800) to 11.6660 (9.8500) following the implementation of International GAAP. Chapter 2 indicated that additional disclosure requirements under IFRS compared to previous national GAAP would be significant, particularly for adopting firms in the UK (Ernst and Young, 2006); the significant increase in disclosure reported in relation to IFRS standards appears to confirm this expectation.

In addition, the complexity of the new reporting standards and a lack of implementation guidance and the absence of uniform interpretations forthcoming from the standard setters were identified as key challenges during the transition process (Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006); the findings of the present study appear consistent with these observations as the low level of disclosure included in the pre-IFRS implementation annual reports compared to the post-adoption annual reports for the sample companies perhaps indicate a degree of uncertainty around the impact of the new standards prior to their adoption.

The results in Table 5.9 also show that there were significant increases in the level of disclosure for the majority of the standards listed. Indeed, 26 out of 33 mean differences were significant given the associated p-values were less than 0.05. However, there was a degree of variation inherent in the absolute amounts disclosed between the sample periods. The standards which exhibited the largest increases in disclosure were IAS 32/IAS 39/IFRS 7, IFRS 3/IAS 36/IAS 38, IAS 19, IAS 12 and IFRS 2. This finding supports prior research that attempted to assess the impact of the implementation of IFRS as many of these standards were highlighted as the most significant areas of impact (PwC, 2003; KPMG, 2005; Aisbitt, 2006; BDO, 2006; Ernst and Young, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; PwC, 2006c; BDO, 2007; Harverals, 2007; PwC, 2007a; Stenka and Ormrod, 2007; Horton and Serafeim, 2008).

Table 5.9: Disclosure by Standard - Number of Pages

Standard	MEANS				MEDIANS			
	Pre IFRS	Post IFRS	Diff	P-value	Pre IFRS	Post IFRS	Diff	P-value
IAS 1	0.0251	0.1967	0.1717	0.0000	0.0000	0.1100	0.1100	0.0000
IAS 2	0.0058	0.0972	0.0914	0.0000	0.0000	0.0700	0.0700	0.0000
IAS 7	0.0060	0.1249	0.1188	0.0000	0.0000	0.0800	0.0800	0.0000
IAS 8	0.0023	0.0025	0.0002	0.9270	0.0000	0.0000	0.0000	0.2609
IAS 10	0.0375	0.1580	0.1205	0.0000	0.0000	0.1300	0.1300	0.0000
IAS 11	0.0010	0.0220	0.0210	0.0160	0.0000	0.0000	0.0000	0.0018
IAS 12	0.0975	0.7151	0.6176	0.0000	0.0000	0.5950	0.5950	0.0000
IAS 14	0.0105	0.1441	0.1336	0.0100	0.0000	0.0000	0.0000	0.0000
IAS 16	0.0377	0.4529	0.4152	0.0000	0.0000	0.3050	0.3050	0.0000
IAS 17	0.0264	0.2770	0.2507	0.0000	0.0000	0.2000	0.2000	0.0000
IAS 18	0,0241	0.3490	0.3249	0.0000	0.0000	0.2450	0.2450	0.0000
IAS 19	0.1371	1.2272	1.0901	0.0000	0.0400	0.8450	0.8050	0.0000
IAS 20	0.0004	0.0140	0.0136	0.0000	0.0000	0.0000	0.0000	0.0000
IAS 21	0.0376	0.4243	0.3867	0.0000	0.0000	0.4000	0.4000	0.0000
IAS 23	0.0017	0.0420	0.0403	0.0000	0.0000	0.0000	0.0000	0.0000
IAS 24	0.0000	0.0782	0.0782	-	0.0000	0.0000	0.0000	-
IAS 26	0.0000	0.0000	0.0000	-	0.0000	0.0000	0.0000	-
IAS 27	0.0301	0.2901	0.2601	0.0000	0.0000	0.2500	0.2500	0.0000
IAS 29	0.0010	0.0008	-0.0002	0.8520	0.0000	0.0000	0.0000	0.5708
IAS 30	0.0000	0.0000	0.0000	-	0.0000	0.0000	0.0000	-
IAS 33	0.0133	0.0557	0.0424	0.0000	0.0000	0.0000	0.0000	0.0000
IAS 34	0.0000	0.0000	0.0000	-	0.0000	0.0000	0.0000	-
IAS 37	0.0140	0.2922	0.2782	0.0000	0.0000	0.1750	0.1750	0.0000
IAS 40	0.0036	0.0586	0.0549	0.0000	0.0000	0.0000	0.0000	0.0000
IAS 41	0.0046	0.0122	0.0076	0.2200	0.0000	0.0000	0.0000	0.1953
IFRS 1	0.0256	0.1947	0.1691	0.0000	0.0000	0.1700	0.1700	0.0000
IFRS 2	0.1233	0.5792	0.4559	0.0000	0.0200	0.4800	0.4600	0.0000
IFRS 4	0.0325	0.2696	0.2371	0.0070	0.0000	0.0000	0.0000	0.0092
IFRS 5	0.0077	0.1669	0.1592	0.0000	0.0000	0.0050	0.0050	0.0000
IFRS 6	0.0008	0.0336	0.0328	0.0230	0.0000	0.0000	0.0000	0.0300
IAS 28/IAS 31	0.0407	0.2420	0.2014	0.0000	0.0000	0.1600	0.1600	0.0000
IAS 32/IAS 39/IFRS 7	0.3039	3.7373	3.4334	0.0000	0.0450	2.5250	2.4800	0.0000
IAS 36/IAS 38/IFRS 3	0.1681	1.1281	1.2398	0.0000	0.0300	1.2400	1.2100	0.0000
TOTAL	1.2197	11.6660	10.4463	0.0000	0.3800	9.8500	9.4700	0.0000

Notes: This table presents the breakdown of the IFRS information provided by the sample companies by standard. This information is based on the number of pages of IFRS-related information in the annual report provided by companies across the seven disclosure categories. The left hand side details the mean levels of disclosure, while the median levels of disclosure are shown on the right hand side. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

The largest increase in disclosure following the changeover to the new reporting regime is attributable to the IAS 32/IAS 39/IFRS 7 group of derivatives-related standards; the mean number of pages rose from 0.3039 to 3.7373. As highlighted in Chapter 2, most concerns regarding a possible decline in the quality of financial

statements produced under IFRS have focused on the financial instruments standards (Fearnley and Hines, 2002; PwC, 2006a, PwC, 2007a). For example, Aisbitt and Walton (2005) found in a study of the 2003 annual reports of FTSE 100 companies, financial instruments was the most frequently cited (78 per cent of cases) issue that was expected to have the most impact. Further, Ernst and Young (2006) analysed 65 FT Global 500 firms and noted that 9 per cent of financial assets and 6 per cent of financial liabilities values were concerned with derivatives disclosed on the balance sheet for the first time.

IFRS 3/IAS 36/IAS 38 provided the second largest increase in disclosure with a mean increase reported of 1.2398 pages following the changeover. Chapter 2 indicated that these standards were among those expected to significantly impact adopting companies given they introduce key changes particularly in relation to the treatment of goodwill and acquired intangible assets (KPMG, 2005; BDO, 2006; Ernst and Young, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; PwC, 2006c; BDO, 2007; ICAEW, 2007; PwC, 2007a).

The standard that exhibited the third largest increase in disclosure related to IAS 19 *Employee Benefits*, with a rise in mean disclosure of 1.0901 between the sample periods. Although it has been noted that, since the recent UK standard on pension accounting FRS 17, the figures produced would be quite similar to those measured under IAS 19 (Aisbitt and Walton, 2005), this standard was frequently cited as another major problematic standard in addition to the financial instruments standards referred to previously (Fearnley and Hines, 2002; Cairns, 2004; Aisbitt and Walton, 2005; Aisbitt, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; KPMG, 2006;

PwC, 2006a; PwC, 2007a; Stenka and Ormrod, 2007). For example, KPMG (2006) found that over half of the UK firms studied reported employee benefits as the most significant adjustment to equity.

A fourth standard which has also shown a large mean increase in disclosure (0.6176) and was also highlighted as a difficult issue is the taxation standard IAS 12 *Income Taxes*. The requirement for full recognition of deferred tax under IAS 12 raised particular concerns, especially for the retail sector (PwC, 2006c). Furthermore, the standard IFRS 2 *Share-Based Payments* revealed a significant mean increase of 0.4559 which supports the findings of Ernst and Young (2006) that the income statement for 90 per cent of firms surveyed contained charges required by this standard where before little disclosure had been provided.

The median results detailed in Table 5.9 largely confirm the findings of the mean results for disclosures relating to the individual IFRS standards; the five standards which exhibited the highest mean increase in disclosure following the transition also reported the largest median increase (IAS 32/IAS 39/IFRS 7, IAS 36/IAS 38/IFRS 3, IAS 19, IAS 12, IFRS 2). Further, the majority of the IFRS standards reported a statistically significant median increase in disclosure post-implementation.

5.4 Conclusion

This chapter has examined the disclosures made by 138 UK-quoted companies prior to and after the introduction of IFRS in January 2005. The results indicate that the implementation of International GAAP had a significant impact on the content of annual reports. There was a large increase in IFRS-related disclosures available in UK

annual reports and this observation holds irrespective of whether IFRS information was measured in actual number of pages disclosed, or the relative measure of the percentage of the annual report devoted to such disclosures. Furthermore, there was a significant increase in the physical size of the annual reports for the vast majority of the firms surveyed. The scale of the impact varied from standard to standard, however the nature and magnitude of the information provided in corporate annual reports has been fundamentally impacted by the introduction of IFRS.

Thus, one of the aims of the standard setters seems to have been achieved as users of UK annual reports were supplied with additional information about these companies. The substantial increase in IFRS information provided by companies in their annual reports following the transition may have informed users about the changes introduced by the new regime and therefore improve their decision making about the impact of IFRS. More specifically, the new disclosures may have revealed whether the changeover had an impact on the sample firms published earnings and reported financial positions and whether underlying business fundamentals of these companies had been affected by the conversion; this may not have been anticipated prior to mandatory adoption given relatively little information about IFRS was disclosed by the sample companies in the annual reports produced in the year before the changeover. In addition, the decisions by users of annual reports may have been affected by the changeover to IFRS because its impact may have varied between companies given the different disclosure levels reported between market listings and industry groupings; the decision whether to invest or de-invest in particular companies located in specific sectors may have been impacted given the changeover did not appear to impact all adopting firms equally.

However, it is acknowledged that the significant increase in volume of IFRS-related disclosures following the adoption of the new regime does not necessarily indicate that the usefulness of annual reports prepared in accordance with the new regime has also increased; indeed, the information contained in corporate financial reports may have become less useful for user decision making under the new standards. Nevertheless, the substantial IFRS-related disclosures provided by the sample companies in their post-adoption financial statements will facilitate an assessment of whether this information aided user decision making; this examination will be conducted in Chapter 7.

Chapter 6 reports the findings of an analysis of the Reconciliation Statements produced upon first-time adoption of IFRS included in the annual report and accounts of adopting companies in the UK. This analysis may inform the findings detailed in the present chapter by indicating whether the significant increase in IFRS-related disclosures reported for the sample of companies are reflected in any significant impact on the reported results of these firms following the transition to the new regime.

Chapter 6

An Analysis of IFRS Reconciliation Statements

Chapter 6 – An Analysis of IFRS Reconciliation Statements

6.1 Introduction

IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires that all EU-listed companies which are adopting IFRS for the first time provide an explanation of how the transition from national GAAP to IFRS impacted on its reported position, financial performance and cash flows. More specifically, adopting companies are required to prepare a reconciliation of both their equity and profit or loss reported under national GAAP to their equity and profit or loss reported in accordance with IFRS. This chapter involves an analysis of these Reconciliation Statements produced upon first-time adoption of IFRS and included in the annual report and accounts of UK quoted companies in 2005. In particular, this analysis examines the impact on both profit and equity as a result of the transition from reporting under UK GAAP to reporting in compliance with IFRS for the first time and determines which individual IFRS standards have contributed toward any impact identified.

This chapter therefore investigates whether the introduction of IFRS has had a material impact on the financial numbers reported by adopting companies in the UK. It compliments the analysis of the previous chapter which focused on the narrative and numerical information supplied in other parts of the company annual reports at the time of IFRS adoption. In particular, Chapter 5 reported a significant increase in disclosures relating to the implementation and impact of individual standards following the adoption of IFRS and the vast majority of the sample of companies presented an explanation of the differences contained within the Reconciliation Statement; an analysis of the Reconciliation Statements produced by the same

companies in this chapter will indicate whether these disclosures reflected any significant impact on the reported results of these firms following the changeover to the new regime. If no sizeable differences in profit and equity are identified between reporting under the different accounting regimes, then any impact of the IFRS-compliant annual reports may simply be due to the new disclosure formats. However, if sizeable differences are found then the international standards that are responsible for these changes can be determined. In particular, the analysis will enable the researcher to investigate whether the standards that were highlighted as problematic for reporting companies during the adoption of IFRS (Aisbitt, 2006; BDO, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; PwC, 2006e; PwC, 2007a; Horton and Serafeim, 2008) did indeed give rise to sizeable adjustments in company Reconciliation Statements under the new reporting regime. Furthermore, the analysis will inform the findings reported in Chapter 5 by indicating whether the standards that provided the biggest disclosure increases in the sample companies' annual reports correspond to those which caused the most financial impact on the financial statement numbers.

The remainder of this chapter is organised as follows: Section 6.2 details the sample used for the analysis of IFRS Reconciliation Statement disclosures. The results of the analysis of the percentage IFRS adjustments to profits and equity for the sample are discussed in Section 6.3 while Section 6.4 documents the results from calculating an index of conservatism for total equity, total profit and each individual adjustment for the sample companies. Section 6.5 compares the findings of the Reconciliation Statement analysis with the results of the Content Analysis reported in Chapter 5. Finally, Section 6.6 offers some concluding observations.

6.2 Data Sample

The research aim of the thesis is to examine the impact of the transition to IFRS for a sample of UK companies implementing the new set of reporting requirements. The focus of this chapter is an analysis of the IFRS Reconciliation Statements provided in the first set of annual report and accounts produced in accordance with the new regime.

The initial sample was based on those companies that were previously selected for the content analysis reported in Chapter 5. Table 6.1 reveals that the initial sample of 138 companies was reduced to a final sample of 132 firms following the exclusion of 6 companies. Although IFRS 1 required Reconciliation Statements to give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statements of reporting firms, it did not provide a specific layout. As a result, a range of different presentations were observed when reviewing the Reconciliation Statements contained in the annual report and accounts of the sample companies. Consequently, 6 companies were excluded from the sample because it was not possible to analyse their Reconciliation Statements in the context of the present study. For example, one company provided an IFRS reconciliation from US GAAP as opposed to UK GAAP (Barclays) whilst another reconciled its profit and equity on a Modified Statutory Solvency basis (Friends Provident).

Table 6.1: Sample Details

Initial sample	138
Companies excluded as the Reconciliation Statement could not be analysed	(6)
Sample for analysis	132
Sub-sample analysed for the income statement	86
Sub-sample analysed for the balance sheet	92

Note: This table provides basic information relating to the sample companies.

IFRS 1 specifically required companies adopting the international regime for the first time to disclose: (i) a reconciliation of its equity reported under previous GAAP to its equity under IFRS, both at the date of transition and at the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP; and, (ii) a reconciliation of the profit or loss reported under previous GAAP for the last period reported to the profit or loss under IFRS for the same period[146]. Although the standard did not provide a specific format for the Reconciliation Statement, the Implementation Guidance outlined an example line-by-line reconciliation of the financial statements (Bonham et al., 2004). Bonham et al. (2004) suggested that such a presentation may be appropriate where a significant number of line items in the primary financial statements are affected by transitional adjustments. Alternatively, they proposed that:

> "A straightforward reconciliation of the equity and profit and loss figures may be able to provide an equally effective explanation of how the adoption of IFRS affects the reported financial position, financial performance and cash flow."
>
> (Bonham et al., 2004, p. 279)

[146] The standard also required first-time adopters to provide an explanation of any material adjustments to the cash flow statement under previous GAAP; however, this requirement only applied where a cash flow statement had been presented under previous GAAP (Bonham et al., 2004). Given that not all companies would have produced a cash flow statement under previous GAAP, this part of the reconciliation was excluded from the analysis in the current thesis.

Reviewing the Reconciliation Statements of the sample companies, and in common with other aspects of financial statements produced under IFRS (Hoogendoorn, 2006), a variety of formats were provided which made it difficult in some instances to attribute transitional adjustments to specific IFRSs. Consequently, of the 132 companies that produced a comprehensive Reconciliation Statement, only a sub-set provided information that enabled the allocation of transitional adjustments to individual standards. The final sample therefore consisted of this subset: 86 companies for the income statement analysis and 92 companies for the balance sheet analysis. These companies are drawn from 10 industries and ranged in size from over £100,000m to less than £100m. Not surprisingly, most were large and had their shares included in the FTSE 100 index since that is how the sample in Chapter 5 was selected. Nevertheless, a good mix of firms is included in the analysis for the current chapter which should mean that any findings reported are not specific to any one group of companies.

6.3 Analysis of IFRS Disclosures

In order to examine the IFRS disclosures provided by the final sample of companies in their Reconciliation Statements, the reconciliation adjustments were transferred to an Excel spreadsheet and grouped according to the relevant standard that they related to. During this process, and consistent with the method employed during the content analysis of Chapter 5, several instances were identified whereby an adjustment related to more than one individual standard. Therefore, a refinement of the groupings of IFRS standards was necessary in order to include such instances within the analysis. For example, there were many instances were an adjustment was reported as being the combined impact of the two financial instruments standards: IAS 32 *Financial*

Instruments: Disclosure and Presentation and IAS 39 *Financial Instruments: Recognition and Measurement*. It became apparent that any attempt to split the impact of certain adjustments between the two standards would have introduced a measure of subjectivity and arbitrariness into the analysis; therefore, the decision was taken to group these two standards together for the purposes of the reconciliation analysis.

In addition, adjustments relating to IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* were reported together by several companies; thus, these standards were also reported together when grouping reconciliation adjustments. Similarly, there were instances where companies provided goodwill adjustments with no reference to the relevant standard that the adjustment related to. Although IAS 38 *Intangible Assets* and IFRS 3 *Business Combinations* both relate to goodwill, they also regulate other aspects of the financial statements. In addition, there were instances of companies reporting an adjustment relating to IFRS 3/IAS 38 without clearly outlining what aspects of these standards the adjustment relates to. Therefore, it was necessary to combine the adjustments relating to these two standards into a single category. Given that IAS 36 *Impairment of Assets* is closely related to both IFRS 3 and IAS 38, adjustments relating to IAS 36 were also included in this grouping[147]. Finally, there were a small number of instances where (i) companies provided an adjustment amount with no description or explanation as to what standard(s) were responsible, or, (ii) where a number of small insignificant adjustments were grouped together; these adjustments were categorised as 'Unclassified' adjustments in the analysis reported in the current chapter.

[147] As mentioned in Chapter 2, IFRS 3 states that goodwill is no longer amortised but instead subject to an annual impairment review under the requirements of IAS 36 (PwC, 2007a). In addition, the provisions of IAS 36 are referred to in other standards including IAS 38 where impairment is to be considered (Bonham et al., 2004).

Following the grouping of the adjustment amounts according to their relevant standard(s), the adjustment amount for each standard (or group of standards), *i*, was expressed as a percentage of the absolute value of the total profit (loss) calculated in accordance with previous UK GAAP in the Income Statement or the total equity reported under UK GAAP in the Balance Sheet for each of the sample firms as follows[148]:

$$\frac{\text{Income Statement Adjustment IFRS } i}{|\text{ Total Profit (Loss) according to UK GAAP }|} \qquad [6.1]$$

and

$$\frac{\text{Balance Sheet Adjustment IFRS } i}{|\text{ Total Equity according to UK GAAP }|} \qquad [6.2]$$

In addition, the impact of the transition to the new reporting regime on total profit (loss) in the income statement and total equity in the balance sheet for the sample of companies was calculated. Specifically, the absolute value of the total profit (loss) in accordance with previous UK GAAP in the income statement was expressed as a percentage of the difference between the profit (loss) reported under IFRS and the corresponding UK GAAP amount. Similarly, the absolute value of the previously reported UK GAAP total equity in the balance sheet was expressed as a percentage of the difference between the total equity reported under IFRS and previous UK GAAP.

[148] In 16 instances, sample firms had reported a loss under UK GAAP while 3 sample companies reported a negative equity amount in accordance with UK GAAP. In these instances, the absolute value of the loss or negative equity figure was used in the denominator of [6.1] and [6.2] to avoid situations where a wrong inference might be drawn from the sign of the IFRS adjustment.

$$\frac{\text{Total Profit (Loss) IFRS} - \text{Total Profit (Loss) UK GAAP}}{|\text{ Total Profit (Loss) UK GAAP }|} \quad [6.3]$$

and

$$\frac{\text{Total Equity IFRS} - \text{Total Equity UK GAAP}}{|\text{ Total Equity UK GAAP }|} \quad [6.4]$$

The calculated percentages were then statistically analysed and descriptive information was produced. This information was produced for the whole sample and is presented in Tables 6.2 and 6.3. Table 6.2 reports the Income Statement adjustments while Table 6.3 presents the Balance Sheet adjustments.

Tables 6.2 and 6.3 are each split into seven columns; the first column outlines the relevant accounting standard associated with the IFRS adjustment and the following six columns present the descriptive statistics. In particular, the number of the sample firms which reported an adjustment for each IFRS is detailed and the mean size of each adjustment calculated as a percentage of total UK GAAP profit (loss) and equity is provided together with its standard deviation. In addition, the median size of the adjustment as a percentage of the total is also displayed so that any influence of outlier observations on the mean value can be observed. Further, the minimum and maximum percentage size of the adjustment relating to each standard across the whole sample of companies is presented to display the range of adjustments reported by the sample firms for each IFRS to provide further insight into the impact of the new regime. A comparison of these two statistics should provide some clue as to whether the data are normally distributed; if the data are not normal, due care is needed when

examining the mean percentages. As such, the median may provide a better estimate of the adjustment reported for a typical firm in the sample.

A visual inspection of Table 6.2 reveals that the reconciliation from UK GAAP to IFRS has increased total profit by 105.85 per cent for the sample companies. This finding is consistent with prior studies which have reported an increase in reported profits following the adoption of IFRS (KPMG, 2005; Ormrod and Taylor, 2006; Christensen et al., 2007; Stenka and Ormrod, 2007; Horton and Serafeim, 2008). Furthermore, the standard deviation reported of 358.11 per cent for total IFRS profits suggests that there was considerable variation in the impact of the transition among the sample firms. This view is confirmed by an analysis of the minimum and maximum values; the maximum impact on profits was 3063.41 per cent (Land Securities) while the minimum amount was -48.95 per cent (Morrisons) indicating that the changeover did not have a positive impact on profit for all companies in the sample. Indeed, a detailed investigation of the total sample reveals that 60 companies reported an increase in profits while 26 firms disclosed a profit decrease following IFRS adoption[149].

A number of points emerge when observing the impact of individual standards on reported profits in Table 6.2. First, the main causes of the mean increase in total IFRS profits are IAS 40 (51.81 per cent), IFRS3/IAS 36/IAS 38 (42.61 per cent), IAS 32/IAS 39 (12.18 per cent) and IAS 10 (9.65 per cent). IAS 40 provided the largest impact on reported profits for the total sample and introduced a key change from previous GAAP as it required gains and losses due to any changes in the fair value of

[149] The 26 companies where the transition to IFRS reduced the reported profit were mainly in the consumer services (9) and health care sectors (4). They tended to be large in size and be listed among the FTSE 100 index.

Table 6.2: Descriptive Statistics of the IFRS Income Statement Adjustments

	n	Mean	SD	Median	Minimum	Maximum
IFRS 1	1	0.00	0.02	0.00	0.00	0.19
IFRS 2	73	0.08	35.49	-1.24	-124.32	292.22
IFRS 4	3	0.00	0.74	0.00	-4.94	4.75
IFRS 5	4	-0.15	2.76	0.00	-22.67	11.37
IAS 1	4	0.57	4.17	0.00	-2.39	35.00
IAS 2	2	0.23	1.91	0.00	0.00	17.65
IAS 7	0	0.00	0.00	0.00	0.00	0.00
IAS 8	0	0.00	0.00	0.00	0.00	0.00
IAS 10	6	9.65	61.28	0.00	-0.28	532.35
IAS 11	1	-0.04	0.33	0.00	-3.03	0.00
IAS 12	53	-9.70	77.73	0.00	-627.09	200.00
IAS 14	0	0.00	0.00	0.00	0.00	0.00
IAS 16	11	-2.72	25.52	0.00	-234.62	26.02
IAS 17	20	0.26	11.96	0.00	-55.88	87.50
IAS 18	4	0.44	6.10	0.00	-16.60	53.91
IAS 19	62	1.19	13.03	0.00	-47.78	92.31
IAS 20	0	0.00	0.00	0.00	0.00	0.00
IAS 21	12	-2.61	19.67	0.00	-180.28	3.66
IAS 23	1	0.02	0.19	0.00	0.00	1.76
IAS 24	0	0.00	0.00	0.00	0.00	0.00
IAS 26	0	0.00	0.00	0.00	0.00	0.00
IAS 27	6	-0.10	0.58	0.00	-4.51	0.75
IAS 29	0	0.00	0.00	0.00	0.00	0.00
IAS 30	0	0.00	0.00	0.00	0.00	0.00
IAS 33	0	0.00	0.00	0.00	0.00	0.00
IAS 34	0	0.00	0.00	0.00	0.00	0.00
IAS 37	2	0.38	3.66	0.00	-1.14	33.94
IAS 40	7	51.81	305.03	0.00	0.00	2506.70
IAS 41	1	1.08	9.99	0.00	0.00	92.60
IAS 28/IAS 31	17	-0.03	11.12	0.00	-62.16	64.80
IAS 32/IAS 39	25	12.18	127.59	0.00	-35.80	1180.17
IFRS 3/IAS 36/IAS 38	77	42.61	106.46	11.78	-48.25	694.59
Other/Unclassified	32	1.20	11.30	0.00	-11.86	99.51
Total Profit – IFRS	86	105.85	358.11	20.88	-48.95	3063.41

Notes: This table details the IFRS adjustments calculated as a percentage of the total profit (loss) reported under UK GAAP. Specifically, summary statistics are reported: n is the number of adjustments reported, Mean is the average, SD is the standard deviation, Median is the mid-point and Minimum and Maximum are the minimum and maximum values.

investment properties to be reported in the income statement; such movements had been taken through the Statement of Recognised Gains and Losses (STRGL) under previous UK GAAP (BDO, 2006). Given that all firms in the sample which included

an IAS 40 adjustment reported an increase in previous GAAP profit, it is clear that these companies experienced revaluation gains on their investment properties. For example, British Land Company reported a 1318.97 per cent positive adjustment to profit while Hammerson disclosed a 243.94 per cent increase to previous GAAP profits. Further, an adjustment of £897.4m (2506.70 per cent) reported by Land Securities, the largest real estate trust in the UK, helped transform a £35.8m loss reported under UK GAAP into a significant profit according to IFRS. This finding is consistent with a BDO study (BDO, 2006) which found that IAS 40 had a significant impact on the income statement of real estate companies.

The second largest impact on profits (or losses) under UK GAAP related to the three standards IFRS 3/IAS 36/IAS 38. IFRS 3 does not permit goodwill to be amortised but instead be subject to an annual impairment test (Bonham et al., 2004). This contrasts with the treatment of goodwill under previous UK GAAP where FRS 10 normally required the amortisation of goodwill (Stenka and Ormrod, 2007). The effect of this change was likely be the reinstatement of goodwill previously amortised under UK GAAP for many of the sample companies thus increasing reported profits under IFRS. For example, NSB Retail Systems reversed over £25m of goodwill amortised under previous UK GAAP from the income statement, turning a UK GAAP reported loss of -£8.61m into an IFRS profit of £16.55m. Indeed, an increase to reported profit was reported by 70 out of the total sample of 86 companies in relation to this group of standards with only 7 firms disclosing a profit decrease in the income statement. Consistent with this finding, Stenka and Ormrod (2007) found that the reinstatement of previously amortised goodwill accounted for 24 per cent of the overall increase in profits of 39 per cent reported by their sample of UK companies

with only 12 per cent of firms indicating that the impact of the changeover on goodwill had been negative. Further, they documented that the amortisation of goodwill that had been avoided because UK GAAP was no longer being used amounted to £1.66 billion for the total sample (Stenka and Ormrod, 2007). This change may possibly increase reported profits going forward, however, should an impairment to goodwill be required, the resulting write down might be significant; therefore, income volatility may increase (Bonham et al., 2004; Horton and Serafeim, 2008).

It was perhaps surprising that the adjustments associated with standards relating to financial instruments (IAS 32/IAS 39) had a positive impact on reported profits. As discussed in Chapter 2, the introduction of IAS 32/IAS 39 has been the subject of much controversy; the literature has documented that these standards have been the most difficult to interpret and apply (Ernst and Young, 2006; Jermakowicz and Gornik-Tomaszewski, 2006). The requirement to disclose all derivatives on the balance sheet with resulting movements in fair values recorded in the income statement coupled with the more stringent restrictions placed on the use of hedge accounting has reportedly led to increased income volatility (PwC, 2003; Ernst and Young, 2006). Therefore, the finding that the adjustments required by these standards have increased reported profits for the sample firms is somewhat surprising; however, further inspection reveals that only 9 companies reported an increase to profit in relation to IAS 32/39 and the positive impact to total reported profits appears to be attributable to a single adjustment of 1180.17 per cent reported by Land Securities without which the total mean impact of these standards would have been -1.58 per cent for the sample. This adjustment primarily relates to a gain of £395m following

the restatement of a bond exchange which took place in November 2004; more specifically,

> "The bond exchange...qualified as an extinguishment of the existing debt and the issue of new debt under UK GAAP. Under IFRS, this is not the case and the existing debt is reinstated with the difference in redemption amounts being amortised over the life of the new debt."
>
> (Land Securities Annual Report 2006, p.135)

By removing this outlier, however, the expectation that the adjustments associated with the two standards relating to financial instruments would adversely impact on profits reported under previous UK GAAP is supported for the vast majority of the sample companies effected by IAS 32/IAS 39. Interestingly, only 25 of the total sample companies reported an adjustment in relation to these standards. Chapter 2 indicated that many firms changed their behaviour in relation to financial instruments with some limiting or even abandoning altogether their use of such instruments in light of the new IFRS requirements; perhaps the relatively low number of companies reporting an IAS 32/IAS 39 adjustment is a reflection of such changes being implemented by the sample firms in an attempt to minimise or even avoid completely any potential income volatility.

An IAS 10 adjustment was reported by only 6 of the sample companies and the significant positive impact of this standard on profits reported is attributable to large adjustments of 532.35 per cent, 165.16 per cent and 128.68 per cent disclosed by Matalan, Brammer and Rentokil Initial respectively. A review of the explanations for the adjustments made by these three companies reveals that they relate to the IAS 10 requirement to recognise dividends only when paid or approved by the shareholders; under UK GAAP (SSAP 9 *Events After The Balance Sheet Date*), dividends were recognised when proposed (Ernst and Young, 2005). This change has resulted in

previously accrued dividends being reversed out in the income statement of these companies thereby increasing reported profits under IFRS.

A second point from Table 6.2 is that the positive impact of the adjustments relating to IAS 40, IFRS3/IAS 36/IAS38, IAS 32/IAS 39 and IAS 10 on total profit under UK GAAP were offset to some extent by changes required under IAS 12 (-9.70 per cent), IAS 16 (-2.72 per cent) and IAS 21 (-2.61 per cent). IAS 12 requires the use of the 'temporary difference' approach when calculating the deferred tax liability which differs from the 'timing difference' approach that has historically been applied in the UK (Horton and Serafeim, 2008). This change, along with many other deferred tax adjustments, probably impacted on the deferred tax charge and effective tax rate which may explain the significant negative impact that this standard had on reported profits for the sample companies (Horton and Serafeim, 2008). However, closer inspection reveals that the three largest IAS 12 adjustments were attributable to Land Securities (-627.09 per cent), British Land Company (-281.03 per cent) and Great Portland Estates (-52.78 per cent) which are all located in the real estate sector.

As previously reported, the investment properties standard, IAS 40, had a significant positive impact on reported profits particularly for real estate firms included in the sample because these companies reported revaluation gains to the income statement when applying the new standard. However, there is a deferred tax implication for recognising such gains; IAS 12 requires a provision to be made for taxable temporary differences which was not previously mandated under UK GAAP (BDO, 2006). Indeed, Land Securities reported a £184.2m reduction to UK GAAP profits as a result of the requirement to provide deferred tax in full on revaluation gains. When

removing the significant negative IAS 12 adjustments reported by these three firms, the revised impact of this standard on total reported profits is a positive adjustment of 1.52 per cent.

With respect to foreign exchange requirements, IAS 21 was revised in 2003 to provide additional guidance on the translation method and on the determination of the functional and presentation currencies in an attempt to reduce or eliminate alternative accounting treatments, redundancies and conflicts (Bonham et al., 2004). Under UK GAAP, it had been possible to recognise some foreign currency gains or losses in the balance sheet reserves; however, under IFRS, the majority of these gains and losses now had to be included in the income statement (Bonham et al., 2004; Cairns, 2004). However, IAS 21 was not highlighted in Chapter 2 as being one of the new standards which was expected to have a potentially significant impact on reported profits as it had not been the subject of a great deal of discussion in the literature. Indeed, only 12 of the sample companies reported an adjustment in relation to this standard and the significant negative adjustment to total profits reported appears to be due to a single adjustment of £2.468m or -180.28 per cent reported by Brammer plc. This amendment related to exchange rate adjustments resulting from other IFRS adjustments denominated in foreign currencies in respect of the recycling of the exchange on the disposal of discontinued operations; without these, the total negative IAS 21 adjustment reported would have been considerably reduced.

The negative adjustment for IAS 16 is attributable to an outlier adjustment of -234.62 per cent reported for Beales. IAS 16 permits companies to apply a historical cost model or a revaluation model for a class of property, plant and equipment (Ernst and

Young, 2006); both freehold properties and long leaseholds were revalued at market value by Beales and although this increased the values of these assets in the balance sheet, an increased depreciation charge was taken through the income statement to reflect these changes thus reducing reported profits. Only 11 sample firms reported an IAS 16 adjustment in the income statement, 4 of which were positive adjustments. Thus, removing the impact of this outlier company would have resulted in a small overall positive adjustment for this standard.

A third observation when reviewing Table 6.2 is that the mean percentage adjustments mask a wide spread of values across the sample firms. The standard deviation figures are sizeable for several of the accounting standards indicating that there was considerable variation in their impact on the sample of companies. The largest standard deviation figures relate to IAS 40 (305.03 per cent), IAS 32/IAS 39 (127.59 per cent), IFRS 3/IAS 36/IAS 38 (106.46 per cent) and IAS 12 (77.73 per cent). This view is confirmed when observing the maximum and minimum values which are very large in a number of cases. For example, the range of adjustments for IAS 12 varied from -627.09 per cent to 200.00 per cent. Indeed, as already highlighted, the mean decrease in reported profits resulting from the application of IAS 12 was predominantly due to the adjustments disclosed by only 3 of the sample firms; further inspection reveals that a significant proportion (40 per cent) of the IAS 12 adjustments reported had a positive impact on the income statement.

Fourth, a number of the accounting standards had no material impact on the reconciliation from UK GAAP to IFRS on reported profits. These standards with a mean adjustment as a percentage of the total IFRS profit adjustment of 0.00 per cent

were IAS 7, IAS 8, IAS 14, IAS 20, IAS 24, IAS 26, IAS 29, IAS 30, IAS 33 and IAS 34 and are predominantly, though not exclusively, oriented towards disclosure. In addition, several standards reported only relatively small adjustments to total UK GAAP profit; these related to IFRS 1, IFRS 2, IFRS 4, IFRS 5, IAS 1, IAS 2, IAS 11, IAS 17, IAS 18, IAS 19, IAS 23, IAS 27, IAS 37, IAS 41 and IAS 28/31.

Fifth, and as illustrated previously when discussing the impact of IAS 10, IAS 16, IAS 21 and IAS 32/IAS 39, care must be exercised when examining the mean adjustment values given the numbers reported may be influenced by outliers. Thus, the median statistics are provided in Table 6.2 and an inspection of these values reveals that the IFRS adjustments required to total UK GAAP profits were almost entirely attributable to the IAS 36/IAS 38/IFRS 3 group of standards for the median firm in the sample. Interestingly, the only other standard which exhibited a median value not equal to zero was IFRS 2 (-1.24 per cent)[150]. Prior studies detailed in Chapter 2 indicated that IFRS 2 was likely have a negative impact on the income statement of affected companies; for example, a PwC (2007a) study found that 23 out of 25 firms reported an adverse charge to profit and loss with the average amount being 6 per cent of previously reported UK GAAP profits. Therefore, caution should be exercised when reviewing mean adjustment values; as the findings for IFRS 2 suggest, median values may provide a better indication of the impact of particular standards on a sample of companies.

[150] The mean adjustment was not among the largest amounts reported earlier. Indeed, 65 of the 86 sample companies reported a negative adjustment to profits in relation to this standard and the small positive total mean adjustment reported is due to a significant positive adjustment of 292.22 per cent reported for Hampson Industries; removing this outlier results in a revised IFRS 2 total mean adjustment of -3.35 per cent which is arguably more reflective of the impact of this standard for the sample as a whole.

Finally, the mean and median statistics provided in Table 6.2 may mask the impact of certain standards on specific types of companies or which only had an impact on a small number of firms. For example, although the mean adjustment for the total sample of IAS 40 was one of the highest increases to reported profits for the total sample, this disguises the finding that only seven companies reported an IAS 40 adjustment to UK GAAP profits. A more detailed inspection reveals that the majority of these companies were real estate firms included within the sample. Furthermore, although adjustments in relation to IAS 21 provided one of the largest mean decreases to reported profits, only 12 of the total sample companies provided an IAS 21 adjustment. Therefore, focusing exclusively on the mean average or median adjustment for the total sample may ignore the impact of certain standards where an adjustment, which may be significant, has only been reported for a small number of the sample companies and which may also relate to a group of firms within the same industry.

An examination of Table 6.3 shows that the reconciliation from UK GAAP to IFRS increased total equity by 20.63 per cent for the sample companies. This finding contrasts with several prior studies which have reported a decrease in total equity following the transition to IFRS (Ormrod and Taylor, 2006; Stenka and Ormrod, 2007; Horton and Serafeim, 2008). However, consistent with the findings for reported profits, the standard deviation of 195.06 per cent indicates that there was significant variation in the impact of the IFRS adoption on the balance sheets for the sample firms. This is confirmed when considering the maximum and minimum impact on the equity for the total sample; it ranged from 1810.89 per cent (NSB Retail Systems) to

Table 6.3: Descriptive Statistics of the IFRS Balance Sheet Adjustments

	n	Mean	SD	Median	Minimum	Maximum
IFRS 1	3	0.89	7.60	0.00	-1.61	72.15
IFRS 2	37	0.22	0.54	0.00	-0.37	3.03
IFRS 4	2	-0.01	0.37	0.00	-3.02	1.80
IFRS 5	1	0.00	0.00	0.00	0.00	0.00
IAS 1	1	-1.24	11.89	0.00	-114.09	0.00
IAS 2	3	0.07	0.62	0.00	-0.05	5.86
IAS 7	0	0.00	0.00	0.00	0.00	0.00
IAS 8	0	0.00	0.00	0.00	0.00	0.00
IAS 10	73	7.76	21.71	3.45	0.00	198.57
IAS 11	1	-0.01	0.13	0.00	-1.27	0.00
IAS 12	64	-2.21	14.72	0.00	-90.20	58.12
IAS 14	0	0.00	0.00	0.00	0.00	0.00
IAS 16	10	2.98	22.83	0.00	-0.60	216.68
IAS 17	25	-0.76	2.76	0.00	-20.85	0.23
IAS 18	7	-0.20	1.16	0.00	-10.53	0.00
IAS 19	75	-12.17	29.20	-2.15	-199.90	80.00
IAS 20	0	0.00	0.00	0.00	0.00	0.00
IAS 21	4	-0.02	0.21	0.00	-1.81	0.53
IAS 23	1	0.40	3.79	0.00	0.00	36.35
IAS 24	0	0.00	0.00	0.00	0.00	0.00
IAS 26	0	0.00	0.00	0.00	0.00	0.00
IAS 27	5	0.02	0.12	0.00	-0.32	0.87
IAS 29	0	0.00	0.00	0.00	0.00	0.00
IAS 30	0	0.00	0.00	0.00	0.00	0.00
IAS 33	0	0.00	0.00	0.00	0.00	0.00
IAS 34	0	0.00	0.00	0.00	0.00	0.00
IAS 37	4	0.20	1.32	0.00	-0.48	11.71
IAS 40	3	-0.02	0.20	0.00	-1.91	0.00
IAS 41	2	0.05	0.50	0.00	0.00	4.74
IAS 28/IAS 31	12	-0.12	1.02	0.00	-9.36	1.20
IAS 32/IAS 39	25	-0.45	4.44	0.00	-36.64	11.55
IFRS 3/IAS 36/IAS 38	82	25.33	195.01	1.68	-16.04	1869.29
Other/Unclassified	48	-0.06	2.40	0.00	-11.29	11.16
Total Equity – IFRS	92	20.63	195.06	-0.28	-118.79	1810.89

Notes: This table details the IFRS adjustments calculated as a percentage of total equity reported under UK GAAP. Specifically, summary statistics are reported: n is the total number of adjustments, Mean is the average, SD is the standard deviation, Median is the mid-point and Minimum and Maximum are the minimum and maximum values.

-118.79 per cent (Brammer). Interestingly, a split of the total sample between those who reported an increase in equity and those who disclosed a equity decrease reveals that a slightly higher proportion of the sample (49 companies) experienced an adverse

impact compared to those who reported a positive adjustment (43 companies). Indeed, by removing the two largest positive adjustments to equity of 1810.89 per cent and 403.57 per cent, a revised total equity adjustment of -3.51 per cent would have been achieved which is consistent with the findings of prior studies.

A number of points can be made regarding the impact of individual standards on reported equity in Table 6.3. First, and consistent with the effect of IFRS on the Income Statement, the overall impact on the Balance Sheet of the conversion to IFRS for the sample companies varied from standard to standard. The key standards which increased total equity reported under UK GAAP were IAS 36/IAS 38/IFRS 3 (25.33 per cent), IAS 10 (7.76 per cent) and IAS 16 (2.98 per cent).

As discussed, goodwill is no longer amortised under IFRS 3 with the effect being the restatement of goodwill previously amortised under UK GAAP thus increasing reported equity under the new regime (Ernst and Young, 2005; Stenka and Ormrod, 2007). In addition, the criteria for recognising internally-developed intangible assets under IAS 38 are not considered as onerous as those of FRS 10 *Goodwill and Intangible Assets* which may lead to the capitalisation of such expenditures as assets under IFRS that would have been expensed under previous UK GAAP (Horton and Serafeim, 2008). Finally, IAS 38 requires development costs to be capitalised on the balance sheet which had not been the case under UK GAAP (Horton and Serafeim, 2008). The net effect of these changes was expected to be an overall increase in both equity in the Balance Sheet and profit in the Income Statement; the findings reported for the impact of the IAS 36/IAS 38/IFRS 3 grouping on total equity for the sample companies appear to confirm this expectation. For example, NSB Retail Systems

reported a change in equity in the balance sheet from a negative figure of £1.68m into a positive figure of £28.74m due to an adjustment for goodwill; the firm's equity also benefited from the capitalisation of £6.38m of development costs under new IAS 38 requirements.

The second largest increase to reported equity is attributable to IAS 10 with the vast majority of the sample companies (79 per cent) disclosing an adjustment relating to this standard. Further, every adjustment reported had a positive effect on equity with no firm disclosing a negative impact to equity following compliance with IAS 10; the minimum adjustment value was 0.00 reported in Table 6.3. A key difference between IAS 10 and previous UK GAAP requirements in relation to dividends is that IAS 10 permits dividend payments to be recorded only when those dividends have been paid or approved by the shareholders; this contrasts with previous rules in the UK where proposed final dividends for the year had to be accrued as a liability (Ernst and Young, 2005). As Aisbitt (2006) explains:

> "Such accruals are not made under IFRS as (a) the proposed dividend does not meet the Framework definition of a liability (there is no past event that acts as a trigger) and (b) IAS 37 requires that there be a legal or constructive obligation, and the IASB does not consider 'economic compulsion' (i.e. investors expect a dividend) as a constructive obligation."
>
> (Aisbitt, 2006, p. 127)

As a result, the adjustments classified under IAS 10 are likely to be a reversal of the accrual made under UK GAAP for the final dividend to be paid out of the current year's profit with a resulting positive effect on equity under IFRS; this finding is consistent with prior studies which have reported a positive impact of IAS 10 on equity (Ernst and Young, 2005; Aisbitt, 2006).

As noted earlier, IAS 16 allows companies to value property, plant and equipment based on historical cost or market value. The greater use of revaluations permitted under the new standard may explain the positive reconciliation adjustment reported for the sample companies. Aisbitt (2006) also noted that this standard had a significant positive impact on equity for her sample of non-financial companies. However, only 10 companies disclosed an IAS 16 adjustment and the positive mean adjustment to total equity reported is heavily influenced by the change implemented for a single company; National Grid disclosed an adjustment of 216.68 per cent in relation to the revised treatment of replacement expenditure under IFRS; excluding this adjustment would reduce the mean to a small positive total adjustment of 0.63 per cent.

A second observation from Table 6.3 is that the positive impact of some standards was partially offset by the negative effects on total equity under UK GAAP of IAS 19 (-12.17 per cent), IAS 12 (-2.21 per cent) and IAS 1 (-1.24 per cent). Chapter 2 indicated that IAS 19 might have a significant impact on the balance sheet with several studies reporting a negative adjustment to equity when applying this standard (Ernst and Young, 2005; Aisbitt, 2006; PwC, 2006a; Stenka and Ormrod, 2007); the finding that IAS 19 provides the largest negative impact to total equity for the sample companies in the current thesis appears to confirm these prior findings. IAS 19 requires the full recognition of pension surpluses or deficits on the balance sheet unlike SSAP 24 *Accounting for Pension Costs* where surpluses or deficits were effectively smoothed through the profit and loss account over the remaining service lives of the employees (Cairns, 2004; Horton and Serafeim, 2008). SSAP 24 was replaced by FRS 17 *Retirement Benefits* in 2004 and was broadly similar to it's

international counterpart in that it also required the recognition of pension scheme surpluses or deficits on the balance sheet; however, FRS 17 transitional requirements permitted companies to continue to report under SSAP 24 whilst providing detailed disclosures under the alternative measurement principles of FRS 17 (Horton and Serafeim, 2008). A study by Horton and Serafeim (2008) noted that the majority of UK companies had taken advantage of the FRS 17 transitional regime; therefore, the adoption of IAS 19 probably resulted in pension scheme surpluses and deficits being disclosed on the balance sheet for the first time. Over 90 per cent of the sample companies who reported an IAS 19 adjustment disclosed a negative impact on equity suggesting that the majority of the sample companies reported pension deficits on the IFRS balance sheet.

Concerns were highlighted in Chapter 2 that the application of IAS 12 might increase the deferred tax liability and hence reduce shareholders' equity compared to previous UK GAAP requirements (KPMG, 2005; BDO, 2006; PwC, 2006c; Horton and Serafeim, 2008). Therefore, the finding that adjustments in relation to IAS 12 provided one of the largest decreases in total equity is perhaps not surprising. Nevertheless, 41 per cent of the sample companies who disclosed an IAS 12 adjustment reported a positive impact to equity from the application of this standard; for example, Brammer reported a 58.12 per cent increase to equity as a result of the requirement to recognise deferred tax on its pension deficit increasing deferred tax assets by £9.5m. Thus, the overall negative impact to equity reported for IAS 12 is not necessarily reflective of its effect on all companies included in the sample given there was an almost even split between those firms reporting a negative adjustment and those disclosing a positive adjustment.

The negative adjustment reported for IAS 1 is attributable to a single adjustment of 114.09 per cent reported for this standard by National Grid. This adjustment relates to the derecognition of regulatory assets previously recognised under UK GAAP because they had met the definition of an asset as set out in FRS 5 Reporting the Substance of Transactions; under IFRS these were not recognised in the balance sheet because they did not satisfy the definition of an asset as defined in IAS 1. This resulted in the removal of regulatory assets worth £1,587m from the IFRS balance sheet.

Similar to the results reported for profits, the mean percentage adjustments mask a wide spread of values across the sample firms. Table 6.3 indicates that the standard deviation figures are sizeable for several of the accounting standards including IFRS 3/IAS 36/IAS 38 (195.01 per cent), IAS 19 (29.20 per cent), IAS 16 (22.83 per cent) and IAS 10 (21.71 per cent). These results suggest that particular standards had a varied impact on the sample companies and this view is confirmed when assessing the maximum and minimum values provided in Table 6.3. For example, the range of adjustments for IAS 12 varies from -90.20 per cent to 58.18 per cent. Indeed, it was highlighted earlier that there was an almost even spread between those sample companies which reported a positive adjustment and those which disclosed a negative adjustment in relation to this standard.

A fourth observation made when examining Table 6.3 is that a number of the accounting standards had no material impact on the reconciliation from UK GAAP to IFRS on reported equity. These standards were IFRS 5, IAS 7, IAS 8, IAS 14, IAS

20, IAS 24, IAS 26, IAS 29, IAS 30, IAS 33 and IAS 34 and most relate to disclosure requirements. In addition, several standards reported only relatively small adjustments to total UK GAAP profit; these related to IFRS 1, IFRS 2, IFRS 4, IAS 2, IAS 11, IAS 17, IAS 18, IAS 21, IAS 23, IAS 27, IAS 37, IAS 40, IAS 41, IAS 28/IAS 31 and IAS 32/IAS 39.

Finally, and as highlighted when discussing the impact on profits, the mean adjustment values should be viewed with caution given the potential influence of outliers; therefore, the median statistics are also provided in Table 6.3. The results reveal that only three standards reported a median adjustment not equal to zero; these were IAS 10 (3.45 per cent), IAS 19 (-2.15 per cent) and IFRS 3/IAS 36/IAS 38 (1.68 per cent). However, these standards also reported the three highest mean adjustments to equity; therefore, the impact of these standards is consistent between the two measures.

6.4 An Index of Conservatism

The IFRS disclosures of the sample companies were also examined by means of a 'conservatism' index[151]. This index, which was developed by Gray (1980), is used to examine whether there are material quantitative differences in profits and equity reported under IFRS compared to those prepared in accordance with UK GAAP. To examine the impact of the transition from UK GAAP to IFRS on profit, the index was calculated as:

$$1 - \frac{(\text{Profit IFRS} - \text{Profit UK GAAP})}{|\text{Profit IFRS}|} \qquad [6.5]$$

[151] A detailed discussion of the Conservatism Index was provided in Chapter 4; this included an overview of various studies which have adopted this research method.

Similarly, to assess the extent of the differences in equity reported in accordance with UK GAAP and IFRS, the index was calculated as:

$$1 - \frac{(\text{Equity IFRS} - \text{Equity UK GAAP})}{|\text{Equity IFRS}|} \quad [6.6]$$

If the index assumes a value greater than one, this indicates that profits or equity reported under UK GAAP were less 'conservative' than those reported using IFRS. By contrast, an index value less than one means that UK GAAP-reported figures were more 'conservative' than those produced under IFRS. An index value equal to one indicates neutrality between UK GAAP-based and IFRS-based figures.

In addition to calculating an overall index of conservatism for both profit and equity, the relative impact of individual adjustments required under each international accounting standard was also examined by constructing partial indices as:

$$1 - \frac{(\text{Partial adjustment})}{|\text{Profit IFRS}|} \quad [6.7]$$

and

$$1 - \frac{(\text{Partial adjustment})}{|\text{Equity IFRS}|} \quad [6.8]$$

Equations [6.5] – [6.8] were used to calculate index values for each of the sample companies. The mean and median index values were then calculated for the total sample of companies and the results reported in Table 6.4 for the Income Statement and in Table 6.6 for the Balance Sheet. More specifically, Tables 6.4 and 6.6 show the mean and standard deviation for the overall conservatism index as well as for each of the partial indices. The tables also report the results from a t-test that was used to determine whether the mean index values were significantly different from the neutral

value of 1. To guard against the possibility that outlying index values may distort the mean findings, the median values are also reported and a non-parametric Wilcoxon signed rank test was conducted to determine whether the median values were significantly different from the neutral value of 1.

A visual inspection of Table 6.4 confirms the findings from the descriptive results reported in Section 6.3. It reveals that, on average, the profits reported under IFRS for the sample companies were considerably higher than those reported in accordance with UK GAAP. More specifically, the results show that reported profits under UK GAAP were only 68.4 per cent per cent of their value under IFRS[152]. In addition, reported profits using IFRS were significantly greater than those disclosed under UK GAAP at the 1 per cent level as the p-value for the mean index values was 0.007. However, it should be noted that there was considerable variation in the impact of IFRS on reported profits of the sample companies as the standard deviation of the mean index values is sizeable at 63.2 per cent; as highlighted in the previous section, 30 per cent of the sample experienced a fall in profits following the changeover. Thus, the results indicate that the introduction of IFRS had a significant impact on the reported profits of the sample companies.

[152] The total profit increase of 32.6 per cent reported for the sample of companies using the conservatism index is considerably lower than the 105.85 profit increase reported in Section 6.3 for the same companies; this is because the denominator used to calculate the percentage change in reported profits differs between the two methods. The percentage adjustment calculated in Section 6.3 used UK GAAP profit as the denominator whilst the conservatism index included IFRS profit as the denominator. The majority of the sample firms reported an increase in profits following the adoption of IFRS; therefore, the percentage increase reported for these firms will be lower using the conservatism index given the inclusion of the higher IFRS profit amount as the denominator in comparison to the lower UK GAAP amount used in Section 6.3. The inclusion of the adjusted IFRS-reported profit as the denominator is consistent with that as stated by Gray (1980) who developed the index and also with prior studies which have used the conservatism index to analyse financial statement numbers (Weetman and Gray, 1990; Norton, 1991; Weetman and Gray, 1991).

Table 6.4: Index of Conservatism - Income Statement

	Mean	SD	p-value	Median	Wilcoxon
IFRS 1	1.000	0.000	0.320	1.000	1.000
IFRS 2	1.000	0.205	0.992	1.011	0.000***
IFRS 4	1.000	0.006	0.978	1.000	0.789
IFRS 5	1.002	0.030	0.504	1.000	0.855
IAS 1	0.992	0.070	0.268	1.000	0.584
IAS 2	0.999	0.005	0.227	1.000	0.371
IAS 7	1.000	0.000	-	1.000	-
IAS 8	1.000	0.000	-	1.000	-
IAS 10	0.946	0.326	0.125	1.000	0.059*
IAS 11	1.000	0.003	0.320	1.000	1.000
IAS 12	1.014	0.095	0.180	1.000	0.088*
IAS 14	1.000	0.000	-	1.000	-
IAS 16	1.006	0.052	0.312	1.000	0.351
IAS 17	0.976	0.253	0.384	1.000	0.162
IAS 18	0.994	0.078	0.445	1.000	0.855
IAS 19	0.995	0.097	0.637	1.000	0.565
IAS 20	1.000	0.000	-	1.000	-
IAS 21	1.039	0.316	0.253	1.000	0.078*
IAS 23	1.000	0.003	0.320	1.000	1.000
IAS 24	1.000	0.000	-	1.000	-
IAS 26	1.000	0.000	-	1.000	-
IAS 27	1.001	0.006	0.128	1.000	0.142
IAS 29	1.000	0.000	-	1.000	-
IAS 30	1.000	0.000	-	1.000	-
IAS 33	1.000	0.000	-	1.000	-
IAS 34	1.000	0.000	-	1.000	-
IAS 37	0.995	0.050	0.329	1.000	1.000
IAS 40	0.952	0.188	0.020**	1.000	0.022**
IAS 41	0.994	0.051	0.320	1.000	1.000
IAS 28/IAS 31	1.001	0.023	0.548	1.000	0.276
IAS 32/IAS 39	1.010	0.083	0.287	1.000	0.258
IFRS 3/IAS 36/IAS 38	0.773	0.469	0.000***	0.878	0.000***
Other/Unclassified	0.995	0.055	0.420	1.000	0.772
Total Profit – IFRS	0.684	0.632	0.000***	0.822	0.000***

Notes: This table details the mean conservatism index (Mean), its standard deviation (SD) and the results from a t-test (p-value) that was used to test whether the mean index value was significantly different from the neutral value of 1. * indicates significance at the 10 per cent level, ** denotes significance at the 5 per cent level and *** indicates significance at the 1 per cent level. The median index values are also reported (Median) and the results of a non-parametric Wilcoxon signed ranks test are provided determining whether the median index values were significantly different from the neutral value of 1. * indicates significance at the 10 per cent level, ** denotes significance at the 5 per cent level and *** indicates significance at the 1 per cent level.

A number of points emerge from an examination of the effect of the individual standards reported for the sample companies. First, a significant p-value was reported for the IFRS 3/IAS 36/IAS 38 group of standards at the 1 per cent level given that the p-value reported was 0.000. This group of standards had the largest impact on the Income Statement of the sample companies; profits under IFRS were 22.7 per cent higher than under UK GAAP primarily due to changes in the treatment of goodwill amortisation under the new regime[153]. The only other standard to report a statistically significant mean index value was IAS 40; this standard increased reported profits by 4.8 per cent for the total sample and was significant at the 5 per cent level given a p-value of 0.020. Although the previous section highlighted that an IAS 40 adjustment to UK GAAP profits was reported only for a small number of the sample companies, all adjustments reported were positive and most were significantly large movements; for example, one company (British Land Company) reported a partial index value of 117.0 per cent of IFRS profits for this standard.

A second point observed when reviewing Table 6.4 is that the IAS 32/IAS 39 group of financial instrument standards reported a small mean index value of 1.010 implying that these standards reduced UK GAAP profits; this finding contrasts with the mean percentage increase to profits reported in the previous section. Indeed, 64 per cent of the sample companies which reported an IAS 32/IAS 39 adjustment disclosed a reduction to profits when applying these standards with the total increase to profits previously reported due to the influence of a significant positive outlier adjustment.

[153] The adjustment value of 22.7 per cent relating to IFRS 3/IAS 36/IAS 38 is lower than the percentage increase to previous UK GAAP profits of 42.61 per cent reported in Section 6.3 for the same standards. Similar to that reported for the change in total profits, this is due to the inclusion of the generally higher IFRS profit figure as the denominator when calculating the index adjustment compared to the predominantly lower UK GAAP amount used in Section 6.3. Nevertheless, the impact of IFRS 3/IAS 36/IAS 38 on the income statement following the adoption of IFRS is substantial regardless of which measure used.

Therefore, the mean index value detailed in Table 6.4 appears to better reflect the impact of these standards on the sample as a whole.

Table 6.4 also indicates that several standards had no effect on the income statements of the sample companies. In particular, the findings show that 10 standards had no impact on the reported profits of the sample firms; much of the focus of these particular standards is on disclosure requirements which are not expected to impact reported figures[154].

The median index values and the results from the Wilcoxon signed ranks test largely confirm the findings reported for the mean values; reported profits under IFRS were higher than those disclosed under UK GAAP with a median increase for the sample companies of 17.8 per cent. In addition, the IFRS 3/IAS 36/IAS 38 group of standards exhibited a statistically significant median index value at the 1 per cent level increasing UK GAAP profits by 12.2 per cent for the median firm. A further examination of the median values detailed in Table 6.4 reveals that reported profits were also significantly impacted by IFRS 2, IAS 10, IAS 12, IAS 21 and IAS 40; as emphasised when reporting the results of the IFRS percentage adjustments in the previous section, caution should be exercised when examining mean values given that they may be influenced by outliers. Therefore, the median values may provide a better indication of the impact of particular standards for the sample companies. This is clearly illustrated by the finding that IFRS 2 had a statistically significant median adjustment value for the total sample although as this standard did not have a significant mean index value. Furthermore, the previous section highlighted that 76

[154] The standards which reported no impact to the income statement were IAS 7, IAS 8, IAS 14, IAS 20, IAS 24, IAS 26, IAS 29, IAS 30, IAS 33 and IAS 34.

per cent of the sample companies reported a negative adjustment for IFRS 2; the overall positive percentage adjustment to profits reported was therefore possibly due to an outlier adjustment. The median index value of 1.011 seems to reflect this; it reveals that the median firm experienced a reduction in profits as a result of the application of IFRS 2. Thus, the median index value arguably provides a better indication of the impact of this standard for vast majority of the sample firms.

It has been suggested that outlying values may be of greater interest to corporate stakeholders than those which are more representative of the whole sample (Weetman and Gray, 1990; 1991). Therefore, the index values were classified into different levels of materiality. Table 6.5 details the number of sample companies which recorded an index value in each level of accounting materiality; the adopted materiality limits were 2, 5 and 10 per cent levels of profit[155]. The results exemplify the dramatic impact that the adoption of a new financial reporting regime can have on reported profits; the distribution of values for the overall conservatism index indicates that IFRS profits are less conservative than those reported under UK GAAP. For example, 50 out of the 86 companies analysed reported an increase in profits of 10 per cent or more following the adoption of IFRS. However, the table also reports that 7 firms disclosed an IFRS profit figure that was at least 10 per cent lower than the UK GAAP amount. In addition, Table 6.5 confirms the impression that the adjustments associated with IFRS 3/IAS 36/IAS 38 were the main standards behind the total results; the mean and median index values for these standards provided the largest statistically significant adjustments to reported profits. Table 6.5 shows that almost

[155] Materiality limits of 5 and 10 per cent were initially adopted which were consistent with those applied in previous studies conducting similar analysis (Weetman and Gray, 1990; Weetman and Gray, 1991; Weetman et al., 1998); however, the vast majority of the sample companies were placed in the range below 5 per cent. Therefore, an additional limit of 2 per cent was included to provide a further split of the sample companies within this range in an attempt to identify more revealing results.

Table 6.5: Levels of Materiality - Income Statement

	UK GAAP figure 10 per cent or more below IFRS figure	UK GAAP figure 5 per cent or more below IFRS figure but less than 10 per cent below IFRS figure	UK GAAP figure 2 per cent or more below IFRS figure but less than 5 per cent below IFRS figure	UK GAAP figure within +/- 2 per cent of IFRS figure	UK GAAP figure 2 per cent or more above IFRS figure but less than 5 per cent above IFRS figure	UK GAAP figure 5 per cent or more above IFRS figure but less than 10 per cent above IFRS figure	UK GAAP figure 10 per cent or more above IFRS figure
IFRS 1	0	0	0	86	0	0	0
IFRS 2	2	0	1	52	18	7	6
IFRS 4	0	0	1	84	1	0	0
IFRS 5	0	1	0	84	0	0	1
IAS 1	2	0	0	84	0	0	0
IAS 2	0	0	1	85	0	0	0
IAS 7	0	0	0	86	0	0	0
IAS 8	0	0	0	86	0	0	0
IAS 10	3	0	1	82	0	0	0
IAS 11	0	0	0	85	1	0	0
IAS 12	4	6	1	57	5	4	9
IAS 14	0	0	0	86	0	0	0
IAS 16	1	0	0	81	0	3	1
IAS 17	1	0	2	79	2	1	1
IAS 18	1	0	0	84	0	0	1
IAS 19	4	2	8	60	7	2	3
IAS 20	0	0	0	86	0	0	0
IAS 21	0	0	1	81	1	1	2
IAS 23	0	0	1	85	0	0	0

IAS 24	0	0	0	86	0	0	0
IAS 26	0	0	0	86	0	0	0
IAS 27	0	0	0	84	2	0	0
IAS 29	0	0	0	86	0	0	0
IAS 30	0	0	0	86	0	0	0
IAS 33	0	0	0	86	0	0	0
IAS 34	0	0	0	86	0	0	0
IAS 37	1	0	0	85	0	0	0
IAS 40	7	0	0	79	0	0	0
IAS 41	1	0	0	85	0	0	0
IAS 28/IAS 31	1	0	1	81	0	2	1
IAS 32/IAS 39	1	2	1	73	4	1	4
IFRS 3/IAS 36/IAS 38	46	1	11	24	0	2	2
Other/Unclassified	3	1	2	75	3	1	1
Total Profit - IFRS	50	4	2	11	5	7	7

Notes: This table provides information on the distribution of index values for the whole index and each partial index. The index values are grouped according to materiality, based on limits of 2 per cent, 5 per cent and 10 per cent.

half of the sample firms reported that UK GAAP profits were 10 per cent or more below IFRS-based profits as a result of changes introduced by these standards.

Table 6.5 also illustrates the impact of outliers on reported results. For example, the previous section indicated that IFRS 2 adjustments resulted in a total mean percentage increase in profits; however, the median index findings in Table 6.5 document that profits were reduced as a result of the application of this standard. Table 6.5 shows that 31 of the sample firms reported IFRS 2 reduced UK GAAP profits by 2 per cent or more. In contrast, only 3 sample firms disclosed a UK GAAP profit figure that was 2 per cent or more below their IFRS profits as a result of IFRS 2 changes (Acal, Hampson Industries, Spring Group). In addition, Table 6.5 highlights the effect that a small group of significant adjustments can have on the total sample figures. Section 6.3 of the chapter documented that the significant positive impact of IAS 40 was attributable to adjustments reported by a small number of sample firms; Table 6.5 confirms this finding by showing that all 7 firms which disclosed an IAS 40 adjustment provided a figure which resulted in UK GAAP profits being 10 per cent or more below their IFRS counterparts (BAA, Beale, British Land Company, Gleeson (M.J.) Group, Great Portland Estates, Hammerson, Land Securities). These findings support earlier conclusions that the transition to IFRS impacted various companies in different ways with the effect of certain standards not necessarily being indicative of the sample companies as a whole.

A similar analysis of the balance sheet equity adjustments reported by the sample companies was conducted; Table 6.6 details the results of this exercise. The effect of IFRS adjustments was to decrease total equity; the mean index value of 1.532

indicates that total equity reported under IFRS is 53.2 per cent lower than that documented under UK GAAP. This finding supports the results of prior studies which have reported a decrease in total equity following the transition to IFRS (Ormrod and Taylor, 2006; Stenka and Ormrod, 2007; Horton and Serafeim, 2008). This result does contrast with the mean percentage increase in total equity reported in the previous section; however, Table 6.6 shows that the total equity mean index value is not statistically significant since the p-value reported is 0.232. Indeed, the standard deviation reported for total equity of 4.239 implies significant variation between the sample firms on the impact of IFRS on the balance sheet. Furthermore, the median index value reported of 1.003 signifies a closer approximation between the number of sample companies who experienced a negative impact on their equity and those firms which disclosed a positive adjustment implying that the mean index value may have been influenced by outlier adjustments. Therefore, it is arguable that the overall impact of IFRS on the reported equity of the sample firms is negligible.

In terms of the impact of individual standards on reported equity, Table 6.6 reveals that a number of standards required adjustments to the balance sheet of the sample companies. For example, IAS 10 (13.9 per cent), IFRS 3/IAS 36/IAS 38 (6.3 per cent) and IAS 16 (2.7 per cent) caused large increases to UK GAAP profits following the changeover whilst IAS 19 (69.3 per cent), IAS 17 (3.9 per cent) and IAS 12 (2.9 per cent) reduced UK GAAP profits. However, only three standards provided statistically significant mean index values according to the p-values detailed in Table 6.6; these were IFRS 3/IAS 36/IAS 38 (0.000), IFRS 2 (0.003) and IAS 10 (0.035).

Table 6.6: Index of Conservatism - Balance Sheet

	Mean	SD	p-value	Median	Wilcoxon
IFRS 1	0.994	0.045	0.233	1.000	0.423
IFRS 2	0.997	0.009	0.003***	1.000	0.000***
IFRS 4	1.000	0.004	0.735	1.000	1.000
IFRS 5	1.000	0.000	0.320	1.000	1.000
IAS 1	1.008	0.078	0.320	1.000	1.000
IAS 2	0.999	0.006	0.251	1.000	0.423
IAS 7	1.000	0.000	-	1.000	-
IAS 8	1.000	0.000	-	1.000	-
IAS 10	0.861	0.623	0.035**	0.961	0.000***
IAS 11	1.000	0.001	0.320	1.000	1.000
IAS 12	1.029	0.507	0.579	1.000	0.040**
IAS 14	1.000	0.000	-	1.000	-
IAS 16	0.973	0.166	0.118	1.000	0.025**
IAS 17	1.039	0.316	0.244	1.000	0.000***
IAS 18	1.003	0.019	0.170	1.000	0.022**
IAS 19	1.693	4.605	0.152	1.023	0.000***
IAS 20	1.000	0.000	-	1.000	-
IAS 21	1.000	0.004	0.796	1.000	1.000
IAS 23	0.984	0.150	0.320	1.000	1.000
IAS 24	1.000	0.000	-	1.000	-
IAS 26	1.000	0.000	-	1.000	-
IAS 27	1.000	0.001	0.245	1.000	0.178
IAS 29	1.000	0.000	-	1.000	-
IAS 30	1.000	0.000	-	1.000	-
IAS 33	1.000	0.000	-	1.000	-
IAS 34	1.000	0.000	-	1.000	-
IAS 37	0.998	0.013	0.156	1.000	0.201
IAS 40	1.000	0.002	0.217	1.000	0.181
IAS 41	0.999	0.005	0.296	1.000	0.371
IAS 28/IAS 31	1.001	0.012	0.384	1.000	0.666
IAS 32/IAS 39	1.012	0.080	0.140	1.000	0.346
IFRS 3/IAS 36/IAS 38	0.937	0.164	0.000***	0.982	0.000***
Other/Unclassified	1.003	0.034	0.487	1.000	0.106
Total Equity – IFRS	1.532	4.239	0.232	1.003	0.357

Notes: This table details the mean conservatism index (Mean), its standard deviation (SD) and the results from a t-test (p-value) that was used to test whether the mean index value was significantly different from the neutral value of 1. * indicates significance at the 10 per cent level, ** denotes significance at the 5 per cent level and *** indicates significance at the 1 per cent level. The median index values are also reported (Median) and the results of a non-parametric Wilcoxon signed ranks test are provided determining whether the median index values were significantly different from the neutral value of 1. * indicates significance at the 10 per cent level, ** denotes significance at the 5 per cent level and *** indicates significance at the 1 per cent level.

Several standards had no effect on the reported equity of the sample companies. For example, Table 6.6 reveals that 10 standards had no effect on the balance sheet of the sample companies; these predominantly, though not exclusively, focus on disclosure and therefore are not expected to affect reported figures[156].

The results from an analysis of median index values and the Wilcoxon signed ranks test reveal a number of standards had a statistically significant median index value; these standards were IFRS 2, IAS 10, IAS 12, IAS 16, IAS 17, IAS 18, IAS 19 and the IFRS 3/IAS 36/IAS 38 group of standards. Most of these standards were among those which exhibited the largest mean index adjustment values; however, a further examination of the median values detailed in Table 6.6 reveals that several of these standards show a statistically significant median value of 1.000 implying that UK GAAP equity is not sizeably different from those prepared under IFRS following their application. As explained previously, mean values may be influenced by outlier observations and therefore the effect of particular standards may be better explained by the median results. For example, only 10 adjustments to equity for IAS 16 were reported; these included one significant positive outlier adjustment. The median index value of 1.000 therefore provides a better indication of the impact of this standard on the sample as a whole as it reveals that the median firm was not affected by the application of this standard.

Table 6.7 provides information on the distribution of index values across the various levels of materiality. The results confirm the finding that the impact of IFRS adoption on the balance sheets varied throughout the sample firms; the distribution of values

[156] The standards which reported no impact to the income statement were IAS 7, IAS 8, IAS 14, IAS 20, IAS 24, IAS 26, IAS 29, IAS 30, IAS 33 and IAS 34.

Table 6.7: Levels of Materiality - Balance Sheet

	UK GAAP figure 10 per cent or more below IFRS figure	UK GAAP figure 5 per cent or more below IFRS figure but less than 10 per cent below IFRS figure	UK GAAP figure 2 per cent or more below IFRS figure but less than 5 per cent below IFRS figure	UK GAAP figure within +/- 2 per cent of IFRS figure	UK GAAP figure 2 per cent or more above IFRS figure but less than 5 per cent above IFRS figure	UK GAAP figure 5 per cent or more above IFRS figure but less than 10 per cent above IFRS figure	UK GAAP figure 10 per cent or more above IFRS figure
IFRS 1	2	0	0	90	0	0	0
IFRS 2	0	1	1	90	0	0	0
IFRS 4	0	0	0	91	1	0	0
IFRS 5	0	0	0	92	0	0	0
IAS 1	0	0	0	91	0	0	1
IAS 2	0	1	0	91	0	0	0
IAS 7	0	0	0	92	0	0	0
IAS 8	0	0	0	92	0	0	0
IAS 10	17	16	30	29	0	0	0
IAS 11	0	0	0	92	0	0	0
IAS 12	5	4	7	49	7	7	13
IAS 14	0	0	0	92	0	0	0
IAS 16	3	1	1	87	0	0	0
IAS 17	0	0	0	84	4	1	3
IAS 18	0	0	0	90	1	0	1
IAS 19	1	0	0	44	8	10	29
IAS 20	0	0	0	92	0	0	0
IAS 21	0	0	1	91	0	0	0
IAS 23	1	0	0	91	0	0	0
IAS 24	0	0	0	92	0	0	0

IAS 26	0	0	0	92	0	0	0
IAS 27	0	0	0	92	0	0	0
IAS 29	0	0	0	92	0	0	0
IAS 30	0	0	0	92	0	0	0
IAS 33	0	0	0	92	0	0	0
IAS 34	0	0	0	92	0	0	0
IAS 37	1	0	2	89	0	0	0
IAS 40	0	0	0	92	0	0	0
IAS 41	0	0	1	91	0	0	0
IAS 28/IAS 31	0	0	1	90	0	0	1
IAS 32/IAS 39	1	1	2	82	2	1	3
IFRS 3/IAS 36/IAS 38	15	13	17	43	1	2	1
Other/Unclassified	0	3	3	81	3	0	2
Total Equity - IFRS	13	12	12	14	11	7	23

Notes: This table provides information on the distribution of index values for the whole index and each partial index. The index values are grouped according to materiality, based on limits of 2 per cent, 5 per cent and 10 per cent.

for the overall index is almost evenly spread between those where equity calculated according to UK GAAP is more conservative than equity reported under IFRS and those where UK GAAP-based equity is less conservative than IFRS equity. For example, 37 out of the 92 companies analysed reported an increase in equity of 2 per cent or more following the adoption of IFRS whilst 41 firms disclosed an equivalent reduction to the equity figure under IFRS. In addition, Table 6.7 shows the overwhelming contribution of IAS 10 and the IFRS 3/IAS 36/IAS 38 group of standards to the increase in equity under UK GAAP; for example, 63 sample firms reported an increase to UK GAAP equity of 2 per cent or more whilst the equivalent amount for IFRS 3/IAS 36/IAS 38 was 35 firms. In contrast, Table 6.7 illustrates the significant negative impact of IAS 19 as indicated by the mean and median index values reported for this standard; 32 per cent of the sample companies reported a 10 per cent or more reduction to equity following the application of IAS 19 requirements.

6.5 A Comparison with the Results of the Content Analysis

The results of the content analysis survey detailed in Chapter 5 reported a significant increase in IFRS-related disclosures included in the annual reports of the sample companies (outside of the financial statements) following the transition to the new reporting regime. The majority of these disclosures made by the sample firms were in the form of narrative information as it was presumed that much of the numerical disclosures relating to IFRS would be contained in the Reconciliation Statements required to be produced in the first year of IFRS adoption. It was found that a substantial proportion of the narrative disclosures provided by the sample firms related to an explanation of the changes and impact of preparing financial statements

under IFRS for the first time including an explanation of the differences contained within the Reconciliation Statement. The assessment of the IFRS Reconciliation Statements in the current chapter found that the implementation of IFRS also had a significant impact on the reported results of the sample companies; this finding perhaps indicates that the significant narrative disclosures detailed in other sections of the annual report and accounts following the transition to IFRS are a reflection of the financial impact of the new regime on the sample companies. Indeed, the majority of the disclosure increases reported in Chapter 5 for the sample companies related to the implementation and impact of individual IFRS standards; the significant financial impact reported in the Reconciliation Statements of the same companies indicates that the level of descriptive disclosures included in the annual reports regarding IFRS standards may have reflected their impact on the financial statement numbers.

Chapter 5 also reported significant increases in disclosures relating to several IFRS standards and the results of Reconciliation Statement analysis in the present chapter indicate that the standards which provided the biggest disclosure increases in the sample companies' annual reports corresponded to those which caused the greatest financial impact on the financial statement numbers. Specifically, Chapter 5 showed that IAS 32/IAS 39/IFRS 7, IAS 36/IAS 38/IFRS 3, IAS 19, IAS 12 and IFRS 2 exhibited the largest increases in disclosure during the changeover for the sample companies; all of these standards also reported a significant financial impact in the Reconciliation Statements of the same companies. For example, the IAS 36/IAS 38/IFRS 3 group of standards caused the most impact on both reported profits and equity for the sample firms and represented the second largest increase in descriptive disclosure within the annual report during the transition. Chapter 2 indicated that

these standards would require substantial additional disclosures compared to previous GAAP and would also introduce volatility in reported results; the findings of the current thesis appear to confirm these prior expectations.

In addition, although IFRS 2 did not have a significant mean impact on the reported profits of the sample companies, it was illustrated that 76 per cent of the sample companies reported a negative adjustment in the income statement when applying the requirements of this standard and is therefore more indicative of its impact on the sample as a whole. Thus, the findings reported for IFRS 2 in the present study are consistent with prior literature which indicated that this standard would introduce significant disclosure changes and have a considerable impact on the financial statement numbers, particularly for UK firms.

Finally, IAS 32/IAS 39/IFRS 7 reported the largest disclosure increase in the annual reports of the sample companies during the transition process which was arguably expected given the majority of the concerns highlighted in the literature have focused on the financial instruments standards; however, although the impact of these standards on the reported profits of the sample companies was among the largest exhibited, their financial effect was perhaps not as large as the disclosures devoted to a discussion of them would suggest. Only 28 per cent of the sample companies reported an IAS 32/IAS 39 adjustment in the income statement and their impact on the balance sheet was minimal; this finding is consistent with Aisbitt (2006) who also noted that the significant discussion relating to concerns about the financial instruments standards prior to IFRS adoption were not reflected in significant adjustments to reported results following the changeover. As noted earlier, this may

be the result of a re-appraisal of the use of financial instruments by adopting companies as the literature indicated that many firms changed their behaviour regarding such instruments in light of the new IFRS requirements, some even abandoning their use altogether.

6.6 Conclusion

This chapter examined the IFRS adjustments detailed in the Reconciliation Statements required to be produced under IFRS 1 *First-time Adoption of International Financial Reporting Standards* in an attempt to determine whether the new reporting regime has had a material impact on the published financial results for adopting companies in the UK. This analysis was undertaken in two ways; first, the IFRS adjustments required by each standard were expressed as a percentage of the total profit (loss) adjustment in the income statement or total equity in the balance sheet, and second, by calculating an index of conservatism. The results indicate that the impact on reported profits was significant; on average, profit disclosed under UK GAAP increased by 105.85 per cent following the implementation of IFRS. The main standards responsible for this increase included IAS 40 and the IFRS 3/IAS 36/IAS 38 group of standards; however, this overall increase in profits was countered by the negative impact of IAS 12. These findings, based on the percentage changes, were confirmed by the results obtained using an index of conservatism. The results also show that the introduction of IFRS has had a significant impact on the total equity of companies; however, there was a large degree of variation between the sample companies with an almost even split between those which experienced an increase in equity following the transition and those disclosing a decrease to equity post-IFRS implementation. The standards which had the largest positive impact on the balance sheet were IFRS 3/IAS 36/IAS 38 and

IAS 10 although the increase to equity resulting from the application of these standards was partially offset by significant negative adjustments reported in relation to IAS 19 and IAS 12. Perhaps not surprisingly, a number of standards had no material impact on both profits and equity reported under UK GAAP; many of these standards were predominantly, though not exclusively, related to disclosure. Thus, the introduction of IFRS appears to have had a material impact on the financial statement numbers of adopting companies in the UK. Given such numbers appear to be used by investors (Arnold and Mozier, 1984), the sizeable changes reported as a result of the adoption of IFRS must have had implications for the decision-usefulness of the data supplied. Therefore, investment decisions may have been affected by the changes to profit and equity reported for companies following the transition which will impact share valuations. In addition, all companies were not affected equally by the introduction of IFRS; this will likely have had a further impact on the decisions by users of annual reports.

Chapter 7

The Decision-Usefulness of the IFRS Disclosures

Chapter 7 – The Decision-Usefulness of the IFRS Disclosures

7.1 Introduction

The primary objective of this thesis is to examine the impact of IFRS on corporate disclosures in the UK. This objective was facilitated in two ways: (i) by an examination of corporate annual reports before and after the implementation of the new reporting regime undertaken in Chapter 5; and, (ii) by an analysis of the Reconciliation Statements produced upon first-time adoption of IFRS outlined in Chapter 6. The findings of this analysis revealed that the introduction of IFRS had a significant and sizeable effect on the content of the sample companies' annual reports and also had a material impact on the financial statement numbers reported by the same firms following the implementation of the new regime[157]. Although the findings of this analysis offered valuable insight into the scale and nature of the changes introduced by the conversion to IFRS on annual reports and accounts, the objective of the current dissertation is also to assess the decision-usefulness of the new IFRS disclosures for users; in other words, it is an investigation of whether the claims of the IASB about the usefulness of the mandated IFRS disclosures for decision-makers were supported in practice with the contents of the financial reports produced by the sample companies. Further, an assessment of the decision-usefulness of the new IFRS information reflects the interpretative philosophical assumptions of the researcher as outlined in Chapter 4; while the content analysis survey and Reconciliation Statement analysis were predominantly objective exercises with a degree of subjective interpretation, the examination of the usefulness of the IFRS disclosures will attempt to explore and interpret the perceived usefulness of the new information for users.

[157] Although there was a material change in some of the IFRS-complaint numbers reported in the Reconciliation Statements of the sample companies, Chapter 6 highlighted that for a lot of the information no change was needed in converting from UK GAAP to IFRS.

The remainder of this chapter is organised as follows. Section 7.2 provides an assessment of the IFRS disclosures reported in the content analysis survey in Chapter 5 and the Reconciliation Statement analysis conducted in Chapter 6 against the qualitative characteristics outlined in the IASB Decision-Usefulness framework discussed in Chapter 3; this section attempts to determine whether the claims of the IASB about the usefulness of the new information are supported in practice by the contents of the annual reports analysed in the present investigation. Section 7.3 reports the findings of the analysis of the additional comments captured during the content analysis survey to provide further insight into the implementation and impact of the changeover while Section 7.4 outlines the interview findings from Dunne et al. (2008); this analysis was conducted in tandem with the present investigation. It was undertaken as part of a larger project which examined the implementation of the new IFRS regime; this analysis may provide additional information about the perceived usefulness of the new disclosures. Finally, some concluding comments are offered in Section 7.5.

7.2 An Assessment of the IFRS Disclosures against the IASB Decision-Usefulness Framework

The qualitative characteristics of the IASB decision-usefulness framework, which were outlined in Chapter 3, are understandability, relevance, reliability (with supporting characteristics of faithful representation, substance over form, neutrality, prudence and completeness) and comparability. This section will assess whether the disclosures reported in the content analysis survey in Chapter 5 and Reconciliation

Statement analysis undertaken in Chapter 6 satisfied the requirements of these characteristics for information to be useful for user decision-making purposes.

7.2.1 Understandability

As detailed in Chapter 3, the IASB stipulated that information provided in financial reports should be "readily understandable by users" (IASC, 1989a, p. 16) who are assumed to have a "reasonable knowledge of business and economic activities and accounting" (IASC, 1989a, p. 16). The findings of the content analysis survey reported in Chapter 5 revealed a significant increase in IFRS-related information disclosed in the annual reports of the sample companies in the year following the adoption of the new regime; the majority of this disclosure increase was attributable to an explanation of the changes and an assessment of the financial impact of preparing financial statements under IFRS for the first time which may have aided users understanding about the impact of the changeover. However, the researcher encountered a number of difficulties when attempting to allocate the specific IFRS standards to the disclosures made by the sample companies for which the information related to. Several instances were identified where information about particular items of the financial statements including their financial impact were attributable to more than one IFRS standard; for example, discussions pertaining to financial instruments were presented by most of the sample companies with reference to both IAS 32 and IAS 39 (and, in some instances, IFRS 7 also). Further, disclosures relating to intangible assets and goodwill were often provided by the sample firms with reference to IAS 36, IAS 38 and IFRS 3; although closely related, these standards also regulate other elements of the financial statements and therefore by combining all disclosures relating to these standards the possible impact of other elements could not be

ascertained. This issue was also apparent during the Reconciliation Statement analysis reported in Chapter 6; companies often presented the financial impact of, for example, IAS 32/IAS 39 and IAS 38/IFRS 3 as a single line item within the Reconciliation Statement thus making it difficult to determine either the individual impact of each standard or the aspects of each standard that the adjustment related to. Further, from the initial sample of companies which produced a Reconciliation Statement for both reported profit and equity, only a sub-set of these firms provided such statements which enabled the allocation of transitional adjustments to individual standards. Therefore, the difficulties faced by the researcher when attempting to determine the financial impact of, and obtain an explanation about, the impact of particular IFRS standards could be extended to the users of financial statements; this potential lack of understandability about the impact of the IFRS standards is even more profound given that many of the IFRS standards for which this issue arose were among those which exhibited the largest disclosure increase and biggest impact on the financial statement numbers following changeover and were among those highlighted in Chapter 2 as being among the most problematic to interpret and implement.

In addition to the difficulties faced when allocating disclosures to particular IFRS standards, Chapter 5 acknowledged that the disclosures provided by the sample companies about the implementation and impact of specific standards on the financial statements were very technical in nature. Indeed, the individual IFRS standard disclosures by the sample companies were found to be relatively generic; it appeared that disclosures relating to specific standards were very similar across the sample companies and this was particularly evident among the accounting policies included

within the sample firms annual reports. For example, Land Securities described their accounting policy with regards to borrowings as follows:

> "Borrowings other than bank overdrafts are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in the income statement over the period of the borrowings, using the effective interest method."
>
> (Land Securities Annual Report 2006, p. 105)

In comparison, AWG outlined their policy with regards to borrowings as:

> "Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method."
>
> (AWG Annual Report and Accounts 2006, p. 71)

The literature review discussed in Chapter 2 provided evidence of 'boiler-plate' disclosures by adopting companies in the UK whereby explanations of accounting policies appeared to imitate those provided in the relevant IFRS standard by the IASB; the similarity of the disclosures outlined above, of which many other examples were observed, appear to support this argument. This finding could indicate that the sample companies were unsure about how to interpret and implement the standards given the generic nature of the disclosures made. The apparent lack of understanding among adopting companies themselves about IFRS implementation may therefore have constrained the "assumed knowledge" of accounting beyond that which can be reasonably expected of users of financial reports when faced with overly technical and broadly similar disclosures about the adoption of the new regime between companies. In addition, the notable lack of company-specific application of the new standards as a result of these findings might further hinder the ability of users to determine how the changes introduced by the changeover specifically impacted on the business and its

future prospects. Although there was a notable increase in disclosures included in the OFR section of the annual report where more general, company-specific information about the implementation of IFRS would perhaps be provided, much of these disclosures appeared to simply summarise the total impact of IFRS on the financial statements. Indeed, only passing references to the specific IFRS standards which contributed to any impact reported as discussed in the disclosures provided in the notes to the accounts explaining the changes outlined in the Reconciliation Statements were given. Thus, adopting companies did not appear to use the OFR section as an opportunity to aid users understanding about the impact of the IFRS transition by presenting this information within a business specific context.

7.2.2 Relevance

The IASB framework states that information must be relevant if it is to be considered useful to decision-makers; this is the case when it helps them "evaluate past, present or future events or confirming or correcting, their past evaluation" (IASC, 1989a, p. 17). It can be reasonably assumed that information about the implementation and impact of the adoption of a new set of reporting standards on the financial statements of adopting companies will have some value to users of such statements and influence their decision-making processes; indeed, the basis underpinning the preparation of financial statements will have changed which may consequently impact upon companies' published earnings and reported financial positions; these are considered key inputs in investor user groups decision-making processes (Arnold and Mozier, 1984). Therefore, a reconciliation of both reported profit and equity prepared under previous UK GAAP to in accordance with the new IFRS regime could be considered relevant to users as any significant changes to the income statement or balance sheet

of adopting companies as a result of the changeover must have had implications for the perceived riskiness of these firms and therefore impacted on investment decisions.

In addition, any narrative disclosures provided by adopting companies which explain the nature of the changes made to the financial results following the transition to IFRS could also be considered relevant. No doubt, they aided users' understanding concerning the financial effect of the adoption and therefore informed their decision making about these firms. Indeed, such disclosures may reveal information about companies that was not previously published or recognised. The finding reported within the current investigation is that the vast majority of the sample companies provided a reconciliation of both reported profit and equity from UK GAAP to IFRS. Most of the narrative disclosures provided by the same companies related to an explanation of the changes introduced by the adoption of the new regime. Both of these findings indicate that the sample companies attempted to provide relevant information to users about the changeover.

Furthermore, the IASB Framework emphasises that relevant information has a predictive and confirmatory role; the Reconciliation Statement and related narrative disclosures about the reporting changes resulting from IFRS adoption arguably satisfy the confirmatory role which they are expected to fulfil; they confirm any past estimations of the impact of the changeover on the financial statements. However, it is perhaps questionable how much predictive value such statements and corresponding disclosures hold; although they may outline the reporting changes that will be required post-IFRS, the full financial impact of these changes may not be absorbed in the first year of adoption. For example, the vast majority of the sample companies

reported an increase to both profit and equity under UK GAAP as a result of adding back previously amortised goodwill which was no longer permitted under IFRS; however, as most firms noted, IFRS now requires an annual impairment review to be undertaken which, as indicated in Chapter 2, may have a significant adverse impact on reported results in subsequent years. Therefore, changes reported in the Reconciliation Statement upon first-time adoption should be treated with caution by users as they may not be reflective of the impact of the new IFRS standards over the long term since this may not yet be known. In addition, the technical nature and apparent lack of business context afforded to the explanations of the changes introduced by the new regime may limit the predictive ability of these disclosures; it may be difficult for users to determine the long term impact of IFRS on a company's prospects and future financial results based on the first year's data. Users may need to learn about the impact of the new accounting standards before they can predict what future financial statement numbers will be.

The IASB further states that the relevance of information is affected by its nature and materiality. In particular, they note that in some instances, the "nature of the information alone is sufficient to determine its relevance" (IASC, 1989a, p. 17). Disclosures provided in financial reports about the introduction of a new set of reporting standards arguably satisfies the relevance criteria by virtue of its nature; the adoption of IFRS has introduced changes to the basis, formats and presentation of the financial statements of adopting companies. It has therefore impacted on the reported financial positions of these firms. In addition, the materiality of these disclosures is not in question; the findings of the Reconciliation Statement analysis indicated that the introduction of IFRS appeared to have a material impact on both total profit and

total equity in the financial statements of adopting companies. For example, the classification of the Reconciliation Statement analysis findings into levels of materiality revealed that 50 out of the 86 companies analysed reported an increase in UK GAAP profit of 10% or more following the adoption of IFRS. Thus, the sizeable changes to both the income statement and balance sheet as a result of the changeover must have had implications for the decision-usefulness of the information supplied given that such information appears to be used by investors (Arnold and Mozier, 1984; Pike et al., 1992; Barker, 1999).

Although the changes reported to both total profit and total equity for the sample companies were significant, this was due to the impact of only a small number of individual IFRS standards. Indeed, the majority of the IFRSs did not have a material impact on either the income statement or balance sheet numbers which the sample companies published; thus, many of the new standards probably had no influence on the decisions of users when evaluating the impact of the changeover for the sample companies.

7.2.3 Reliability

The IASB postulated that information is reliable when it is "free from material error and bias" (IASC, 1989a, p. 18) and users can depend on it to "represent faithfully that which it purports to represent or could be reasonably be expected to represent" (p. 18). Although the relevance and materiality of the disclosures made by the sample companies in their annual report and accounts about the implementation and impact of IFRS is not in question, there are doubts about the reliability of the study findings. Significant changes to both the income statement and balance sheet numbers of the

sample companies were reported in the IFRS Reconciliation Statements; however, there was considerable variation in the impact of the transition among the sample firms. For example, although the reconciliation from UK GAAP to IFRS revealed an overall increase in total profit for the sample companies, 30 per cent of these firms disclosed a decrease to profit following the changeover indicating that IFRS adoption did not have a positive impact for all companies included in the sample. Further, the impact on the balance sheet of the sample firms was negligible; the distribution of results is almost evenly spread between those companies which reported an increase to reported equity following the changeover and those firms which disclosed an equity decrease post-adoption. Thus, although the adoption of IFRS resulted in a material impact on the reported results for the vast majority of the firms analysed, any overall increase or decrease in total profit and total equity for the whole sample was not necessarily a reliable reflection of the impact of the changeover across each of the individual companies analysed.

In addition, although the findings revealed that a number of individual IFRS standards had a material impact on the financial statements of the sample companies following the changeover, it was indicated that the effect of several of these standards was significantly influenced by outlier values which contributed to the large overall impacts reported for the whole sample. For example, IAS 40 provided the largest impact on reported profits for the total sample, however, only seven companies reported an IAS 40 adjustment to UK GAAP profits; closer inspection revealed that the majority of these companies were based in the real estate sector. Indeed, many of the standards reported as having a significant impact on the income statement and balance sheet of the sample firms only did so due to a small number of companies

reporting large adjustments for those standards; thus, although the impact of these standards is relevant and material for some firms, again it is not necessarily reflective in the context of their impact on the sample companies as a whole.

Furthermore, although the impacts of some standards were sizeable for the vast majority of the sample companies, their long term effects may be negligible beyond the time period of the current analysis. For example, as mentioned earlier, a significant increase was reported for the IAS 36/IAS 38/IFRS 3 group of standards on both reported profit and equity; this was predominantly as a result of the requirement to add back goodwill which had previously been amortised under UK GAAP; although a positive adjustment arose upon first time adoption of the new regime, this may be offset in subsequent years by the new requirement to subject goodwill to an annual impairment review. Such a review may result in significant reductions in both reported profit and equity. Indeed, the literature highlighted in Chapter 2 has indicated that the full impact of the new standards may not become apparent or well understood as it may be several years before the changes are fully absorbed within the reported results. Therefore, although relevant and material within the time period of analysis, the changes reported in the Reconciliation Statements should be treated with a degree of caution as they may be misleading given the transitory nature of the adjustments where the full impact may only reveal itself in the years following the changeover; this argument is none more evident than when reflecting upon the recent financial crisis and the fair value controversy that has arisen as a result of the economic downturn (Whittington, 2008).

7.2.3.1 Faithful Representation

The IASB stipulated that to be reliable, information must "represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent" (IASC, 1989a, p. 18). The analysis of the narrative IFRS disclosures and Reconciliation Statement adjustments conducted in the present investigation arguably makes an assessment of whether the information studied faithfully represents that what it purports to represent difficult to achieve; a deeper investigation is needed into the context and nature of the disclosures. Nevertheless, the IFRS Reconciliation Statements and related disclosures appeared to achieve what they were expected to provide; almost the entire sample of companies provided a reconciliation of both reported profit and equity from previous UK GAAP to IFRS upon first time adoption of the new regime. In addition, these companies supplied detailed explanations of the changes contained within the Reconciliation Statements to aid users understanding of the nature and impact of the changeover.

Further, the IASB acknowledged that:

> "Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events."
>
> (IASC, 1989a, p. 18)

When analysing the narrative IFRS disclosures included in the annual reports of the sample companies, particularly the accounting policies included in the notes to the accounts section, a trend became apparent. Most of the sample firms took advantage of the many exemptions available upon first-time adoption including exemptions relating to IAS 32/IAS 39, IAS 19 and IFRS 3. There may be specific reasons why

particular companies opted to utilise the exemptions available, however, perhaps the widespread use of exemptions among the sample firms is a reflection of a lack of preparedness on the part of these companies to fully comply with the requirements of standards where exemptions were available. The literature indicated that many companies faced difficulties when attempting to implement the new standards where a range of information not previously disclosed, or even produced, was now required; the use of exemptions may result from these difficulties as companies were not yet in a position to fully comply with the new requirements. Indeed, it has been documented that many companies waited until competitors disclosed information relating to particular requirements before they decided on their publication format (Dunne et al., 2008). Perhaps the widespread use of exemptions also indicated a level of hesitance on the part of adopting companies to disclose sensitive information before their peers in order to avoid being put at a competitive disadvantage.

In addition, perhaps the measurement period and presentation of the Reconciliation Statements involves an element of risk that the information they contain may not fully represent what they purport to portray. Although the Reconciliation Statements provided by the sample companies do, as required by IFRS 1, provide a reconciliation of both reported profit and equity between UK GAAP and IFRS upon first-time adoption of the new standards with related explanations about any changes reported, as discussed previously, the usefulness of this information may be limited when attempting to generalise from the impact of the changeover. This is because some of the adjustments included with the Reconciliation Statements may be one-off in nature; therefore, they may not necessarily reflect the impact of the new standards over the long term. Thus, the Reconciliation Statements may not necessarily represent

faithfully the full impact of IFRS adoption and users should exercise some caution when relying on them to inform their decision-making.

Interestingly, the example provided by the IASB of information which may not provide a faithful representation of what it intends to portray relates to the treatment of goodwill; they argue that "although most entities generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably" (IASC, 1989a, p. 18). Coincidentally, the IAS 36/IAS 38/IFRS 3 group of standards, which all regulate the treatment of goodwill, were among the standards which provided one of the largest increases in narrative disclosures in the annual reports of the sample companies. They also generalised the biggest impact on both the reported profit and equity numbers for sample companies as the vast majority of firms reported an adjustment in the income statement and balance sheet in relation to these standards. The requirement to add back any goodwill previously amortised under UK GAAP and instead subject goodwill to an annual impairment review under the new regime appears to have significantly impacted on most of the sample firms; thus, an item of the financial statements for which the IASB acknowledge involves a degree of difficulty and subjectivity was associated with some of the biggest changes in the transition to IFRS. Indeed, the IASB contributed to this impact by requiring an annual impairment review involving a high degree of judgement.

7.2.3.2 Substance over Form

The IASB stated that information must be accounted for and presented with reference to it's "substance and economic reality and not merely its legal form" if it is to satisfy the criterion of faithful representation (IASC, 1989a, p. 18). Similar to the study's

findings in the context of faithful representation, examining the legitimacy of the information gathered in the current investigation with reference to its substance and form would require a closer inspection of the disclosures analysed. Nevertheless, as indicated earlier, although the purpose of the Reconciliation Statement that was required by IFRS 1 was to reconcile both reported profit and equity from previous UK GAAP to IFRS upon first-time adoption of the new standards. It sought to determine the impact of the changeover on the financial statements of adopting companies, although the results and changes reported may not capture the full impact of the transition. As outlined in Chapter 2, many aspects of the new standards are likely to only reveal their full impact on the reported results in the subsequent years following adoption; therefore, the legal requirement to produce a Reconciliation Statement upon first-time adoption may not fully reveal the underlying substance of the information that this statement contains in terms of the impact of the changeover over the long term.

7.2.3.3 Neutrality

The IASB postulate that financial reports are not neutral if,

> "...by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome."
>
> (IASC, 1989a, p. 19)

When undertaking the content analysis of the narrative disclosures contained in the sample companies' annual reports, it was initially intended that any indication as to whether the IFRS-related information analysed was disclosed as good, bad or neutral news would be noted; this was to determine whether, and if so how, the transition had a positive or negative impact on adopting companies. However, there were so few

disclosures which could be interpreted in this way that this sub-category was removed from the final analysis. For example, it became apparent that the sample companies mostly discussed changes to reported results under IFFRS in terms of an increase or decrease in the financial statement numbers instead of, for example, a favourable or unfavourable adjustment. Indeed, as mentioned previously, much of the disclosures provided by the sample firms about the impact of the changeover lacked business-specific context as they were predominantly technical in nature. There was little or no reference to whether the reported changes benefited or were detrimental to the underlying business and its future prospects which is presumably what users of the annual reports were attempting to determine. Nevertheless, the disclosures were primarily focused on the accounting changes made to the financial statements; this could be interpreted as meeting the criterion of neutrality given that little reference was made to the impact on the business fundamentals; no attempt was made to influence users interpretation about the impact of the new regime and therefore their decision to invest in or maintain or withdraw their shareholding in the company.

The neutrality of the narrative disclosures made by the sample companies in the current investigation may not be wholly extended to the IFRS Reconciliation Statements produced by the same companies. Although most sample firms provided a reconciliation of both total profit and total equity reported under UK GAAP to those disclosed under IFRS, only a sub-set of these statements could be analysed because a number of companies presented their Reconciliation Statements in a format which did not allow for the identification and allocation of transitional adjustments to IFRS standards. Indeed, the Reconciliation Statements were presented in a number of different formats between the sample firms which is perhaps unsurprising given that

the IASB did not prescribe a specific layout for these statements; only an example of line-by-line reconciliation was outlined in the Implementation Guidance (Bonham et al., 2004). Therefore, an element of flexibility, and potential scope for impression management, was afforded to companies when preparing their IFRS reconciliation statements; this was apparent in the current investigation since many firms presented their Reconciliation Statements in a manner which made an interpretation of the adjustments to reported profit and equity numbers difficult. This was particularly true of those companies which provided a line-by-line reconciliation of the balance sheet items from UK GAAP to IFRS since no specific guidance was usually supplied on the individual IFRS standards which impacted on the reported changes.

7.2.3.4 Prudence

A further quality that information provided in financial reports should possess is prudence. The IASB claimed that prudence is the,

> ..."inclusion of a degree of caution in the exercise of judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated."
> (IASC, 1989a, p. 19)

The apparent lack of forward-looking disclosures provided by the sample companies would seem to indicate that some element of prudence existed with regards to the long-term impact of the adoption of the new regime. As indicated in Chapter 2, perhaps this is a reflection of a degree of uncertainty among adopting firms about what the long-term impact of the changes will be; therefore, the absence of such forward-looking information in the annual reports of the sample companies could be considered as prudent by these firms given that they may not be aware of how the adoption of IFRS will affect future results.

However, the degree of prudence implicit in the findings of the Reconciliation Statement analysis is questionable. The majority of the sample companies reported a significant increase in total profit as a result of the changeover. Indeed, there were instances where a reported loss under UK GAAP became a large profit under IFRS post-adoption. These findings could be interpreted as implying that the IFRS regime is less prudent than previous UK GAAP. Indeed, UK GAAP was found to be more conservative than IFRS for reported profit. Given the high level of quality associated with the UK regime (Haller, 2002), it could be suggested that a more relaxed set of requirements has been introduced with the adoption of IFRS. This would appear to be at odds with the exercise of prudence; this is quite a profound change given that prudence is also a qualitative characteristic outlined in the ASB's Statement of Principles. Perhaps the significant changes reported to the income statements are the result of one-off introductory adjustments following the transition. The impact of the new standards over a longer time period may be more conservative; nevertheless, the adoption of the new standards has given rise to a significant increase in reported profits of the sample firms which may reflect a less prudent approach under IFRS compared to that employed by UK GAAP. Indeed, the recent global financial crisis has only served to support such an argument as many researchers have attributed much of the cause of the turmoil to the recent proliferation of fair values for assets and liabilities in the financial statements (Accountancy Age, 2008a; Whittington, 2008); a key difference between IFRS and UK GAAP is the greater use of fair values under the new regime (Chapter 2). This concern was highlighted among adopting companies in terms of the perceived riskiness and volatility in financial results a move to fair values would introduce (Aisbitt, 2006). With hindsight, it would seem that the greater use of fair values under IFRS may have overstated the value of assets and

understated the value of liabilities in the balance sheet of adopting companies at the time of the changeover.

7.2.3.5 Completeness

An assessment of the completeness of the findings of the Reconciliation Statements analysis and the associated narrative disclosures included in the annual reports would require a more detailed examination to be undertaken in order to understand whether any omissions were made by the sample companies which could cause information to be "false or misleading and thus unreliable" (IASC, 1989a, p. 19). However, not every Reconciliation Statement provided by the sample could be analysed as it was difficult in some instances to attribute particular IFRS standards to the individual adjustments made to UK GAAP profit and equity. Although this difficulty does not necessarily indicate that the reconciliation of both total profit and total equity was incomplete, the lack of descriptive details about any reporting changes which impacted the income statement or balance sheet numbers might have created difficulties for users when trying to ascertain why the reported results had altered. Thus doubts may have been raised in the minds of users about the reliability of the information provided on the overall impact of the changeover.

7.2.4 Comparability

The IASB stated that users should be able to compare the financial reports of a company "through time in order to identify trends in its financial position and performance" (IASC, 1989a, p. 19). The present investigation examines the annual reports and accounts of UK companies in the year prior to and following the adoption of IFRS; thus, it is not possible to adequately compare the financial statements of the

sample firms between these two periods given they were prepared in accordance with two different reporting regimes. However, the IASB required adopting companies to provide an IFRS Reconciliation Statement upon first-time adoption of the new regime reconciling both reported profit and equity under the previous UK GAAP to the equivalent figures disclosed in accordance with the new IFRS standards. Thus, a comparison of the financial statement numbers reported between the two regimes over the same time period could be made to determine the impact on the financial position and performance of adopting companies following the changeover; the vast majority of the companies analysed in the present study provided an IFRS Reconciliation Statement together with narrative disclosures providing an explanation of the changes reported.

However, the IASB also required that users must be able to compare the financial statements of "different entities in order to evaluate their relative financial position, financial performance and cash flows" (IASC, 1989a, p. 19). A number of firms were excluded from the sample for the Reconciliation Statement analysis because their Reconciliation Statements could not be examined for the purpose of the investigation; it was found that the Reconciliation Statements provided were presented in a range of formats by the sample companies and this constrained the comparability of these statements between the firms.

In addition, the results of the Reconciliation Statement analysis themselves question the degree of comparability among the sample firms in terms of the financial impact of the changeover; the changes reported to UK GAAP profit and equity following the transition varied significantly between the sample companies particularly with respect

to the effect on the balance sheet; there was an almost even split between these firms reporting an increase to equity and those disclosing an equity decrease post-adoption. This widespread variability can be extended to the impact of the individual standards as several standards had a varied impact on the sample companies' financial statements (see Tables 6.2 and 6.3 in Chapter 6). Some reported large adjustments while others documented minor changes to reported results. Indeed, a few reported no adjustments to the financial statement numbers. Further, certain standards appeared to impact only those sample firms located within specific sectors; for example, the majority of the firms which reported an IAS 40 adjustment to the income statement were based in the real estate industry. Finally, the variability reported for the narrative disclosures analysed between both market listing and sector further implies that the impact of the adoption of IFRS may not be comparable between the sample companies.

7.3 An Analysis of the Comments provided by the Sample Companies about IFRS Adoption

When undertaking the content analysis in Chapter 5, the inclusion of a *General impact of implementation* category was designed to capture the sample firms' general opinion about the conversion to International GAAP. As such, the researcher noted any comments made by the sample companies which offered an insight into the implementation process undertaken within these firms, the effect, if any, the transition to IFRS had on the underlying business and whether the changeover to the new regime was considered a positive move; the comments captured are included in Appendix 7.1. An analysis of this Appendix reveals that despite reporting a significant increase in IFRS-related disclosure for the sample companies following the

changeover, only three of the sample firms offered any notable general opinion on the IFRS transition process: Daily Mail & General Trust, Legal & General and Royal & Sun Alliance. For example, Daily Mail and General Trust stated that the move to IFRS,

> "...led to considerable changes in the format of [their] primary statements, to increased volatility of the numbers within the Income Statement and to a far longer and more complex set of accounts. IFRS seems to favour the use of fair values over the traditional measure of historical cost and increasingly appears to be driven by academic theory, at the expense of commercial reality. Whilst many IFRS standards follow the UK principles-based approach, enabling the exercise of professional judgement, several of its newer US-influenced standards have introduced complex rules and this trend seems set to continue."
> (Daily Mail & General Trust Annual Report 2006, p. 28)

By contrast, the annual report of Legal & General was more favourable:

> "We believe the IFRS (and EEV) developments have been an important step towards improving the consistency and comparability of accounts of European insurers. However, this has resulted in a much longer annual report and accounts document this year."
> (Legal & General Annual Report and Accounts 2005, p. 18)

Similarly, the CEO of Royal & Sun Alliance was broadly supportive of the change:

> "While such a significant change in accounting basis can make it harder to understand how a business is really performing, I believe that the move to IFRS, combined with the changes in disclosure we have initiated ourselves, will make it easier to see how we are performing."
> (Royal & Sun Alliance Annual Report & Accounts 2005, p. 27)

The above quotes highlight many of the issues discussed in Chapter 2 regarding the impact of the implementation of IFRS, including; (i) increased volatility in reported results (Aisbitt and Walton, 2005; Jermakowicz and Gornik-Tomaszewski, 2006), (ii) greater complexity of accounts (Ernst and Young, 2006; FRC, 2006), (iii) the influence of US GAAP (Accountancy, 2005d; Gandy, 2005; International Accountant, 2006); and, (iv) an increase in the size of the annual report post-IFRS adoption

(Accountancy Age, 2005a; Financial Director, 2006; FRC, 2006). However, it is perhaps surprising that only three of the 138 sampled firms discussed these issues given the importance and scale of the task faced by companies when converting to a new reporting regime.

Perhaps even more surprisingly, several companies indicated that the transition to IFRS would have no or only a minimal impact on their business; for example, Friends Provident stated in their pre-IFRS adoption annual report for 2004 that IFRS would "not materially impact profits, embedded value, dividend policy or solvency" (p. 24). Legal and General indicated that they did "not expect significant impact on shareholders' funds" (p.17) following the changeover while Reuters advised that they did "not expect IFRS to alter specific future guidance" for the company (p. 23). In addition, Aviva stated in their post-IFRS adoption annual report that they,

> "...believe[d] that IFRS represents a technical change, [would] not impact dividend policy, [have] no significant impact on solvency calculations, [leave] EEV results unaffected and does not represent a material change to the economics of business."
>
> (Aviva Annual Report and Accounts 2005, p. 46)

Although Chapter 2 indicated that the introduction of IFRS was anticipated to be a purely accounting change, it is surprising that the underlying business of some companies may not have been affected by the adoption of the new reporting regime given the scale of the change required and the significant impact reported to both profit and equity in the IFRS Reconciliation Statements found in the current investigation.

Chapter 2 highlighted that the implementation of IFRS involved substantial transition programmes for many of the larger UK companies; several of the sample companies

disclosed details of such programmes including Aviva where the IFRS changes were included in a £171 million investment in a "global finance transformation programme" (p. 17). Barclays stated that the changeover provided a "considerable resource stretch and [was] subjected to cost/benefit analysis" (p. 12) and Legal and General made "significant investment in regulatory and reporting systems to prepare for IFRS implementation" (p. 29). RBS indicated that the transition process began several years prior to adoption as debt, staff and pension costs increased between the periods 2002-03 and 2003-04 "partly due to additional resources devoted to Group IFRS project" (p. 126). When describing how they implemented the transition to IFRS reporting following a major acquisition, Weir Group undertook a,

> "...carefully managed 100 day integration plan...executed by a cross-functional team that included sales & marketing, HR, lean production...to ensure rapid alignment of the conversion to IFRS reporting standards."
> (Weir Group 2006 Annual Report, p. 32)

Further, many firms indicated that specific training was provided to their directors in order to ensure that they understood the changes required and their impact.

In addition to the internal programmes and exercises undertaken by adopting companies, many of the sample firms disclosed that they employed additional services from auditors as part of their preparations for the changeover; Chapter 2 indicated that this was particularly prevalent among smaller companies who did not possess the same level of internal resources as larger counterparts. Much of these disclosures were made in the notes to the accounts as part of the costs of further audit-related services although the sample firms did not quantify exactly how much of these services related specifically to guidance on the IFRS conversion. Nevertheless, it is clear that many of the sample companies obtained advice from auditors as part of their IFRS preparations and given the concerns raised in the literature about the apparent

lack of preparedness of the auditors themselves, it would be interesting to gauge the opinions of these firms as to whether their expenditure on these additional auditor services to help manage the IFRS transition was worthwhile.

7.4 Findings from Dunne et al. (2008)

The content analysis survey and Reconciliation Statement analysis included in the current dissertation were undertaken as part of a larger ICAS-funded project which examined the implementation of IFRS. This larger study also included an interview survey with multiple stakeholders on the adoption of IFRS including interviews with preparers, auditors, analysts and regulators[158]. These interviews were undertaken in an attempt to assess the costs associated with the adoption of the new regime, identify the IFRS standards which caused the most problems for preparers to implement and as part of the wider study objective of examining the decision-usefulness of the information required under the new regime for users. Thus, the interview findings of Dunne et al. (2008) may provide additional information and further inform the findings about the usefulness of the new disclosures reported in the current investigation.

When interviewing preparers about their experiences during the planning for the implementation, the complexity of the new IFRS standards was highlighted with particular difficulties in applying them to certain types of businesses; for example, one interviewee argued that:

[158] It is acknowledged that UK, Irish and Italian participants were interviewed as part of this study, however, the assessment of the interview findings in the present investigation will only focus on the results of the UK-based interviews.

> "All accounting standards are written for the widget manufacturer in Birmingham who has one pension fund and one subsidiary in the UK and one overseas subsidiary and it doesn't work with companies across one hundred countries."
>
> (Dunne et al, 2008, p. 99)

More specifically, the interviewees noted that not all standards had been finally agreed at the date of implementation with particular emphasis on the lack of agreement on IAS 39; this caused problems for preparers when developing new systems to capture and audit the proposed changes. Further, some of the biggest problems were associated with the implementation of the details of certain standards which in practice became completely immaterial once implemented; these findings are consistent with the observation in the present study that there was widespread use of exemptions upon first-time adoption of the new regime. Further, it was indicated that the dearth of IFRS disclosures in the annual reports of the sample companies in the year prior to adoption may have reflected a degree of uncertainty about the impact of the conversion on the financial statements; perhaps this was, at least in part, due to a number of standards not being finalised at the time of the changeover.

The interviewees also highlighted difficulties when deciding whether to apply IFRS to all companies in the group or to publish only the consolidated accounts under the new regime. Indeed, a few companies applied IFRS to all their subsidiaries; among the sample firms analysed in the current study, only 42 per cent reported their parent company financial statements in accordance with the new IFRS standards; thus, it would appear that most adopting companies did not believe, at least at the time of

adoption, that preparing parent company financial statements under the new regime would be beneficial.[159]

When conducting the interviews with users of financial statements it was found that they had to update themselves about the new IFRS standards; this is particularly surprising given that the primary objective of the new regime is to provide useful information to users for their decision-making and therefore it would be expected that adopting companies would seek to educate users about IFRS and their impact on the business. Indeed, the additional narrative disclosures discussed in the previous section revealed that only a handful of companies noted in their annual reports that they had engaged users about the conversion to IFRS. The interviewees also noted that users were particularly interested in how financial statement information was going to be presented under the new IFRS format and whether the financial numbers and ratios that users consulted were consistent with those previously reported. The findings of the content analysis for the pre-adoption annual reports in Chapter 5 do not provide evidence that adopting companies attempted to address these user needs; few disclosures about IFRS were made by the sample firms with only a small minority of companies indicating what the likely impact of the changeover on the financial statement numbers would be and even fewer firms presenting the impact of the changeover in the new IFRS format. The findings of the Reconciliation Statement analysis in Chapter 6 revealed that the adoption of the new regime had a material impact on the financial statements of the sample companies; the income statement and balance sheet figures were often considerably different from those that previously reported under UK GAAP. However, it was highlighted in the previous section that

[159] BDO (2006) indicated that the impact on taxation and distributable reserves were the most likely reasons behind this decision.

several sample companies emphasised the use of adjusted figures as being a better reflection of the actual performance than the IFRS measures; this was also a concern among adopting companies in Chapter 2. These disclosures may have been an attempt to aid user needs by presenting the financial results following the changeover in a manner consistent with how the figures were reported previously although such an assertion only serves to undermine the perceived usefulness of the new IFRS disclosures.

Discussions with the preparer user group revealed that companies typically benchmarked themselves against other companies; they reviewed the financial statements of either their direct competitors or companies who had a reputation for good disclosure practices. However, the perceived usefulness of using other company accounts as a guide for financial statement preparation was questioned for a number of reasons. First, the number of choices available to preparers under IFRS hampered the ability for benchmarking with other companies; it was noted earlier that there was widespread use of exemptions among the sample companies analysed in the present study and such choices will only constrain the possibility of benchmarking given that many companies chose not to disclose certain items under a number of IFRS standards. Second, it was argued that some companies were put at a competitive disadvantage by being among the first to report IFRS results within their peer group. This presented an opportunity for competitors to see how the company treated certain items for which they were unsure about how to disclose; this observation may reflect the apparent degree of caution asserted by the sample firms in the current study given the lack of IFRS-related disclosures provided in their pre-adoption annual reports. The

disclosures may not have wanted to reveal what the impact on the financial statements from complying with the new regime for fear of competitive disadvantage.

Third, adopting companies may have been put at a further disadvantage compared to competitors who did not comply with IFRS when preparing their financial statements at the time of UK adoption. It was argued that the IFRS regime may have compelled competitors to disclose more information than they had previously reported; for example, one preparer explained that following the completion of an acquisition, the goodwill associated with brands was not reported and this may provide the market with information which could be used at a later point to determine whether the company overpaid for that acquisition with potentially adverse consequences on company value. Indeed, disclosures relating to goodwill were among those which provided the greatest amount of narrative information for the annual reports analysed in the current study. They also provided one of the largest impacts on the financial statements as evidenced in the IFRS Reconciliation Statements. Although such disclosures may have placed companies at a competitive disadvantage, it is arguable that this information was useful to investor analysts when attempting to determine the value of a company as part of their investment decisions.

During the content analysis survey, it was acknowledged that few disclosures were made about the cost of the implementation of the new reporting regime despite the nature and scale of the change. The vast majority of the preparers interviewed by Dunne et al. (2008) believed that the conversion to IFRS had a significant cost; some conceded that a proportion of the costs were likely to be one-off and non-recurring, however, it was also argued that there were additional unquantifiable costs. For

example, several interviewees indicated that implementation costs were expensed which had the knock on effect of reducing the cashflows and distributable reserves available to shareholders. Indeed, one preparer revealed that their company did not pay a dividend in the conversion year partly as a consequence of IFRS conversion costs; such additional unquantifiable impacts are likely to have had an adverse effect on the investment decisions of investors.

It was widely acknowledged that an argument in favour of the introduction of IFRS was the provision of more forward-looking information which might improve the ability of users to monitor management performance; however, most interviewees in Dunne et al. (2008) tended to disagree with the notion that IFRS would provide any information which could improve the predictive ability of financial statements for users. This is consistent with the prior observation regarding the degree of caution which should be exercised when relying on the IFRS financial statements; it was noted that changes reported in the Reconciliation Statements may have been one-off adjustments in the year of adoption and therefore may not necessarily be a reflection of the full impact of the conversion which had yet to be known. Thus, the evidence provided by both the interviewees in Dunne et al. (2008) and analysis undertaken in the current study indicate that users should exercise caution when attempting to predict the impact of the changeover over the longer term.

The new IFRS regime was introduced by the IASB to provide comparable information that is useful to user decision-making. The interviewees in Dunne et al. (2008) did not believe that greater transparency and comparability was achieved at IFRS adoption because there were too many choices available in the standards.

Indeed, comparability was an issue in the present study when conducting the Reconciliation Statement analysis as a range of formats were provided by the sample firms with some Reconciliation Statements proving too difficult to analyse. Some interviewees in Dunne et al. (2008) did suggest that comparability may be less of an issue in the medium to long-term; however, it was also acknowledged that comparability may never be achieved while US-based companies were required to satisfy the demands of two standards boards, the IASB and FASB. Thus, the achievement of greater comparability of global financial reporting will likely depend much on the success of the current IASB/FASB joint project being undertaken (IASB, 2009).

In addition, it was generally agreed among the interviewees in Dunne et al. (2008) that financial statements prepared under IFRS did not improve analysis of a company's performance or provide better predictive ability in comparison to those presented in accordance with previous UK GAAP; hence it did not assist decision-making. Many interviewees in Dunne et al. (2008) did not believe that the new IFRS reporting formats were more useful and indicated that their use of the disclosures in the financial statements had not altered; this indicates that the additional disclosures reported by the sample firms following the adoption of the new regime in the current investigation did not provide any additional useful information to users. The interviewees claimed that the length and complexity of the reports prepared under IFRS were the reasons why they did not think the IFRS financial statements were decision-useful; the findings of the present study support this observation as it was reported that the size of the average annual report increased by nearly 30 per cent and the researcher faced great difficulties when attempting to allocate disclosures to

individual IFRS standards due to the complex and technical nature of the disclosures provided by the sample companies. Further, a number of the sample firms Reconciliation Statements were excluded from the final analysis because they were too difficult to analyse; all these points support the notion that the decision-usefulness of the new disclosures may have been constrained by the nature and complexity of the disclosures provided by adopting companies.

7.4.1 Other Literature on the Usefulness of the IFRS Disclosures

Although there have been few empirical studies which have explicitly investigated the decision-usefulness of the new IFRS disclosures provided by adopting companies, a number of surveys have been undertaken by the professional accounting firms and within the financial press which have attempted to determine whether the new information was perceived as being useful to users. An Accountancy Age survey discussed in Chapter 2 indicated that the majority of UK Financial Directors did not believe that the introduction of IFRS was beneficial to UK business due to a lack of preparedness amongst the adopting companies and a lack of understanding among investors about the changes made (Accountancy Age, 2005c). The limited IFRS disclosures provided by the sample companies within their pre-adoption annual reports analysed in the present study was attributable to a possible degree of uncertainty among these firms about what the impact of the conversion would be; perhaps this was, at least in part, because the sample companies were not yet fully prepared for the changeover in the year prior to adoption. In addition, few sample firms disclosed details about whether they engaged investors about the implementation of IFRS and its impact on the reported results; taken together with the general difficulties faced by the researcher when analysing the impact of the IFRS

standards on the financial statements and the broadly technical nature of the narrative disclosures made about these standards, evidence of a lack of understanding among investors about the new regime is perhaps not surprising.

It was anticipated that the introduction of IFRS would be a purely accounting change that would not have an impact on company market valuation (Mazars, 2006); however, PwC (2006b) reported that perceptions of company values had changed following IFRS adoption as the majority of the fund managers surveyed revealed their investment decisions had been impacted. This finding is perhaps not surprising given the size of the changes reported to the financial statement numbers disclosed in the IFRS Reconciliation Statements analysed in the present investigation. Greater management information and transparency following the changeover were attributed as the reasons for these changes in company perception and this provided evidence that the new IFRS disclosures conveyed new information that was relevant to firm valuation; thus, it would appear that the additional disclosures reported in the sample companies post-adoption annual reports provided users with new and useful information about these firms. It was revealed in Chapter 2 that this assertion has been empirically investigated by a number of researchers including Christensen et al (2007) who found that the market responded significantly to the announcements of the IFRS reconciliations; therefore, these statements provided new information to the market. They concluded that the similarity between IFRS and UK GAAP was not as apparent as commentators had suggested; the wide variations to both reported profit and reported equity found in the present study further support this observation.

7.5 Conclusion

This chapter assessed the decision-usefulness of the new IFRS-related disclosures provided in the annual reports and accounts of adopting companies analysed in the content analysis survey and Reconciliation Statement analysis. First, an examination of the IFRS information against the qualitative characteristics outlined in the IASB decision-usefulness framework was undertaken; the results indicate the disclosures provided by the sample companies may not have satisfied the requirements of many of these characteristics for such information to be useful for user decision-making. In particular, it was argued that the IFRS disclosures may not be readily understandable by users given the difficulties faced by the researcher when attempting to allocate specific IFRS standards to the disclosures made, the generic and technical nature of the disclosures made and the lack of business-specific context provided by the sample companies. In addition, although the Reconciliation Statement numbers and associated disclosures were undoubtedly relevant to users given the scale of the changes made and impact reported, it was questionable how much predictive value the disclosures provided given the short time period of analysis as the full impact of the conversion may not yet be known.

Further, doubts about the reliability of the new disclosures were raised given the wide variation reported for the impact on both the income statement and balance sheet and also the influence of a small number of large adjustments reported for many IFRS standards; the overall impact of certain standards may not be a reliable reflection of their impact on the adopting companies as a whole. It was also highlighted that the significantly higher profits reported in the IFRS Reconciliation Statements could be perceived to indicate that IFRS is less prudent than the previous UK GAAP; this

suggests that a more relaxed set of requirements was introduced following the changeover and, with hindsight, the recent global financial crisis and the subsequent fall out regarding the role of fair value accounting during this crisis has only served to reaffirm this observation. Finally, a lack of comparability between the IFRS Reconciliation Statements was reported given the range of formats provided by the sample companies and the widespread variation in impact reported to the financial statement numbers.

An analysis of the additional comments provided by the sample companies in their annual reports further highlighted a lack of company-specific information reported about the changeover while a review of the interview findings in Dunne et al. (2008) reiterated that: (i) the new standards were complex and difficult to implement; (ii) users had to update themselves about the impact of the changeover consistent with the lack of stakeholder engagement noted within the additional comments provided by the sample companies; (iii) the new regime did not provide forward-looking information that would improve the predictive value of the financial statements to users; (iv) greater transparency and comparability was not achieved due to the number of choices available within the standards; and, (v) the new reporting formats were not more useful and use of financial statement disclosures had not altered following the changeover.

In summary, the introduction of IFRS appeared to have had implications for the decision-usefulness of the disclosures provided by adopting companies in their annual reports and accounts. The widespread variation in impact on reported results, the complexity of the supplementary narrative disclosures, absence of company-specific

and forward-looking information, uncertainty about the long-term impact of the changeover and the lack of comparability between the Reconciliation Statements will likely have constrained the usefulness of the new disclosures provided for users and therefore their investment decisions.

Chapter 8

Conclusion

Chapter 8 - Conclusion

8.1 Introduction

The primary objective of this thesis was to examine the impact of the introduction of IFRS on UK corporate reporting practices. More specifically, the aim was to conduct an assessment of the decision-usefulness of the information required by the new reporting regime. An investigation of the impact of IFRS on corporate reporting practices was facilitated by: (i) an analysis of the contents of corporate annual reports (other than the financial statements) before and after the implementation of the new reporting standards; and, (ii) an examination of the Reconciliation Statements produced upon first-time adoption of the new regime included in corporate annual reports. The annual reports for a range of firms differing in both size and sector were analysed to trace the impact of the transition to International GAAP on a diverse mix of companies. The implications of the resulting disclosures for decision-usefulness were then examined using the qualitative characteristics outlined in the IASB decision-usefulness framework; this facilitated an assessment of whether the claims of the IASB about the usefulness of mandated IFRS disclosures for decision-makers were supported in practice with the contents of annual reports produced by adopting companies.

The philosophical assumptions of the researcher dictated the use of both quantitative and qualitative research methods. To this end, the thesis used the content analysis method of research and a form of Reconciliation Statement analysis employing the Conservatism Index, to study 138 annual reports both prior to and following the implementation of IFRS. Further, an assessment of the findings of this analysis against the IASB decision-usefulness framework was undertaken to examine whether

the new IFRS disclosures presented useful information for user decision-making. The aim was to provide a descriptive account of both IFRS-related disclosures and IFRS financial statement numbers and to interpret the perceived usefulness to users of this information. Therefore, the study was exploratory in nature and no attempt was made to test hypotheses.

The remainder of the chapter is structured as follows. Section 8.2 provides a summary of the results of the content analysis as reported in Chapter 5 and Section 8.3 reports the key findings of the analysis of IFRS Reconciliation Statements as detailed in Chapter 6. The findings of the assessment of the decision-usefulness of the IFRS disclosures are summarised in Section 8.4. The main findings are restated in Section 8.5 and some policy implications are offered in Section 8.6. Limitations of the current research are outlined in Section 8.7 and Section 8.8 provides summary details of potential areas for future research.

8.2 A Summary of the Content Analysis Findings

Chapter 5 presented the results of a content analysis survey of the annual reports of 138 UK listed companies before and after the implementation of IFRS in 2005. The change in IFRS-related disclosures was examined for seven categories of disclosure and a breakdown was provided by sector and also by market listing. In addition, the nature of the annual reports surveyed was noted and the change in the physical size of the annual reports studied was documented. Finally, an analysis focusing on identifying the individual standards that precipitated the most disclosure was undertaken.

The findings of this analysis indicate that the introduction of IFRS had a significant impact on the content of corporate annual reports in the UK. There was a large increase in IFRS-related disclosures in the annual reports surveyed following the changeover to the new reporting regime. For example, the average number of pages devoted to IFRS-related information increased from 1.76 pages to 13.18 pages following the adoption of the new reporting regime. Further, the percentage increase in IFRS disclosures increased from 1.46 per cent to 9.82 per cent during the transition period. Therefore, this observation holds irrespective of whether the information is measured in terms of the actual number of pages disclosed, or the relative measure of the percentage of the annual report devoted to such disclosures is assessed. Ernst and Young (2006) highlighted that IFRS disclosure requirements were almost double the amount required under the previous UK GAAP reporting regime; the extent of the disclosure increases is even more pronounced from the findings reported in the current analysis. Therefore, one of the aims of the standard setters seems to have been achieved as users of UK annual reports were supplied with additional information about these companies. The significant increase in IFRS information provided by companies in their annual reports following the transition may have informed users about the impact of the new regime and thus improve their decision-making about the changes introduced by IFRS; this may not have been known prior to adoption given little information about IFRS was disclosed in company annual reports produced in the year before the changeover.

In addition, there was a significant increase in the physical size of the annual reports for the vast majority of the companies surveyed; this is consistent with the findings reported in prior studies (Accountancy Age, 2005a; Accountancy, 2006a; Financial

Director, 2006; FRC, 2006). For example, the number of pages in the typical annual report for the sample of companies analysed in the current dissertation rose by over 29 per cent. Interestingly, although the difference in total number of pages was greater for the FTSE 100 firms analysed than their FTSE Other counterparts, the FTSE Other firms exhibited the larger percentage increase in number of pages. However, such findings may understate the true increase in disclosure since as Chapter 2 indicated, many firms presented information relating to IFRS prior to the mandatory adoption of the new reporting standards (Street et al., 1999; Daske and Gebhardt, 2006); they prepared early for the changeover to IFRS.

The change in disclosure was examined for seven categories of disclosure, namely: (i) factual information; (ii) cost of implementation; (iii) general impact of information; (iv) progress to date; (v) operational and strategic decisions taken by management; (vi) implementation and impact of individual standards; and, (vii) general other. Five of these categories reported a rise in the volume of IFRS-related disclosure, although the increase was found to be especially pronounced for the *Implementation and impact of individual standards* disclosure category. The increase in this particular category is likely to be due to the requirement to prepare financial statements under a new set of reporting standards as part of the transition to International GAAP. Although there was a disclosure decrease in two categories, namely *Progress to date* and *Operational and strategic decisions taken by management*, such reductions were expected given that most operational and strategic level preparations would have been planned prior to the implementation of the new reporting regime. Indeed, several researchers found that many listed companies had been preparing for the changeover many years prior to implementation (e.g. Aisbitt and Walton, 2005).

There was a considerable increase in the *General impact of implementation* disclosure category during the sample period and Chapter 2 highlighted that one of the criticisms of the transition process was that few companies were quantifying the effects of IFRS prior to adoption (Accountancy, 2005d). This criticism may explain the disclosure increase reported in this category as companies were better positioned to discuss the impact of the changeover to IFRS; prior to full adoption, they may have been uncertain about the likely impacts of the implementation on the financial statements. This uncertainty may therefore be extended to the users of annual reports and therefore the information disclosed about the impact of IFRS following the transition may have provided useful information about the changes introduced by the new regime.

The increase in disclosure was found to be significantly larger for FTSE 100 listed firms than their FTSE Other counterparts; this finding is consistent with the conclusions of researchers such as Dunne et al. (2003) that FTSE 100 firms tend to exhibit greater disclosure increases than their FTSE Other counterparts following the introduction of new reporting requirements. Decisions by users of annual reports may have been impacted by the introduction of the new reporting requirements given that IFRS disclosure levels varied between the two groups of companies indicating that not all firms were affected equally. Although the disclosure increases reported in the *Cost of Implementation* disclosure category for FTSE Other firms equated to approximately half those exhibited by their FTSE 100 counterparts, this may mask the true impact of IFRS in relation to the implementation costs between the groupings given that the literature has indicated that the average cost of producing financial

statements under IFRS was greater for FTSE Other firms than for FTSE 100 companies (PwC, 2007c).

In line with the findings reported previously, the implementation of IFRS was associated with an increase in IFRS-related disclosures across all sectors analysed. The financial sector - especially banks and insurance firms - had been highlighted as one of the market groupings likely to be significantly affected by the changeover to the new reporting regime (PwC, 2003; Ernst and Young, 2006; PwC, 2006a); the Financial sector exhibited the second largest disclosure increase among the industry groupings surveyed in the present analysis. Therefore, users of annual reports of companies located in the financial sector may have been provided with useful information about the impact of IFRS on these companies which was anticipated prior to its adoption.

An analysis of the nature of the IFRS-related information in the sample period found that, consistent with prior expectations from the literature, the largest increase in IFRS disclosure was evident with the narrative information provided by the sample companies. Presumably, much of the numerical disclosure about the impact of the transition was provided in the Reconciliation Statement which is discussed in the next section. In addition, a breakdown of the IFRS disclosures reported by the sample firms according to its location in the annual report indicated that the largest disclosure increase was found in the notes to the accounts section of the annual report; this location category was expected to exhibit a significant rise in disclosure post-implementation given such disclosures were required under IFRS in comparison to the disclosures provided in this section pre-adoption which were prepared under the

previous UK GAAP regime. The second largest increase in IFRS-related disclosure was in the IFRS location category; following the change to a new reporting regime, almost all of the companies surveyed included an explanation of the changes and impact of preparing financial statements under IFRS for the first time.

Finally, the analysis indicated a significant increase in the level of disclosure for the majority of the IFRS standards reported by the sample firms, however, the scale of the impact varied from standard to standard. The standards which exhibited the largest disclosure increases were IAS 32/IAS 39/IFRS 7, IFRS 3/IAS 36/IAS 38, IAS 19, IAS 12 and IFRS 2; these findings are consistent with the standards highlighted as the most significant areas of impact in prior studies which attempted to assess the impact of the implementation of IFRS (PwC, 2003; Ernst and Young, 2005; KPMG, 2005; Aisbitt, 2006; BDO, 2006; Ernst and Young, 2006; Jermakowicz and Gornik-Tomaszewski, 2006; PwC, 2006a; PwC, 2006c; BDO, 2007; Harverals, 2007; PwC, 2007a; Stenka and Ormrod, 2007; Horton and Serafeim, 2008). However, the largest increase in disclosure, and by some distance, is attributable to the IAS32/39/IFRS7 group of derivatives-related standards; most concerns regarding a possible decline in the quality of financial statements prepared under IFRS related to the financial instruments standards and this finding supports these concerns (Fearnley and Hines, 2002; Aisbitt and Walton, 2005; Ernst and Young, 2006; PwC, 2006a; PwC, 2007). Thus, users of annual reports were provided with additional information which may have helped them understand the affect of those IFRS standards which were anticipated to have the most impact on adopting companies.

8.3 A Summary of the Reconciliation Statement Analysis Findings

Chapter 6 reported the results of an analysis of the Reconciliation Statements produced upon first-time adoption of IFRS included in the 2005 annual report and accounts of the same sample companies surveyed for the content analysis in Chapter 5. More specifically, the adjustment amounts reported in the Reconciliation Statements in relation to individual IFRS standards were expressed as a percentage of the absolute value of the total profit (loss) calculated in accordance with previous UK GAAP in the Income Statement or the total equity reported under UK GAAP in the Balance Sheet for each of the sample firms. In addition, the impact of the transition to the new reporting regime on total profit (loss) in the income statement and total equity in the balance sheet for the sample of companies was calculated; the absolute value of the total profit (loss) or equity reported in accordance with previous UK GAAP was expressed as a percentage of the difference between the profit (loss) or equity reported under IFRS and the corresponding UK GAAP amount.

The findings of this analysis reveal that the introduction of IFRS had a material impact on the financial statement numbers reported in corporate annual reports and accounts in the UK. Since such numbers appear to be used by investors (Arnold and Mozier, 2004), the changes caused by the introduction of IFRS must have had implications for the decision-usefulness of the data supplied. Indeed, the changes to the profit and equity numbers were sizeable. For example, the reconciliation from UK GAAP to IFRS increased total profit by 105.85 per cent for the sample companies; this finding is consistent with previous studies which have examined the impact of IFRS on the income statement (KPMG, 2005; Ormrod and Taylor, 2006; Christensen et al., 2007; Stenka and Ormrod, 2007; Horton and Serafeim, 2008). Further, there

was considerable variation in the impact of the transition among the sample firms; for example, a split of the total sample reveals that 60 companies reported an increase in profits while 26 firms disclosed a profit decrease following IFRS adoption. The level of volatility in financial statement numbers reported under IFRS will likely provide better information for evaluating risk of companies. Thus, decisions by users of annual reports will probably have been affected by the introduction of IFRS because all companies were not affected equally.

The individual IFRS standards which were the main causes of the increase in total IFRS profits were IAS 40 (51.81 per cent), IFRS 3/IAS 36/IAS 38 (42.61 per cent), IAS 32/IAS 39 (12.18 per cent) and IAS 10 (9.65 per cent). IAS 40 provided the largest impact on reported profits and was attributable to changes in the treatment of investment properties which resulted in a significant positive effect on the income statement for a small numbers of sample firms; it was revealed that the majority of these companies were located in the real estate sector.

The IFRS 3/IAS 36/IAS 38 group of standards introduced significant changes in the treatment of goodwill compared to previous UK GAAP requirements; in particular, IFRS 3 does not permit the amortisation of goodwill and instead requires that it be subject to an annual impairment test. This was likely to result in an increase in reported profits under IFRS due to the reinstatement of previously amortised goodwill under UK GAAP; it was found that 81 per cent of the sample companies reported an increase to profit in the income statement in relation to these standards.

Much of the controversy surrounding the introduction of IFRS was directed at the financial instrument standards IAS 32/IAS 39 as the literature indicated that the requirements of these standards were the most difficult to interpret and apply and would likely result in increased income volatility (PwC, 2003; Ernst and Young, 2005; Jermakowicz and Gornik-Tomaszewski, 2006); thus, it is perhaps surprising that these standards were responsible for one of the largest increases in reported IFRS profits for the sample firms. However, further inspection revealed the majority of the total impact of these standards was attributable to a single significant adjustment reported by Land Securities; when removing this adjustment, the mean effect of these standards would have been a negative amount of -1.58 per cent which is in line with prior expectations. In addition, only 29 per cent of the sample firms reported an IAS 32/IAS 39 adjustment; perhaps this is a reflection of indications in the literature that many companies changed their behaviour in relation to financial instruments in an attempt to minimise or avoid completely any potential income volatility as a result of the introduction of these standards.

The positive impact of the adjustments relating to IAS 40, IFRS 3/IAS 36/IAS 38, IAS 32/IAS 39 and IAS 10 on profits reported under UK GAAP were offset by adjustments relating to IAS 12 (-9.70 per cent), IAS 16 (-2.72 per cent) and IAS 21 (-2.61 per cent). Previous literature indicated IAS 12 requires several changes in the treatment of deferred tax in comparison to previous UK GAAP which would likely result in a negative impact on the income statement of adopting companies (Horton and Serafeim, 2008); the results of the present study appeared to support this assertion. However, closer inspection revealed that the total negative adjustment in relation to IAS 12 was attributable to 3 sample companies (Land Securities, British

Land Company and Great Portland Estates); these firms are primarily based in the real estate sector and the tax adjustments reported by these companies related to deferred tax requirements for investment property revaluation gains. The significant negative impact on reported profits attributable to IAS 16 and IAS 21 were due to the influence of large single adjustments as few of the sample companies reported an adjustment in relation to these standards.

The total mean increase to profits under IFRS reported by the sample companies' mask a significant degree of variation in the impact of several standards; for example, large standard deviations were reported for IAS 40 (305.03 per cent), IAS 32/IAS 39 (127.5 per cent), IFRS 3/IAS 36/IAS 38 (106.46 per cent) and IAS 12 (77.73 per cent). In addition, a number of standards had no material impact on the reconciliation from UK GAAP to IFRS on reported profits and therefore will not likely have had any implications on the decisions of annual report users; these standards were predominantly, though not exclusively, oriented towards disclosure.

An assessment of the impact of the introduction of IFRS on reported equity reveals that total equity increased by 20.63 per cent following the transition to the new regime. This finding contrasts with prior studies which documented equity reductions following the changeover to IFRS (Ormord and Taylor, 2006; Stenka and Ormrod, 2007; Horton and Serafeim, 2008); however, the standard deviation reported of 195.06 per cent indicates a considerable degree of variation in the impact of IFRS on the balance sheets for the sample companies. Indeed, more companies reported a decrease to equity reported under previous UK GAAP (53 per cent) than those who disclosed an equity increase (47 per cent). Thus, similar to the finding reported on the

affect of IFRS on the income statement, the changes to the balance sheet reported were not equal for all companies and this will likely impact decisions by annual report users.

Consistent with the findings reported for the impact of IFRS on the Income Statement, the overall impact on the Balance Sheet of the adoption of IFRS for the sample companies varied from standard to standard. The main causes of the total mean increase to reported equity under UK GAAP were IFRS 3/IAS 36/IAS 38 (25.33 per cent), IAS 10 (7.76 per cent) and IAS 16 (2.98 per cent). As discussed previously, IFRS 3/IAS 36/IAS 38 introduced significant changes in the treatment of goodwill, and together with recognition changes in relation to internally-developed intangible assets compared to previous UK GAAP and the capitalisation of development costs under IFRS, the adoption of the requirements of these standards was expected to be an increase in both equity in the balance sheet and profit in the income statement (Ernst and Young, 2005; Stenka and Ormrod, 2007; Horton and Serafeim, 2008). The findings reported for these standards in the current investigation appear to confirm this expectation.

The vast majority of the sample firms reported an adjustment in relation to IAS 10 (79 per cent). Further, each adjustment had a positive impact on equity and this is likely to be due to the reversal of the accrual included in the balance sheet under UK GAAP for the final dividend to be paid out of the current year's profit which is not permitted under IFRS. Only 10 companies reported an adjustment in relation to IAS 16 and the total positive adjustment to equity reported was heavily influenced by a single outlier adjustment.

The positive impact of IFRS 3/IAS 36/IAS 38, IAS 10 and IAS 16 was partially offset by the negative adjustments reported for IAS 19 (-12.17 per cent), IAS 12 (-2.21 per cent) and IAS 1 (-1.24 per cent). Prior literature indicated that the requirements of IAS 19 would likely lead a negative adjustment to equity and the significant negative impact to total equity reported for the sample companies in the current study confirms this expectation (Ernst and Young, 2005; Aisbitt, 2006; PwC, 2006a; Stenka and Ormrod, 2007). It was acknowledged that the introduction of IAS 19 probably resulted in pension surpluses and deficits being disclosed on the balance for the first time (Horton and Serafeim); over 90 per cent of the sample companies reported a negative adjustment to equity in relation to this standard suggesting that the majority of the sample firms reported pension deficits on the IFRS balance sheet.

In addition, concerns that IAS 12 might increase the deferred tax liability and hence reduce reported equity compared to previous UK GAAP requirements also appear to be confirmed by the findings in the present investigation (KPMG, 2005; BDO, 2006; PwC, 2006e; Horton and Serafeim, 2008); however, 41 per cent of the sample companies disclosed a positive adjustment to equity for IAS 12 indicating that the total negative impact reported may not necessarily be reflective of its effect on all sample firms. The significant adjustment reported in relation to IAS 1 was attributable to a single adjustment reported by National Grid in relation to the derecognition of regulatory assets.

Similar to the results reported for profits, the standard deviation figures are sizeable for a number of standards including IFRS 3/IAS 36/IAS 38 (195.01 per cent), IAS 19

(29.20 per cent), IAS 16 (22.83 per cent) and IAS 10 (21.71 per cent). These findings suggest that certain standards had a varied impact on the balance sheet of the sample firms; indeed, as noted earlier, the number of sample companies which reported a positive adjustment compared with the number of sample firms which disclosed a negative impact was almost evenly spread. In addition, several standards had no material impact on equity reported under UK GAAP; most of these standards related to disclosure requirements and therefore will not be expected to have had an impact on the decisions of users of annual reports.

The IFRS Reconciliation Statements were also examined by means of a conservatism index in an attempt to examine whether there are material quantitative differences in profits and equity reported under IFRS compared to those prepared in accordance with UK GAAP. The results of this analysis for profit reported under IFRS largely confirm the findings reported earlier; profits reported under UK GAAP were only 68.4 per cent of their value under IFRS. IFRS 3/IAS 36/IAS 38 and IAS 40 were the main causes of the total increase in profits under IFRS. However, considerable variation in the impact of IFRS on reported profits is noted; indeed, as highlighted earlier, 30 per cent of the sample companies experienced a reduction in profits following the transition to the new regime.

A similar analysis was undertaken for the balance sheet equity adjustments reported by the sample companies; the results reveal that total equity reported under IFRS is 53.2 per cent lower than that documented in accordance with UK GAAP which supports the findings of prior studies which reported a decrease to total equity following the changeover to the new regime (Ormord and Taylor, 2006; Stenka and

Ormrod, 2007; Horton and Serafeim, 2008). However, this finding is not statistically significant as considerable variation between the sample firms on the impact of IFRS on the balance sheet is documented; as highlighted earlier, there was a close approximation between the number of sample companies which experienced a positive impact and those which disclosed a negative adjustment in the balance sheet. Therefore, it is arguable that the overall impact of the introduction of IFRS on the reported equity of the sample firms is negligible.

8.4 A Summary of the Decision-Usefulness Assessment Findings

Chapter 7 presented the findings from an assessment of the decision-usefulness of the IFRS disclosures that were provided in the annual reports and accounts of adopting companies; this was the same information that was studied in the content analysis survey in Chapter 5 and the Reconciliation Statement investigation conducted in Chapter 6. More specifically, an examination of the IFRS information provided by the sampled companies was compared against the qualitative characteristics outlined in the IASB decision-usefulness based conceptual framework was undertaken; this was conducted to determine whether the claims of the IASB about the usefulness of the mandated IFRS disclosures were supported in practice in the contents of the financial reports produced by adopting companies. Further, a study of the additional comments captured during the content analysis survey was undertaken to provide further insight into the implementation and impact of the changeover. Finally, the interview findings from Dunne et al. (2008) were reviewed as these were completed in tandem with the present investigation as part of a larger IFRS project; this analysis revealed additional information about the perceived usefulness of the new disclosures.

The qualitative characteristics of information according to the IASB decision-usefulness based conceptual framework, which were outlined in Chapter 3, are understandability, relevance, reliability (with supporting characteristics of faithful representation, substance over form, neutrality, prudence and completeness) and comparability. An assessment of the IFRS disclosures against these characteristics revealed that the new information might not have satisfied the requirements of many of these characteristics for such information to be considered useful for users in a decision-making context. In particular, the understandability of the new disclosures was questionable given the difficulties faced by the researcher when attempting to allocate the specific disclosures made by the sample companies to IFRS standards during the content analysis survey and Reconciliation Statement analysis. These problems faced when attempting to determine the financial impact of particular IFRS standards were sizeable; such problems may also be experienced by the users of financial statements. These problems possibly hindered the understandability of the new information mandated under IFRS. This was especially true for many of the contentious IFRS standards which exhibited the largest disclosure increase and biggest impact on the financial statement numbers (for example, IAS 39 and IFRS 3).

In addition, the results suggested that the disclosures provided by the sample companies about the implementation and impact of specific standards were very technical in nature; indeed, it appeared that disclosures relating to individual standards were similar across the sample companies. This finding could indicate that the sample companies were unsure about how to interpret and implement the standards given the generic nature of the disclosures made; the boiler-plate disclosures may have limited the usefulness of any disclosures made by companies for users of financial statements.

It seems reasonable to assume that information regarding the implementation and impact of the adoption of a new set of reporting standards on the financial statements of adopting companies will have some influence on the decision-making of users. Published earnings and reported financial positions are considered as key inputs in investor user groups decision-making processes (Arnold and Mozier, 1984); therefore, any significant changes to the income statement or balance sheet of adopting companies following the conversion to IFRS must have had implications for the perceived riskiness of these firms and therefore impacted on investment decisions. Indeed, the finding of the current investigation that the vast majority of the sample firms provided a reconciliation of both reported profit and equity from UK GAAP to IFRS together with an explanation of the changes introduced by the new regime indicates that the sample companies attempted to provide relevant information to users about the changeover. Further, the findings of the Reconciliation Statement analysis indicated that the changeover to IFRS appeared to have a material impact on both total profit and total equity in the financial statements of adopting companies; the sizeable changes to both the income statement and balance sheet must have had implications for the decision-usefulness of the information supplied given that such information appears to be used by investors (Arnold and Mozier, 1984; Pike et al., 1992; Barker, 1999).

However, it is questionable whether this information holds any predictive value as the full financial impact of these changes may not have been absorbed in the first year of the adoption process. For example, the vast majority of the sample companies reported a increase to both profit and equity under UK GAAP as a result of adding

back previously amortised goodwill which was no longer permitted under IFRS; however, as most firms noted, IFRS now requires an annual impairment review to be undertaken which may have a significant impact on reported results in subsequent years. Therefore, it may have been difficult for users to determine the long term impact of IFRS on a company's prospects and future financial results based on the first year's data.

Although the average IFRS disclosures made by the sample companies in their annual reports and accounts are, for the most part, material, there are doubts about the reliability of the mean findings from this study. There was considerable variation in the impact of the transition on the income statement and balance sheet numbers reported by the sample firms. For example, the impact on the total equity figures published by the sample companies was negligible as there was an almost equal split between those firms that reported an increase to reported equity following the changeover and those firms that disclosed an equity decrease post-adoption. Further, many of the IFRS standards reported as having a significant impact on the overall sample only did so due to a small number of companies reporting large adjustments for those standards; the full impact of some standards was negligible for a lot of companies once these outliers were removed from the analysis. Thus, the average impact of the new IFRS standards may not be a reliable reflection of the effect of the changeover across each of the individual companies analysed or in the subsequent years following adoption; the latter argument is none more evident than when reflecting upon the recent financial crisis and the fair value controversy that has arisen as a result of the economic downturn (Accountancy Age, 2008a).

The reliability of the IFRS disclosures was further questioned when assessing the new information against the qualitative supporting characteristics of information encompassing faithful representation, substance over form, neutrality, prudence and completeness. For example, the IFRS Reconciliation Statements and related disclosures appeared to faithfully represent what they purported to achieve given that almost the entire sample of companies investigated provided such a statement together with detailed explanations of the adjustments contained within this document. However, the widespread use of exemptions among the sample firms was acknowledged; this may have reflected a lack of preparedness on the part of these companies to fully comply with the requirements of various standards where exemptions were available. Further, some of the adjustments included within the Reconciliation Statements may have been one-off in nature; they may not necessarily reflect the impact of the new standards over the longer term. Thus, the Reconciliation Statements may not faithfully represent the full impact of IFRS adoption and users should exercise caution when relying on them to inform their decision-making.

The neutrality of the narrative disclosures contained in the sample companies' annual reports was not questioned. During the content analysis survey, it was initially intended that any indication as to whether the IFRS-related information analysed was disclosed as *good*, *bad* or *neutral* news would be noted; however, there were so few disclosures about whether, and if so how, the transition had a positive or negative impact on the underlying business and future prospects of adopting companies that this sub-category was removed from the final analysis. Despite the presumed usefulness that such information would hold for users of annual reports, this finding could be interpreted as evidence that the information was supplied in a neutral manner

given that little reference was made to the effect of the IFRS information on the business fundamentals; no attempt was made by the sampled companies to influence users about the impact of the new regime.

However, the neutrality that was afforded to the narrative disclosures made by the sample companies was not extended to the IFRS Reconciliation Statements provided by the same firms. The results indicated that only a sub-set of the Reconciliation Statements provided by the sample companies could be analysed as these statements were presented in a range of different formats which made comparisons between the firms difficult. Given that the IASB did not prescribe a specific layout for these standards with only a line-by-line example reconciliation provided in the Implementation Guidance, an element of flexibility, and potential scope for impression management, was afforded to companies when preparing their IFRS Reconciliation Statements.

The apparent lack of speculative disclosures provided by the sample companies would seem to indicate that some element of prudence existed with regards to the long-term impact of the adoption of the new reporting regime; this may reflect a degree of uncertainty among adopting firms about what the long-term impact of the changes will be. However, the degree of prudence implicit in the findings of the Reconciliation Statement analysis is open to question. The majority of the sample companies reported a significant increase in total profit as a result of the changeover; this could be interpreted as implying that the IFRS regime has introduced a more relaxed set of requirements and therefore is less prudent than previous UK GAAP. Indeed, the recent global financial crisis has only served to support such an argument as the

proliferation of fair values for assets and liabilities in the financial statements has been blamed for the turmoil (Accountancy Age, 2008a); a key difference between IFRS and UK GAAP is the greater use of fair values under the new regime (Aisbitt, 2006; Cairns et al., 2008; Whittington, 2008). With hindsight, it would seem that the greater use of fair values under IFRS may have overstated the values of assets and understated the value of liabilities in the balance sheet of adopting companies at the time of the changeover. In addition, the subsequent change in the fair values of assets and liabilities has impacted a great deal of volatility to the published numbers.

A longitudinal comparison of the financial statement numbers reported under both the new IFRS regime and previous UK GAAP over the same period could determine the long run impact of the changeover on adopting companies' financial positions and performances. However, the IFRS Reconciliation Statement was only published for the transition year which hinders any long-term analysis which might be conducted. Indeed, the results of the transition-year Reconciliation Statement analysis question the degree of comparability among the sample firms in terms of the financial impact of the changeover; the changes reported to both UK GAAP profit and equity figures following the transition varied significantly between the sample companies. This variability was not distributed equally across individual standards as only a number of standards had an impact on the sample companies' financial statements; these findings further imply that the impact was not comparable between the sample companies.

An analysis of the additional comments about IFRS adoption provided by the sample companies in their annual reports was conducted to provide further insight into the

implementation process undertaken within these firms, the effect, if any, the transition to IFRS had on the underlying business and whether the changeover to the new regime was considered a positive move. However, despite reporting a significant increase in IFRS-related disclosure for the sample companies following the conversion, only three of these firms offered any notable general opinion on the IFRS transition process. The comments provided by these firms highlighted many of the issues documented in Chapter 2 regarding the impact of the implementation of IFRS including increased volatility in reported results, greater complexity of accounts, the influence of US GAAP and the increased size of the annual report post-IFRS adoption (Accountancy, 2005d; Accountancy Age, 2005a; Aisbitt and Walton, 2005; Gandy, 2005; Ernst and Young, 2006; Financial Director, 2006; FRC, 2006; International Accountant, 2006; Jermakowicz and Gornik-Tomaszewski, 2006); however, it is surprising that only three of the 138 sample companies discussed these issues given the importance and scale of the task faced by companies when converting to a new reporting regime. This finding is even more surprising when one considers the details of substantial transition programmes that were disclosed by the sample companies; many of the sample firms reported that they incurred additional audit costs as part of their preparations for the changeover. These findings further highlight the scale of the change for the sample companies and therefore the dearth of company-specific information provided by these firms about the impact of the transition to IFRS is troubling.

A review of the interview findings from Dunne et al. (2008) confirmed the results about the usefulness of the new IFRS disclosures reported in the current investigation. Dunne et al.'s analysis reiterated that: (i) the new standards were complex and

difficult to implement; (ii) users had to update themselves about the impact of the changeover consistent with the lack of stakeholder engagement noted within the additional comments provided by the sample companies; (iii) the new regime did not provide forward-looking information that would improve the predictive value of the financial statements to users; (iv) greater transparency and comparability was not achieved due to the number of choices available within the standards; and, (v) the new reporting formats were not more useful and use of financial statement disclosures had not altered following the changeover.

8.5 Major Findings

There are two major findings which emerged from this study. First, the implementation of IFRS had a significant and sizeable effect on the content of UK corporate annual reports. The scale of the impact varied across companies, with firms in some industrial sectors and market groupings supplying more information than others. In addition, the scale of the impact varied between individual standards. Second, the transition to International GAAP had a material impact on the financial statement numbers reported by UK companies. The scale and direction of the adjustment to profit and equity varied between companies and the majority of the total adjustments were attributable to a small number of individual IFRS standards.

The majority of the significant increase in IFRS-related disclosure included in the annual reports of the sample companies' following the implementation of IFRS was in the form of narrative information; it was presumed that much of the numerical disclosures relating to IFRS would be contained in the Reconciliation Statements produced upon first-time adoption of the new regime. Indeed, a large proportion of

the disclosures provided by the sample firms related to an explanation of the changes and impact associated with preparing financial statements under IFRS for the first time including an explanation of the differences contained within the Reconciliation Statements; the significant impact on the reported results documented for the sample companies perhaps indicates that these additional disclosures are a reflection of the scale and magnitude of the financial impact of the adoption of IFRS for the sample companies.

In addition, significant increases in disclosure relating to several IFRS standards were documented; the standards that exhibited the biggest disclosure increases were IAS 32/IAS 39, IFRS 3/IAS 36/IAS 38, IAS 19 and IAS 12. The analysis of the sample companies' Reconciliation Statements revealed that these standards had a significant financial impact on the reported results of the sample firms; this indicates that the standards which provided the biggest disclosure increases in the sample companies' annual reports corresponded to those which caused the most impact on the financial statement numbers. Interestingly, the financial instruments standards IAS 32/IAS 39/IFRS 7 were responsible for the largest disclosure increase in the annual reports of the sample companies during the transition process; however, although these standards exhibited a significant impact on the total reported profits of the sample companies, their financial effect was not as large as the disclosures devoted to a discussion of them would suggest. As noted earlier, this may be the result of a re-appraisal of the use of financial instruments by adopting companies as the literature indicated that many firms changed their behaviour regarding such instruments in light of the new IFRS requirements, some even abandoning their use altogether (PwC, 2007b).

As discussed in Chapter 3, the aim of financial statements produced under IFRS as detailed in the IASB framework is to provide information that is useful to users of such statements for decision-making purposes. The findings of the content analysis survey and IFRS Reconciliation Statement analysis in the present study indicate that the additional information supplied by UK firms and the changes to reported results under the new reporting regime may have provided users with useful information about these companies. Indeed, information about the reporting changes introduced by different IFRS standards and their impact on the financial statement numbers may have revealed information about companies that was not previously disclosed or recognised. For example, the changes to earnings numbers and equity values with the move to IFRS may have effected share valuations if, as research suggests, company fundamentals are used by analysts in their equity valuation models (Arnold and Mozier, 1984). In addition, negotiations for mergers may have been effected by the IFRS-compliant annual reports produced by companies. More importantly, bond covenant restrictions may have been *loosened* by the increase in average profits and rise in equity values reported under IFRS. Further, the ability to pay out dividends may have been enhanced by the larger IFRS profits published by firms.

Much of the criticism directed toward the transition to IFRS reporting focused on the lack of implementation guidance and uniform interpretations forthcoming from the standard setters (Larson and Street, 2004; Jermakowicz and Gornik-Tomaszewski, 2006). However, the significant increase in disclosures, particularly in relation to those disclosures discussing the implementation and impact of IFRS, highlighted that these companies made significant attempts to bridge this gap by providing an

explanation of the changes made during the changeover to International GAAP. Thus, the additional information provided by these companies in their annual reports may have supplied users with a better understanding of the process, helped users understand the financial impact of the new standards, and therefore improved their decision-making about the impact of the transition to the new reporting regime.

However, the findings of the assessment of the IFRS disclosures against the qualitative characteristics of the IASB Decision-Usefulness framework do not wholly support the assertion that user decision-making benefited from the new information provided in the annual reports and accounts of adopting companies. The widespread variation in impact on reported results, the complexity of the supplementary narrative disclosures, the absence of company-specific and forward-looking information, uncertainty about the long-term impact of the changeover and the lack of comparability between the Reconciliation Statements will have constrained the ability of users to understand the transition process as well as the impact of the changeover on the financial statement numbers. Indeed, the interview findings of Dunne et al. (2008) revealed that users did not find the new IFRS disclosures to be more useful than those previously provided under UK GAAP.

It was particularly disappointing that only three of the sample companies offered an opinion about the changeover. Given the many difficulties and significant changes and costs involved in the IFRS transition process as highlighted in Chapter 2, it is perhaps surprising that other firms did not express their views about the impact of the introduction of IFRS. This disappointment is further compounded by the significant impact of IFRS on the financial statement numbers reported in the present thesis; such

information is considered a key input for investment decision making and therefore it is in a company's best interests to fully engage with these stakeholders in order to ensure that the significant changes reported are understood and interpreted correctly. Indications that the lack of forward-looking, company-specific information provided by adopting companies may have arisen because of uncertainty about the full impact of the IFRS conversion on the financial statements adds to the perceived lack of reliability which can be afforded to the new disclosures supplied by these firms. The new IFRS regime, and in particular the greater use of fair values compared with previous UK GAAP, has been a key focus of much of the controversy surrounding the recent financial crisis; the findings of the present investigation have only served to add weight to this debate as adopting companies did not appear to fully disclose, or even fully understand, the potential volatility that the adoption of the IFRS would introduce into the financial statement numbers. This assertion is even more profound when one considers that the changeover was agreed to be a mere accounting change with no impact on underlying business fundamentals or future prospects; with hindsight, such arguments appear short-terminist and ill-conceived.

8.6 Policy Implications

The findings of the present thesis raised questions about the role of the audit profession during the transition process given the relative lack of disclosure about IFRS included in the annual reports produced in the year prior to implementation. Although there was a significant increase in IFRS-related disclosures following the transition to the new regime, perhaps this reflects a degree of uncertainty among adopting companies about the changes required by the new standards and their financial impact prior to their mandatory adoption. Indeed, the literature documented

variations in the degree to which companies were prepared for the transition to IFRS and few companies had publicly quantified the impact of IFRS on their 2005 or 2004 reported results (Aisbitt and Walton, 2005; Accountancy, 2005d).

Further, it was indicated that the IFRS Reconciliation Statements and related narrative disclosures explaining the changes reported may not have provided a reliable reflection of the impact of the changeover as the full effect of the new standards may not have been known among adopting companies during 2005. A study by BDO (2007) found that companies experienced delays in reaching agreements with auditors during the implementation process, were kept waiting while audit firms reached a consensus on the approach to common issues and auditors often proposed literal, as opposed to practical interpretations; the latter point may explain the generic and overly technical disclosures provided by the adopting companies analysed in the present investigation. Although Dunne et al. (2008) found that auditors had generally started the planning process for the adoption of IFRS pre-2000, and earlier than their client companies, the findings of the current study question the preparedness of the auditors for assisting adopting companies during the transition. The few IFRS-related disclosures made in the year before mandatory adoption and the broadly boiler-plate and technical narrative disclosures and potentially unreliable financial impact reported in the year following the conversion indicate that the considerable additional assurance services utilised by adopting companies as part of their preparations for the changeover may not have provided the level of guidance they required in order to help manage the adoption of the new regime. Thus, audit firms should have worked more closely with the IASB, and also the professional bodies, to ensure that they had a clear understanding of the new standards, and any future requirements, so that they were in

a position to provide practical, timely and consistent guidance and support to client firms. After all, auditors are responsible for ensuring that company annual reports and accounts are fully compliant with the requirements of statutory reporting standards in the public interest; therefore, it is imperative that they are not seen to be lacking in knowledge and expertise when advising on the interpretation and implementation of such standards.

However, the criticism of the audit profession might also be applied to the regulators and professional bodies. The introduction of IFRS had a material impact on the financial statements of adopting companies and the findings of the current research suggest that companies may not have been fully aware of the impact of IFRS in the year prior to its adoption. In fact, they may not have understood the impact of the new regime on the financial statements beyond the first year of adoption; this raises concerns about the level of guidance and support that was available to help them manage the implementation of the new reporting regime. Such concerns may explain why many adopting firms utilised additional auditor services in order to provide support during the transition process; perhaps the assistance provided by the IASB was not sufficient to manage the conversion effectively. Indeed, the narrative disclosures provided by adopting companies analysed in the present study explaining the changes made to the financial statements following the conversion were very technical in nature and broadly similar in context across these firms; perhaps more generic guidance could have been provided by the IASB to aid companies during the adoption process. Further, given the widespread use of exemptions reported in the current investigation, the comparability of financial reports between adopting

companies might have been improved if the IASB had reduced the number of choices available within the new standards.

In addition, very little literature has been published by the professional bodies about the implementation of IFRS and no adopting company analysed within the present investigation indicated whether any engagement with the professional bodies was undertaken during the conversion process. Perhaps the professional bodies should have been more pro-active and worked closer with the audit profession as well as the regulators in ensuring a general consensus emerged about the new standards. The professional bodies have a duty to its current and future members, many of whom are employed in publicly-listed companies, to ensure that they are fully informed of the latest developments in financial reporting; therefore, it is important that the professional bodies themselves are actively engaged in any new reporting standard developments given that the professional development they provide will help shape future corporate financial reporting practices.

The findings reported in Chapter 7 indicated that the new IFRS disclosures may not have been useful for user decision-making due to the lack of company-specific and forward-looking information provided by the sample companies; this may have constrained the ability of users to assess the future performance of these firms. Although this may have been due to a degree of uncertainty among these firms about the long-term impact of the changeover to the new regime, they should have communicated openly with users to ensure that all available information, however uncertain, was provided such that an informed investment decision could be made. Indeed, the findings of the Reconciliation Statement analysis revealed that more than

half of the companies analysed reported a decrease in total equity following the conversion to IFRS; this may have had implications for the ability of these firms to raise additional finance if the strength of their balance sheets had been eroded. Thus, it is within these companies' best interests to ensure that stakeholders understood the full implications of this change in their reported financial position and whether the financial strength of their operations had been affected especially if the changes have brought to light an issue or situation that was not previously disclosed or recognised. The recent economic crisis, and, in particular, the role of the greater use of fair values for assets and liabilities under IFRS, has served to underline the impact of the failure to fully understand and communicate the effect of new reporting requirements on a companies' market valuation and, in some instances, a firm's continued existence.

8.7 Limitations of the Study

This dissertation examined the impact of IFRS on UK corporate annual report and accounts. The decision to analyse the content of annual reports published in the years prior to, and following, the introduction of IFRS may be recognised as a limitation of the present study. The significant increase in IFRS-related disclosures following the transition to the new reporting regime may understate the true rise in disclosure as many companies may have presented IFRS information in their annual reports several years prior to its mandatory adoption. Additional insights about the decision process and potential impact of the introduction of International GAAP could be yielded from an analysis of these early adopters' annual reports in the years preceding the changeover.

Further, a study by Roberts et al (2005) discussed in Chapter 4 indicated that it may be misleading to evaluate the impact of a change in accounting convention in the first year of conversion only as any changes reported may be one-off in nature. This presents an additional limitation of the present study given the examination of the impact of the implementation of IFRS was undertaken by analysing the annual reports and accounts produced in the year following the adoption of the new regime. Therefore, the significant increase in IFRS-related narrative disclosures and substantial impact reported to the financial statement numbers disclosed within the sample companies' post-IFRS annual reports may have been transitory in nature; the findings may not be reflective of the impact of the changeover over the longer term. An examination of the annual reports and accounts of the same companies in the years following the first year of adoption may provide further insight into the changes introduced by the new regime.

It is also acknowledged that the present study is limited in its scope. The new requirement for companies to produce their financial statements in accordance with IFRS applies to all listed companies in the EU; this thesis is an examination of the impact of this requirement on a sample of UK listed companies only. Although the findings reported may be generalisable in terms of the impact of IFRS on annual report and accounts in the UK given the large sample analysed, they may not reflect the impact the transition may have had on company annual report and accounts in other countries within the EU. Thus, conclusions drawn about the implementation and impact of the new reporting regime in the present investigation are limited by reference to its impact in the UK only.

Other limitations relate to the research methods employed in the investigation. The aim was to provide a descriptive account of IFRS-related disclosures and the underlying philosophical assumptions of the researcher, coupled with the broad objectives of the study, indicated the use of a qualitative research method, namely, a content analysis survey and a quantitative research method, being a form of Reconciliation Statement analysis. It is acknowledged that the use of the content analysis technique involves a substantial element of subjectivity. For example, the analysis of 276 annual reports is a lengthy process and susceptible to human error when calculating the amount of disclosure in each annual report. The use of a second coder who replicated a random sample of the documents analysed helped to reduce the scope for such error. Further difficulties associated with the content analysis technique relate to the questions being asked or the source materials available. However, this element of error was reduced by the presence of a suitable, reliable and accurate coding scheme that guided the coders during the content analysis survey and the choice of the commonly used and well defined corporate annual report as the medium of analysis.

Although the analysis of Reconciliation Statements is considered to be an objective exercise given that it involves the use of quantitative data, a degree of subjectivity is involved when categorising the line items included in Reconciliation Statements particularly when it is not clearly apparent what reporting standard or issue a particular adjustment relates to. However, this element of subjectivity was minimised by the involvement of a second researcher who analysed a random sample of the total number of Reconciliation Statements subject to investigation to ensure that similar categorisations were used where deemed necessary.

A further limitation relates to the nature of the research design for the purpose of investigating the IFRS disclosures within a decision-usefulness framework. Although a qualitative research method, the content analysis survey undertaken in the present investigation involved systematic counting procedures in order to determine the nature and magnitude of the narrative IFRS-related disclosures included company annual reports. Further, the analysis of the IFRS Reconciliation Statements involved quantifying the impact of the changeover on the financial statement numbers of adopting companies. Therefore, the potential consequences of this primarily quantitative IFRS information for user decision-making will require a leap of faith in the absence of any attempt to ask users directly about whether the new information was useful for decision-making purposes. However, the assessment of the IFRS disclosures against the qualitative characteristics detailed in the IASB conceptual framework provides a link between the theory (decision-usefulness) and the study findings; the stipulated purpose of the new IFRS disclosures is to provide useful information for user decision-making as defined by the qualitative characteristics outlined by the IASB. Therefore, an assessment of the results against the IASB decision-usefulness based framework will determine whether the claims of the IASB about the usefulness of the new mandatory information are supported by the content of the IFRS-compliant annual reports and accounts. Although it is acknowledged that there are difficulties when attempting to assess predominantly quantitative information against a set of qualitative characteristics, this examination will yield initial insights about the perceived usefulness of the IFRS disclosures; further research conducting stakeholder interviews would seek to confirm whether this new information was in fact useful or not.

Finally, this research was limited to a focus on the usefulness of IFRS-related disclosures for the investor user group; no attempt is made to assess the usefulness of the IFRS information reported by adopting companies in their annual report and accounts for other user groups such as employees, lenders, suppliers and trade creditors, customers, the government, and the general public. The introduction of IFRS will likely have had an impact on the corporate interests of these user groups given that it impacts on the financial reporting disclosures and reported results of adopting companies; for example, the significant reporting changes in relation to employee benefits under IFRS is considered to be an important issue for the employees of affected companies. Although beyond the scope of the current thesis, a survey of the impact of IFRS on other user groups may yield further insights about the transition to the new reporting regime.

8.8 Avenues for Future Research

Five extensions of the present thesis are identified as potential avenues for future research. The first involves a consultation with a variety of financial reporting stakeholders, including finance directors, treasury and other company personnel, institutional investors, analysts and bankers from a variety of sectors across different-sized firms. Such an investigation would assess the impact on the interviewees of the changes to the processes and the procedures involved in the preparation of annual reports associated with the introduction of the new reporting regime. This evaluation would provide additional information which may supplement and further inform the findings reported in the current study; especially given that the introduction of IFRS had a material impact on the reported results of the sample companies and only three

of the sample firms surveyed in the current research expressed a general opinion in the present study about the implementation and impact of the new reporting standards.

Further, views on the adoption of IFRS in light of the recent global economic crisis may be a fruitful second area for future research; interviews with interested parties may provide further insights and indicate whether these developments changed stakeholder perceptions of the regime and whether the decision-making processes of these stakeholders had changed.

It was highlighted in Chapter 2 that the full impact of IFRS might not be ascertained until several years following the implementation of the new reporting regime. Indeed, the recent global economic crisis has raised concerns about the use of fair value measurement under IFRS, among other jurisdictions, and has been blamed for contributing to the recent collapse of the worldwide banking system (Accountancy Age, 2008a). Therefore, a third extension may involve extending the content analysis undertaken in the present study over a number of years following the first year of adoption of the new regime. This may provide further insights about the effect the new reporting requirements has had on UK company reporting practices given that the full impact of IFRS may not yet have been suffered by affected firms or, particularly in the case of the banking sector, have only more recently been incurred.

A fourth extension could assess the impact of IFRS on stock market participants. The introduction of a new financial reporting regime will likely bring new information to the market about corporate activities. Further, given there was almost no early or supplementary adoption of IFRS prior to 2005, the introduction of the new regime

provides a relatively clean setting with which to assess market reactions as adopting companies prepared financial statements in accordance with IFRS for the first time. Therefore, an extension to the present analysis could examine whether the publication of the first annual reports prepared under IFRS for the same sample companies produced any market reaction in the UK. This analysis could provide further insights about the impact of the implementation of the new reporting regime in the UK.

Given that the introduction of IFRS applies to all listed companies within the EU, a fifth extension might involve a cross-country comparative analysis in an attempt to examine the implementation of IFRS across the region. This investigation would facilitate an analysis of the impact of differing cultural norms on the adoption of a new reporting regime. Thus, a further content analysis survey and assessment of IFRS Reconciliation Statements could be undertaken to examine the impact of the introduction of International GAAP across Europe. In addition, a questionnaire study would provide further insights on the problems associated with applying an international financial reporting regime in different economic and cultural environments.

Nevertheless, despite the limitations identified and the avenues for future research suggested, the current thesis represents an important contribution to the debate surrounding the implementation and impact of the new IFRS accounting standards. In particular, the present investigation provided a systematic analysis of the impact of the new reporting standards on both disclosure practices and the financial statement numbers on a scale not previously undertaken. Further, the potential consequences of the new information for user decision-making were examined. Therefore, the current

study has endeavoured to plug an existing gap in the literature by collectively examining: (i) the impact of the conversion to IFRS on corporate annual report disclosures; (ii) the specific IFRS standards which contributed to any changes reported; and, (iii) the implications of the new information for user decision-making purposes. Given that the process of IFRS adoption is currently happening in other countries and is planned for other states, the results might yield valuable insights about the impact and implications of the adoption process from the UK.

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Appendices

Appendix 2.1 List of International Financial Reporting Standards

International Financial Reporting Standards (IFRSs)

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Assets
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments

International Accounting Standards (IASs)

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 3	Consolidated Financial Statements (Superseded in 1989 by IAS 27 and IAS 28)
IAS 4	Depreciation Accounting (Withdrawn in 1999, replaced by IAS 16, IAS 22, and IAS 38, all of which were issued or revised in 1998)
IAS 5	Information to Be Disclosed in Financial Statements (Superseded by IAS 1 in 1997)
IAS 6	Accounting Responses to Changing Prices (Superseded by IAS 15, which was withdrawn December 2003)
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 9	Accounting for Research and Development Activities (Superseded by IAS 38 effective 01 July 1999)
IAS 10	Events After the Reporting Period
IAS 11	Construction Contracts

IAS 12	Income Taxes
IAS 13	Presentation of Current Assets and Current Liabilities (Superseded by IAS 1)
IAS 14	Segment Reporting
IAS 15	Information Reflecting the Effects of Changing Prices (Withdrawn December 2003)
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 22	Business Combinations (Superseded by IFRS 3 effective 31 March 2004)
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 25	Accounting for Investments (Superseded by IAS 39 and IAS 40 effective 2001)
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions (Superseded by IFRS 7 effective 2007)
IAS 31	Interests In Joint Ventures
IAS 32	Financial Instruments: Presentation (Disclosure provisions superseded by IFRS 7 effective 2007)
IAS 33	Earnings Per Share

IAS 34	Interim Financial Reporting
IAS 35	Discontinuing Operations (Superseded by IFRS 5 effective 2005)
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture

Final Interpretations Issued by the International Financial Reporting Interpretations Committee

IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments
IFRIC 3	Emission Rights (Withdrawn)
IFRIC 4	Determining Whether an Arrangement Contains a Lease
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 11	IFRS 2: Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes

IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 17	Distributions of Non-cash Assets to Owners
IFRIC 18	Transfers of Assets from Customers

Final Interpretations Issued by the Standing Interpretations Committee

SIC 1	Consistency – Different Cost Formulas for Inventories (Superseded and incorporated into IAS 2 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 2	Consistency – Capitalisation of Borrowing Costs (Superseded by IAS 8 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 3	Elimination of Unrealised Profits and Losses on Transactions with Associates (Superseded by IAS 28 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 5	Classification of Financial Instruments - Contingent Settlement Provisions (Superseded by and incorporated into IAS 32 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 6	Costs of Modifying Existing Software (Superseded by and incorporated into IAS 16 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 7	Introduction of the Euro
SIC 8	First-Time Application of IASs as the Primary Basis of Accounting (Superseded by IFRS 1, June 2003)
SIC 9	Business Combinations – Classification either as Acquisitions or Unitings of Interests (Superseded by and incorporated into IFRS 3 effective 31 March 2004)
SIC 10	Government Assistance – No Specific Relation to Operating Activities
SIC 11	Foreign Exchange – Capitalisation of Losses Resulting from Severe Currency Devaluations (Superseded by IAS 21 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)

SIC 12	Consolidation – Special Purpose Entities
SIC 13	Jointly Controlled Entities – Non-Monetary Contributions by Venturers
SIC 14	Property, Plant and Equipment – Compensation for the Impairment or Loss of Items (Superseded by and incorporated into IAS 16 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 15	Operating Leases – Incentives
SIC 16	Share Capital – Reacquired Own Equity Instruments (Treasury Shares) (Superseded by and incorporated into IAS 32 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 17	Equity – Costs of an Equity Transaction (Superseded by and incorporated into IAS 32 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 18	Consistency – Alternative Methods (Superseded by IAS 8 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 19	Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29 (Superseded by IAS 21 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 20	Equity Accounting Method – Recognition of Losses (Superseded by IAS 28 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets
SIC 22	Business Combinations – Subsequent Adjustment of Fair Values and Goodwill Initially Reported (Superseded by and incorporated into IFRS 3 effective 31 March 2004)
SIC 23	Property, Plant and Equipment – Major Inspection or Overhaul Costs (Superseded by and incorporated into IAS 16 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 24	Earnings Per Share – Financial Instruments and Other Contracts that May Be Settled in Shares (Superseded by and incorporated into IAS 33 (Revised 2003) effective annual financial reporting periods beginning 1 January 2005)

SIC 25	Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders
SIC 27	Evaluating the Substance of Transactions in the Legal Form of a Lease
SIC 28	Business Combinations – 'Date of Exchange' and Fair Value of Equity Instruments (Superseded by and incorporated into IFRS 3 effective 31 March 2004)
SIC 29	Disclosure – Service Concession Arrangements
SIC 30	Reporting Currency – Translation from Measurement Currency to Presentation Currency (Superseded by IAS 21 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)
SIC 31	Revenue – Barter Transactions Involving Advertising Services
SIC 32	Intangible Assets – Web Site Costs
SIC 33	Consolidation and Equity Method – Potential Voting Rights and Allocation of Ownership Interests (Superseded by IAS 27 (Revised 2003) and by IAS 28 (Revised 2003) effective for annual financial reporting periods beginning 1 January 2005)

The above list is adapted from a listing provided by Deloitte and Touche which is available online at http://www.iasplus.com/standard/standard.htm (accessed 22/05/09).

Appendix 5.1 Sample Companies for Content Analysis

Company	SE Listing	Sector
3i	FTSE100	Financials
Acal	FTSEOther	Industrials
Albion (Hardy Underwriting Group)	FTSEOther	Consumer Goods
Alliance Unichem	FTSE100	Health Care
Amstrad	FTSEOther	Consumer Goods
Amvescap	FTSE100	Financials
Anglo American	FTSE100	Basic Materials
Antofagasta	FTSE100	Basic Materials
Associated British Foods	FTSE100	Consumer Goods
Aston Villa	FTSEOther	Consumer Services
AstraZeneca	FTSE100	Health Care
Aviva	FTSE100	Financials
AWG	FTSEOther	Utilities
BAA	FTSE100	Industrials
BAE Systems	FTSE100	Industrials
Barclays	FTSE100	Financials
Beale	FTSEOther	Consumer Services
Bespak	FTSEOther	Health Care
BG Group	FTSE100	Oil & Gas
BHP Billiton	FTSE100	Basic Materials
Body Shop International	FTSEOther	Consumer Services
Boots Group	FTSE100	Consumer Services
BP	FTSE100	Oil & Gas
Brammer	FTSEOther	Industrials
British Airways	FTSE100	Consumer Services
British American Tobacco	FTSE100	Consumer Goods
British Land Co	FTSE100	Financials
British Sky Broadcasting Group	FTSE100	Consumer Services
BT Group	FTSE100	Telecommunications
Cable & Wireless	FTSE100	Telecommunications
Cadbury Schweppes	FTSE100	Consumer Goods
Caffe Nero Group	FTSEOther	Consumer Services
Capita Group	FTSE100	Industrials
Care UK	FTSEOther	Health Care
Centrica	FTSE100	Oil & Gas
Chapelthorpe	FTSEOther	Consumer Goods
Christie Group	FTSEOther	Industrials
CML Microsystems	FTSEOther	Technology
Compass Group	FTSE100	Industrials
Corin Group	FTSEOther	Health Care
Daily Mail & General Trust	FTSE100	Consumer Services
Diageo	FTSE100	Consumer Goods
Dixons Group	FTSE100	Consumer Services
Domino Printing Sciences	FTSEOther	Industrials
Elementis	FTSEOther	Basic Materials
EMAP	FTSE100	Consumer Services
Enterprise Inns	FTSE100	Consumer Services
Flying Brands	FTSEOther	Consumer Services
Friends Provident	FTSE100	Financials
Gallaher Group	FTSE100	Consumer Goods
Game Group	FTSEOther	Consumer Services
GlaxoSmithkline	FTSE100	Health Care
Gleeson (M.J.)Group	FTSEOther	Industrials
Great Portland Estates	FTSEOther	Financials
GUS	FTSE100	Consumer Services
Hammerson	FTSE100	Financials
Hampson Industries	FTSEOther	Industrials

Hanson	FTSE100	Industrials
Hays	FTSE100	Industrials
HBOS	FTSE100	Financials
Helphire Group	FTSEOther	Financials
HSBC Hldgs	FTSE100	Financials
Huntleigh Technology	FTSEOther	Health Care
IMI	FTSEOther	Industrials
Imperial Chemical Industries	FTSE100	Basic Materials
Imperial Tobacco Group	FTSE100	Consumer Goods
Intercontinental Hotels Group	FTSE100	Consumer Services
Intermediate Capital Group	FTSEOther	Financials
International Power	FTSE100	Utilities
Johnson Matthey	FTSE100	Basic Materials
Johnston Press	FTSEOther	Consumer Services
Kingfisher	FTSE100	Consumer Services
Kingston Communications (Hull)	FTSEOther	Telecommunications
Land Securities Group	FTSE100	Financials
Legal & General Group	FTSE100	Financials
Liberty International Plc	FTSE100	Financials
Lincat Group	FTSEOther	Industrials
Lloyds TSB Group	FTSE100	Financials
London Stock Exchange	FTSEOther	Financials
Man Group	FTSE100	Financials
Marks & Spencer Group	FTSE100	Consumer Services
Matalan	FTSEOther	Consumer Services
Morrison (Wm.)Supermarkets	FTSE100	Consumer Services
Morse	FTSEOther	Technology
National Grid Transco	FTSE100	Utilities
Next	FTSE100	Consumer Services
Northern Rock	FTSE100	Financials
NSB Retail Systems	FTSEOther	Technology
Old Mutual	FTSE100	Financials
Paragon Group Of Companies	FTSEOther	Financials
Pearson	FTSE100	Consumer Services
Pennon Group	FTSEOther	Utilities
Plasmon	FTSEOther	Technology
Prudential	FTSE100	Financials
R.E.A.Hldgs	FTSEOther	Consumer Goods
Reckitt Benckiser	FTSE100	Consumer Goods
Reed Elsevier	FTSE100	Consumer Services
Regus Group	FTSEOther	Industrials
Rentokil Initial	FTSE100	Industrials
Reuters Group	FTSE100	Consumer Services
Rexam	FTSE100	Industrials
Rio Tinto	FTSE100	Basic Materials
Rolls Royce Group	FTSE100	Industrials
Royal & Sun Alliance Insurance Group	FTSE100	Financials
Royal Bank Of Scotland Group	FTSE100	Financials
RPC Group	FTSEOther	Industrials
SABMiller	FTSE100	Consumer Goods
Sage Group	FTSE100	Technology
Sainsbury (J)	FTSE100	Consumer Services
Schroders	FTSE100	Financials
Scottish & Newcastle	FTSE100	Consumer Goods
Scottish & Southern Energy	FTSE100	Utilities
Scottish Power	FTSE100	Utilities
Severn Trent	FTSE100	Utilities
Shell Transport & Trading Co	FTSE100	Oil & Gas
Shire Pharmaceuticals Group	FTSE100	Health Care
Skyepharma	FTSEOther	Health Care

Smith & Nephew	FTSE100	Health Care
Smiths Group	FTSE100	Industrials
Spring Group	FTSEOther	Industrials
Standard Chartered	FTSE100	Financials
Tate & Lyle	FTSE100	Consumer Goods
Taylor Nelson Sofres	FTSEOther	Consumer Services
Telspec	FTSEOther	Telecommunications
Tesco	FTSE100	Consumer Services
Topps Tiles	FTSEOther	Consumer Services
Tribal Group	FTSEOther	Industrials
Unilever	FTSE100	Consumer Goods
United Utilities	FTSE100	Utilities
Vodafone Group	FTSE100	Telecommunications
Volex Group	FTSEOther	Industrials
Weir Group	FTSEOther	Industrials
Whitbread	FTSE100	Consumer Services
Wolseley	FTSE100	Industrials
Woolworths Group	FTSEOther	Consumer Services
WPP Group	FTSE100	Consumer Services
Xstrata Plc	FTSE100	Basic Materials
Yell Group	FTSE100	Consumer Services

Note: This table provides basic details relating to the UK sampled companies. Details pertaining to industry sector were based on the Industry Classification Benchmark (ICB) categorisation. FTSE Other companies are a random sample of FTSE All Share Index listed companies outside the FTSE 100.

Appendix 5.2: Content Analysis Decision Rules

General
The content analysis sample was drawn from companies listed in the UK. The FTSE 100 and a random sample of other companies listed on the LSE were used. The content analysis is based on the methodology previously adopted in a study undertaken by Dunne et al. (2003).

Unit of Measurement
- A standard A4 template divided into percentages of a page, with a standard margin, measures proportions of page.
- Margins and blank areas of pages are to be associated with words, tables etc. covering the areas of disclosure.
- Actual physical size of page is to be ignored.

Evidence Category
- Disclosures may be either narrative (N) or numerical (Q) in nature.

Auditable/Verifiable
- Disclosure is categorised as 'auditable' if given access to the organisation, it would be possible to confirm the statements made.

News
- Good – statements beyond the minimum which include, for example, specific details where these details have a creditable or neutral reflection on the company; any statements which reflect credit on the company; upbeat analysis/discussion/ statements.
- Neutral – statement of policy or intent within statutory minimum with no details of what or how; statement of fact whose credit/discredit to the company is not obvious – which are unaccompanied by editorialising.
- Bad – any statement which reflects/might reflect discredit on the company.

Location in Annual Report
Possible locations include: Chairman's Statement; Financial Director's Review; Chief Executive's Review; Operating and Financial Review; Directors' Report; Corporate Governance Statement; Remuneration Report; Accounting Policies; Notes to the Accounts; IFRS Compliance Statement; Statement of Directors' Responsibilities; Other.

Memo
- For any additional information or disclosure worth highlighting.

Categories of Disclosure

The principal content analysis classification categories were based on a review of the extant professional and academic literature. A breakdown of the items expected under each of the headings is provided in these decision rules.

1. Factual Information

This category includes information relating to the transition process and the implementation of IFRS. It also includes information that identifies where users can find IFRS-related information within the annual report.

Examples:
- From 1 January 2005, the Group is required to prepare its financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK.
- An explanation of how the transition from UK GAAP to IFRS has affected the Group's financial position, financial performance and cash flow is set out in the following tables and the notes that accompany the tables.

2. Cost of Implementation

This category includes information which details any costs incurred in relation to the implementation of the IFRS.

Example:
- Audit related services primarily relate to fees charged in respect of transition to IFRS.

3. General Impact of Implementation

This category includes information about the general impact of the implementation of IFRS. The information could be positive/negative/neutral in orientation. The information may highlight general difficulties associated with the implementation of IFRS, or could relate to the general impact of the IFRS on the financial performance of the company.

Examples:
- The principal differences between UK GAAP and IFRS, as they relate to the Consolidated Financial Statements, are accounting for goodwill and intangible assets before 29 September 2005, the accounting of income taxes...
- While such a significant change in accounting basis can make it harder to understand how a business is really performing, I believe that the move to IFRS will make it easier to see how we are performing.
- The restated net assets at 31st March 2005 under IFRS are £10.4m higher than under UK GAAP.

4. Progress to Date

This category includes information about the transition process undertaken by the sample companies, such as details of preparations made and any projects undertaken to implement the new reporting regime.

Example:

- Since the beginning of 2005 the Audit Committee has monitored the work being undertaken by the company in preparation for the introduction of International Financial Reporting Standards (IFRS) and reviewed the statement issued by the Company on the restatement of financial statements in accordance with IFRS.

5. Operational & Strategic Decisions Taken by Management

This category includes information about specific operational and strategic decisions taken by managers owing to the implementation of IFRS.

Example:

- Propose to make amendments to Article 85 (Power to borrow money) to update the terminology used by Article 85 to the new terminology used by IFRS…

6. Implementation & Impact of Individual Standards

There are two principal types of information included in this category: (i) information about the application of individual IFRS; and, (ii) information about the impact of the application of individual IFRS.

Example:

- Under UK GAAP, the costs of software development are predominantly expensed as incurred. Under IFRS, these costs are capitalised and amortised over the useful life of the software, normally being three years. The impact is an increase of £21m in the pre tax profit for the year ended 31 December and a pre tax increase of £39m in the equity and reserves at 31 December 2004.

This category will be totalled for inclusion in the main analysis. However, a breakdown by standard will also be included.

7. General Other

This category represents any other information regarding IFRS that does not fall within the scope of the other categories listed. This could include, for example;

- I would like to welcome our new finance director who has supported the organisation through the transition to IFRS.

Appendix 5.3: Content Analysis Record Sheet

Appendix 5.4: Content Analysis Template

IFRS Content Analysis Template

Company Name

Year **1/2 1/4 2/4 3/4 4/4 y/e**
(circle as appropriate)

(Interim/Qtrly only) Audited: Yes/No
Independent Review Report: Yes/No

Total Pages/ Accountancy Pages

Category	Prop. of Page	Evidence	Auditable	News	Location	Page no.	Memo
Factual information							
Cost of implementation							
General impact of implementation							
Progress to date							
Operational & strategic decisions taken by mgt							
Implementation & Impact of individual standards							
General Other							
TOTAL							

Appendix 5.5: Sample Companies - Number of Pages of the Pre- and Post-IFRS Annual Report

Company	SE Listing	Total Pages Pre	Total Pages Post	Absolute Difference	Percentage Difference
3i	FTSE100	82	102	20	24.39
ACAL	FTSEOther	57	82	25	43.86
ALBION (HARDY UNDERWRITING GROUP)	FTSEOther	57	99	42	73.68
ALLIANCE UNICHEM	FTSE100	93	129	36	38.71
AMSTRAD	FTSEOther	38	55	17	44.74
AMVESCAP	FTSE100	52	92	40	76.92
ANGLO AMERICAN	FTSE100	160	170	10	6.25
ANTOFAGASTA	FTSE100	112	137	25	22.32
ASSOCIATED BRITISH FOODS	FTSE100	86	125	39	45.35
ASTON VILLA	FTSEOther	38	58	20	52.63
ASTRAZENECA	FTSE100	162	161	-1	-0.62
AVIVA	FTSE100	169	248	79	46.75
AWG	FTSEOther	94	131	37	39.36
BAA	FTSE100	108	148	40	37.04
BAE SYSTEMS	FTSE100	113	166	53	46.90
BARCLAYS	FTSE100	253	349	96	37.94
BEALE	FTSEOther	42	54	12	28.57
BESPAK	FTSEOther	69	80	11	15.94
BG GROUP	FTSE100	180	184	4	2.22
BHP BILLITON	FTSE100	218	258	40	18.35
BODY SHOP INTERNATIONAL	FTSEOther	62	86	24	38.71
BOOTS GROUP	FTSE100	73	106	33	45.21
BP	FTSE100	130	178	48	36.92
BRAMMER	FTSEOther	65	81	16	24.62
BRITISH AIRWAYS	FTSE100	68	112	44	64.71
BRITISH AMERICAN TOBACCO	FTSE100	124	160	36	29.03

BRITISH LAND CO	FTSE100	110	125	15	13.64
BRITISH SKY BROADCASTING GROUP	FTSE100	77	178	101	131.17
BT GROUP	FTSE100	144	147	3	2.08
CABLE & WIRELESS	FTSE100	152	172	20	13.16
CADBURY SCHWEPPES	FTSE100	229	232	3	1.31
CAFFE NERO GROUP	FTSEOther	37	49	12	32.43
CAPITA GROUP	FTSE100	98	109	11	11.22
CARE UK	FTSEOther	68	88	20	29.41
CENTRICA	FTSE100	103	145	42	40.78
CHAPELTHORPE	FTSEOther	55	80	25	45.45
CHRISTIE GROUP	FTSEOther	54	82	28	51.85
CML MICROSYSTEMS	FTSEOther	33	42	9	27.27
COMPASS GROUP	FTSE100	109	128	19	17.43
CORIN GROUP	FTSEOther	53	73	20	37.74
DAILY MAIL & GENERAL TRUST	FTSE100	96	145	49	51.04
DIAGEO	FTSE100	163	157	-6	-3.68
DIXONS GROUP	FTSE100	97	129	32	32.99
DOMINO PRINTING SCIENCES	FTSEOther	54	74	20	37.04
ELEMENTIS	FTSEOther	78	81	3	3.85
EMAP	FTSE100	82	110	28	34.15
ENTERPRISE INNS	FTSE100	82	130	48	58.54
FLYING BRANDS	FTSEOther	45	57	12	26.67
FRIENDS PROVIDENT	FTSE100	125	207	82	65.60
GALLAHER GROUP	FTSE100	173	183	10	5.78
GAME GROUP	FTSEOther	56	67	11	19.64
GLAXOSMITHKLINE	FTSE100	212	219	7	3.30
GLEESON(M.J.)GROUP	FTSEOther	59	119	60	101.69
GREAT PORTLAND ESTATES	FTSEOther	70	85	15	21.43
GUS	FTSE100	99	125	26	26.26
HAMMERSON	FTSE100	104	115	11	10.58
HAMPSON INDUSTRIES	FTSEOther	58	89	31	53.45
HANSON	FTSE100	160	220	60	37.50

HAYS	FTSE100	69	82	13	18.84
HBOS	FTSE100	131	183	52	39.69
HELPHIRE GROUP	FTSEOther	48	60	12	25.00
HSBC HLDGS	FTSE100	449	483	34	7.57
HUNTLEIGH TECHNOLOGY	FTSEOther	68	78	10	14.71
IMI	FTSEOther	88	102	14	15.91
IMPERIAL CHEMICAL INDUSTRIES	FTSE100	160	192	32	20.00
IMPERIAL TOBACCO GROUP	FTSE100	132	131	-1	-0.76
INTERCONTINENTAL HOTELS GROUP	FTSE100	112	130	18	16.07
INTERMEDIATE CAPITAL GROUP	FTSEOther	56	77	21	37.50
INTERNATIONAL POWER	FTSE100	114	146	32	28.07
JOHNSON MATTHEY	FTSE100	89	118	29	32.58
JOHNSTON PRESS	FTSEOther	94	110	16	17.02
KINGFISHER	FTSE100	69	105	36	52.17
KINGSTON COMMUNICATIONS(HULL)	FTSEOther	60	62	2	3.33
LAND SECURITIES GROUP	FTSE100	130	162	32	24.62
LEGAL & GENERAL GROUP	FTSE100	94	155	61	64.89
LIBERTY INTERNATIONAL PLC	FTSE100	66	82	16	24.24
LINCAT GROUP	FTSEOther	48	67	19	39.58
LLOYDS TSB GROUP	FTSE100	114	130	16	14.04
LONDON STOCK EXCHANGE	FTSEOther	58	68	10	17.24
MAN GROUP	FTSE100	99	135	36	36.36
MARKS & SPENCER GROUP	FTSE100	92	140	48	52.17
MATALAN	FTSEOther	38	58	20	52.63
MORRISON(WM.)SUPERMARKETS	FTSE100	63	82	19	30.16
MORSE	FTSEOther	78	103	25	32.05
NATIONAL GRID TRANSCO	FTSE100	179	209	30	16.76
NEXT	FTSE100	62	86	24	38.71
NORTHERN ROCK	FTSE100	80	106	26	32.50
NSB RETAIL SYSTEMS	FTSEOther	63	64	1	1.59
OLD MUTUAL	FTSE100	169	229	60	35.50
PARAGON GROUP OF COMPANIES	FTSEOther	74	102	28	37.84

PEARSON	FTSE100	128	174	46	35.94
PENNON GROUP	FTSEOther	98	109	11	11.22
PLASMON	FTSEOther	44	51	7	15.91
PRUDENTIAL	FTSE100	172	286	114	66.28
R.E.A.HLDGS	FTSEOther	60	90	30	50.00
RECKITT BENCKISER	FTSE100	66	61	-5	-7.58
REED ELSEVIER	FTSE100	205	200	-5	-2.44
REGUS GROUP	FTSEOther	53	67	14	26.42
RENTOKIL INITIAL	FTSE100	78	131	53	67.95
REUTERS GROUP	FTSE100	133	170	37	27.82
REXAM	FTSE100	124	180	56	45.16
RIO TINTO	FTSE100	152	182	30	19.74
ROLLS ROYCE GROUP	FTSE100	89	121	32	35.96
ROYAL & SUN ALLIANCE INSURANCE GROUP	FTSE100	103	129	26	25.24
ROYAL BANK OF SCOTLAND GROUP	FTSE100	302	336	34	11.26
RPC GROUP	FTSEOther	64	76	12	18.75
SABMILLER	FTSE100	137	162	25	18.25
SAGE GROUP	FTSE100	65	121	56	86.15
SAINSBURY(J)	FTSE100	83	106	23	27.71
SCHRODERS	FTSE100	69	120	51	73.91
SCOTTISH & NEWCASTLE	FTSE100	84	73	-11	-13.10
SCOTTISH & SOUTHERN ENERGY	FTSE100	66	108	42	63.64
SCOTTISH POWER	FTSE100	237	209	-28	-11.81
SEVERN TRENT	FTSE100	77	117	40	51.95
SHELL TRANSPORT & TRADING CO	FTSE100	176	169	-7	-3.98
SHIRE PHARMACEUTICALS GROUP	FTSE100	216	259	43	19.91
SKYEPHARMA	FTSEOther	78	107	29	37.18
SMITH & NEPHEW	FTSE100	183	205	22	12.02
SMITHS GROUP	FTSE100	86	110	24	27.91
SPRING GROUP	FTSEOther	58	88	30	51.72
STANDARD CHARTERED	FTSE100	130	146	16	12.31

TATE & LYLE	FTSE100	129	138	9	6.98
TAYLOR NELSON SOFRES	FTSEOther	88	97	9	10.23
TELSPEC	FTSEOther	60	60	0	0.00
TESCO	FTSE100	114	166	52	45.61
TOPPS TILES	FTSEOther	74	78	4	5.41
TRIBAL GROUP	FTSEOther	70	81	11	15.71
UNILEVER	FTSE100	226	230	4	1.77
UNITED UTILITIES	FTSE100	109	132	23	21.10
VODAFONE GROUP	FTSE100	194	179	-15	-7.73
VOLEX GROUP	FTSEOther	66	78	12	18.18
WEIR GROUP	FTSEOther	73	106	33	45.21
WHITBREAD	FTSE100	127	100	-27	-21.26
WOLSELEY	FTSE100	102	154	52	50.98
WOOLWORTHS GROUP	FTSEOther	54	78	24	44.44
WPP GROUP	FTSE100	178	193	15	8.43
XSTRATA PLC	FTSE100	182	259	77	42.31
YELL GROUP	FTSE100	116	114	-2	-1.72
			MEAN	26.03	29.33

Notes: This table presents the total number of pages of both the pre- and post-IFRS annual reports for each of the sample firms with the mean number of pages and the average percentage difference also detailed. The mean total for the sample both pre-IFRS and post-IFRS annual reports is also shown.

Appendix 5.6: Disclosure by Market Listing – Percentage of Annual Report

Panel A – Means

Type of Disclosure	FTSE 100 Pre IFRS	FTSE 100 Post IFRS	FTSE 100 Difference	FTSE 100 P-Value	FTSE Other Pre IFRS	FTSE Other Post IFRS	FTSE Other Difference	FTSE Other P-Value
Factual information	0.3076	0.6684	0.3608	0.0000	0.2287	1.1655	0.9368	0.0000
Cost of implementation	0.0095	0.0129	0.0034	0.2610	0.0009	0.0120	0.0111	0.0090
General impact of implementation	0.1201	0.3064	0.1863	0.0000	0.1017	0.2548	0.1531	0.0020
Progress to date	0.0661	0.0220	-0.0441	0.0000	0.0959	0.0144	-0.0815	0.0010
Operational & strategic decisions taken by management	0.0134	0.0053	-0.0081	0.2710	0.0011	0.0006	-0.0005	0.6690
Implementation and impact of individual standards	1.1910	8.7460	7.5550	0.0000	0.5650	8.4700	7.9050	0.0000
General other	0.0000	0.0087	0.0087	-	0.0000	0.0003	0.0003	-
TOTAL	1.7070	9.7700	8.0630	0.0000	0.9930	9.9180	8.9250	0.0000

Panel B – Medians

Type of Disclosure	FTSE 100 Pre IFRS	FTSE 100 Post IFRS	FTSE 100 Difference	FTSE 100 P-Value	FTSE Other Pre IFRS	FTSE Other Post IFRS	FTSE Other Difference	FTSE Other P-Value
Factual information	0.2185	0.6353	0.4168	0.0000	0.1830	0.9941	0.8111	0.0000
Cost of implementation	0.0000	0.0000	0.0000	0.1143	0.0000	0.0000	0.0000	0.0799
General impact of implementation	0.0830	0.2133	0.1303	0.0000	0.0587	0.1561	0.1561	0.0001
Progress to date	0.0476	0.0125	-0.0351	0.0000	0.0578	0.0000	-0.0578	0.0000
Operational & strategic decisions taken by management	0.0000	0.0000	0.0000	0.8919	0.0000	0.0000	0.0000	1.0000
Implementation and impact of individual standards	0.4980	8.6170	8.1190	0.0000	0.1480	7.9880	7.8400	0.0000
General other	0.0000	0.0000	0.0000	-	0.0000	0.0000	0.0000	-
TOTAL	0.9320	9.5510	8.6190	0.0000	0.5540	9.6830	9.1290	0.0000

Notes: This table presents the IFRS information measured as a percentage of the annual report by market listing. Panel A details the mean figures and Panel B shows the median amounts for this information across the seven disclosure categories. In both panels, the left hand side details the levels of disclosure provided by FTSE 100 companies, while the levels of disclosure presented by FTSE Other firms are shown on the right hand side. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

Appendix 5.7: Narrative versus Numerical – Percentage of the Annual Report

Panel A – Means

	Narrative				Numerical			
Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value	Pre IFRS	Post IFRS	Difference	P-Value
Factual information	0.2774	0.8413	0.5639	0.0000	0.0027	0.0000	-0.0027	-
Cost of implementation	0.0051	0.0037	-0.0014	0.3350	0.0016	0.0089	0.0073	0.0000
General impact of implementation	0.0780	0.1280	0.0500	0.0000	0.0355	0.1616	0.1261	0.0000
Progress to date	0.0764	0.0193	-0.0571	0.0000	0.0000	0.0000	0.0000	-
Operational & strategic decisions taken by management	0.0091	0.0034	-0.0057	0.2380	0.0000	0.0002	0.0002	-
Implementation and impact of individual standards	0.8570	7.0140	6.1570	0.0000	0.1156	1.6740	1.5584	0.0000
General other	0.0002	0.0032	0.0030	0.0200	0.0000	0.0026	0.0026	-
TOTAL	1.3030	8.0130	6.7100	0.0000	0.1555	1.8470	1.6915	0.0000

Panel B – Medians

	Narrative				Numerical			
Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value	Pre IFRS	Post IFRS	Difference	P-Value
Factual information	0.2066	0.7536	0.5470	0.0000	0.0000	0.0000	0.0000	-
Cost of implementation	0.0000	0.0000	0.0000	0.7000	0.0000	0.0000	0.0000	0.0002
General impact of implementation	0.0485	0.0992	0.0507	0.0001	0.0000	0.0445	0.0445	0.0000
Progress to date	0.0541	0.0000	-0.0541	0.0000	0.0000	0.0000	0.0000	-
Operational & strategic decisions taken by management	0.0000	0.0000	0.0000	0.8310	0.0000	0.0000	0.0000	-
Implementation and impact of individual standards	0.3040	6.8310	6.5270	0.0000	0.0000	1.3230	1.3230	0.0000
General other	0.0000	0.0000	0.0000	0.4051	0.0000	0.0000	0.0000	-
TOTAL	0.7450	7.9110	7.1660	0.0000	0.0000	1.4820	1.4820	0.0000

Notes: This table presents the results based on the percentage of the annual report devoted to IFRS-related information of the disaggregation of IFRS information between narrative and numerical disclosure form. Panel A details the mean figures and Panel B shows the median amounts for this information across the seven disclosure categories. In both panels, the left hand side details the levels of disclosure provided in narrative form, while the levels of disclosure presented in numerical form are shown on the right hand side. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

Appendix 5.8: Disclosure by Location – Percentage of Annual Report

Panel A – Means

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Chairman's Statement	0.0136	0.0214	0.0078	0.2080
Financial Director's Review	0.0450	0.0360	-0.0090	0.6340
Chief Executives Review	0.0095	0.0132	0.0037	0.6390
Operating & Financial Review	0.5060	0.6040	0.0980	0.0276
Directors' Report	0.0610	0.1800	0.1190	0.0000
Corporate Governance	0.0156	0.0223	0.0067	0.1080
Remuneration Report	0.0148	0.0236	0.0088	0.0590
Notes to the Accounts	0.1000	5.9900	5.8900	0.0000
IFRS	0.6800	2.6600	1.9800	0.0000
Other	0.0147	0.2780	0.2633	0.0000
TOTAL	1.4600	9.8300	8.3700	0.0000

Panel B – Medians

Type of Disclosure	Pre IFRS	Post IFRS	Difference	P-Value
Chairman's Statement	0.0000	0.0000	0.0000	0.1422
Financial Director's Review	0.0000	0.0000	0.0000	0.7146
Chief Executives Review	0.0000	0.0000	0.0000	0.5338
Operating & Financial Review	0.2941	0.3094	0.0153	0.3108
Directors' Report	0.0000	0.0926	0.0926	0.0000
Corporate Governance	0.0000	0.0000	0.0000	0.1418
Remuneration Report	0.0000	0.0000	0.0000	0.1064
Notes to the Accounts	0.0000	5.7238	5.7238	0.0000
IFRS	0.0000	2.4382	2.4382	0.0000
Other	0.0000	0.1464	0.1464	0.0000
TOTAL	0.8102	9.5963	8.7861	0.0000

Notes: This table shows the IFRS information measured in percentage of the annual report provided by the sample companies by location. Panel A presents the mean figures and Panel B details the median amounts for this information across the ten disclosure categories of location. The mean p-values are based on a 2-sample t-test, while a Mann-Whitney test was used to calculate the median p-values.

Appendix 7.1: Sample Companies IFRS Comments captured during the Content Analysis Survey

Company	Pre- or Post – IFRS Annual Report	Comment	Location
Aviva	Pre	In anticipation of these [IFRS] changes, Aviva has made a significant investment of £171million to date in our global finance transformation programme.	Financial Review (p. 24)
	Pre	By adopting these [EEV] principles early the directors are seeking to achieve, through supplementary reporting, consistency and continuity of performance reporting at a time of significant and ongoing change to the group's primary reporting arising from the two-phased approach to accounting for insurance business under IFRS.	Financial Review (p. 25)
	Post	We are required to report our results on an International Financial Reporting Standards basis. However, the directors consider the European Embedded Value (EEV) methodology provides a more accurate and meaningful reflection of the value of the group's life operations. Accordingly, we analyse and measure net asset value and total capital employed for the group on an EEV basis.	Business Review (p. 39)
	Post	We present the results and financial position of our life and related businesses on an EEV basis, in addition to the IFRS basis. The directors' opinion is that the EEV basis provides a more accurate and transparent view of the performance of the life and related operations year on year than the results presented under the IFRS basis... Under the EEV methodology, the total profit recognised over the full lifetime is the same as under the IFRS basis of reporting. However, the EEV basis gives a fairer indication of the profitability of business on inception. Additionally, shareholders' funds incorporate internally-generated additional value-in-force (AVIF) on an EEV basis, this is not the case under IFRS.	Business Review (p. 39)

		We continue to believe that: - IFRS represents a technical accounting change and does not represent a material change to the economics of our business - IFRS will not impact our dividend policy - IFRS will have no significant impact on our solvency calculations - EEV results are unaffected by IFRS	
	Post	We actively engage in the development of new accounting standards, via industry forums and working parties, reviewing and providing comment on proposals from the IASB.	Business Review (p. 39)
	Post	We support the IASB's efforts to develop a comprehensive global accounting standard for insurance and we are engaging with stakeholders in Europe and the US. We are aiming for a final standard that reflects the underlying economics of the business and provides relevant information for investors on value added capital adequacy and cash flow. Whilst the standard is under development we will continue to focus on EEV as the best measure of value added for long-term savings business.	Business Review (p. 39)
	Post	In the directors' opinion, the EEV basis provides a more accurate reflection of the performance of the Group's life and related operations year on year than results presented under the IFRS basis. The directors consider that the EEV methodology represents a more meaningful basis of reporting the underlying value of the Group's life and related businesses and the underlying drivers of performance. This basis allows for the impact of uncertainty in the future investment returns more explicitly and is consistent with the way the business is priced and managed.	Financial statements (p. 204)

BAA	Pre	The Board of BAA believes that timely and relevant communication of the Group's transition to IFRS is important. Consequently, an IFRS announcement was issued and a presentation provided on 15 March 2005 to advise shareholders and the financial community of the implications of transition. This announcement provided a preliminary unaudited restatement of the Group's UK GAAP 30 September 2004 interim announcement. In summary, the transition to IFRS will result in a change in the manner that items are presented and introduce volatility into BAA's financial statements. However, the Group's strategy and the underlying economics of the business remain unaffected by the transition.	Operating and Financial Review (p. 36)
Barclays	Pre	Continued significant investments in risk management and risk systems (for regulatory changes including IFRS).	Risk Management (p. 44)
	Pre	Considerable resource stretch and subjected to cost/benefit analysis.	Chairman's Statement (p. 5)
BP	Post	The adoption of IFRS from 1 January 2005 has not fundamentally changed BP's approach to managing financial risk.	Performance Review (p. 24)
British Land Company	Pre	We made a presentation to investors and analysts of the expected impact of adoption of IFRS on 21 January 2005.	Operating and Financial Review (p. 27)
British Sky Broadcasting Group	Post	The support advisor advises on... accounting including IFRS... for any existing or new incentives and remuneration schemes... (New Bridge Street Consultants LLP).	Report on Directors' Remuneration (p. 64)
BT	Pre	The group started its IFRS transition project in 2005. The project team is overseen by the Group Finance Director and regular updates have been provided to the Audit Committee. The project involved a detailed assessment of the impact of IFRS on BT's	Operating and Financial Review (p. 41)

		accounting polices and reported results; system changes to capture additional data; training of staff and communications. As part of the transition to IFRS, in March 2005, we presented on our investor relations website our view of the pro-forma financial impact of adopting IFRS for the 2004 financial year. Furthermore, the adoption of IFRS does not affect BT's strategy or underlying business performance.	
Cadbury Schweppes	Post	During 2005, the majority of the Non-Executive Directors attended training on the adoption of IFRS...	Corporate Governance Report (p. 30)
Capita	Post	We now operate Capita through 7 divisions, ... As a consequence of this and the requirement to comply with the new International Financial Reporting Standards, we are now providing shareholders with increased detail regarding the performance of individual parts of Capita's business in the accounts.	Business Review (p. 24)
Care UK	Post	Care UK is continuing to monitor proposed changes to adopted IFRS, assessing how best practice develops, and gauging their impact on the group financial statements. Shareholders will be kept informed as to how such changes may impact the group's financial statements.	Finance Review (p. 14)
Centrica	Post	Following the adoption of IFRS in 2005, the Committee agreed, having taken advise from Kepler and having consulted with the ABI and the RREV, to continue with the financial target of economic profit calculated in accordance with IFRS adjusted for exceptional items and certain re-measurements arising on the application of IAS 32 and IAS 39...excluded on the grounds that such standards do not represent the underlying performance of the business.	Remuneration Report (p. 29)
Christie Group	Post	A very substantial amount of work has been put into adopting IFRS at a Group and subsidiary company level.	Financial Review (p. 24)

Daily Mail and General Trust	Pre	Whilst IFRS will alter the format of the financial statements, we will continue to present adjusted numbers in addition because we believe they give a more comparable indication of the Group's underlying business position.	Operating and Financial Review (p. 17)
	Post	This led to considerable changes in the format of our primary statements, to increased volatility of the numbers within the Income Statement and to a far longer and more complex set of accounts. IFRS seems to favour the use of fair values over the traditional measure of historical cost and increasingly appears to be driven by academic theory, at the expense of commercial reality. Whilst many IFRS standards follow the UK principles-based approach, enabling the exercise of professional judgement, several of its newer US-influenced standards have introduced complex rules and this trend seems set to continue.	Financial and Treasury Review (p. 28)
	Post	Whilst the Group's Accounts are likely to be more difficult for shareholders to understand, this Financial Review focuses on the adjusted numbers, in addition to the statutory figures, because we believe the alternative measures give a more comparable indication of the Group's underlying business performance.	Financial and Treasury Review (p. 28)
DSG (Dixons Group)	Post	The directors believe that the "underlying" profit and "adjusted" earnings per share measures provide additional useful information for shareholders on underlying performance of the business, and are consistent with how business performance is measured internally. It is not a recognised profit measure under IFRS and may not be directly comparable with "adjusted" profit measures used by other companies.	Notes to the Financial Statements (p. 64)
Friends Provident	Pre	IFRS will not materially impact Friends Provident achieved profit results, embedded value, dividend policy or solvency. We believe the achieved profit basis will continue to provide a more representative method of accounting for long-term business.	Financial Review (p. 31)

	Post	Management consider that underlying profit better reflects the ongoing performance of the Group and focus on this measure of profit in internal monitoring of the Group's IFRS results.	Financial Statements (p. 67)
Great Portland Estates	Pre	This will involve a radical reshaping of the way in which the Group's activities are reported, even though the fundamentals of our business will not have changed.	Chairman's Statement (p. 6)
Gus	Pre	The move to IFRS will not change how the Group is managed and will have no impact on cashflow. It will, however, be likely to lead to increased volatility in the profit and loss account and balance sheet, with the presentation of the financial statements also affected.	Financial Review (p. 29)
Hampson Industries	Post	With the introduction of International Financial Reporting Standards ("IFRS") there has been increased focus on the liabilities faced by many engineering companies as a result of their defined benefit pension schemes.	Chairman's Statement (p. 5)
HBoS	Pre	The cost increase also includes project spend to meet the requirements of the changing regulatory environment, in particular, the implementation of International Financial Reporting Standards.	Corporate and Treasury (p. 20)
	Pre	Briefings of topics of special interest have also been arranged [for shareholders], for example…a briefing in respect of the implications for the Company of the adoption of IFRS.	Corporate Governance (p. 58)
	Post	The Chairman requires all Directors to update their skills continually and ensure they have the necessary knowledge and familiarity to fulfil their role effectively. Specifically, development undertaken in 2005 covered… the impacts of the introduction of International Financial Reporting Standards…	Corporate Governance (p. 70)
IMI	Pre	[Implementation of IFRS] is not expected to change the way the Group manages its commercial or economic exposures.	Financial Review (p. 23)

Intermediate Capital Group	Post	Although the financial statements have been prepared under different standards, we have decided to maintain the existing presentation by splitting core income, net gains on investments, impairment provisions, and, for the first time, movements on derivatives.	Business and Financial Review (p. 13)
Kingfisher	Post	First to continue to raise operating margins to the levels of the best-performing competition. 15% (under 2004 UK GAAP) has finally been achieved. 20%, or 19% under IFRS, is much tougher, but not out of the question.	How we're doing (p. 21)
Legal and General	Pre	...made significant investment in regulatory and reporting systems to prepare for the implementation of International Financial Reporting Standards. A group wide programme was established in 2003 to deliver the necessary changes and ensure a timely and efficient transition. IFRS conversion has been a highly complex exercise for all affected companies... Overall, we do not expect there to be a significant impact on the Group's shareholders' funds as a result of the transition to IFRS. However, significant additional disclosure and presentational changes will be required.	Finance Director's Review (p. 17)
	Post	We believe the IFRS and EEV developments have been an important step towards improving the consistency and comparability of accounts of European insurers. However, this has resulted in a much longer annual report and accounts document this year.	Finance Director's Review (p. 18)
Man Group	Post	The Board has also reviewed the implications of the Group's adoption of International Financial Reporting Standards (IFRS)...	Corporate Governance (p. 62)

Prudential	Pre	Head Office costs increased...mainly reflects the substantial work undertaken for the implementation of International Financial Reporting Standards.	Financial Review (p. 15)
	Post	The adoption of IFRS does not have a significant impact on the business or the underlying financial position.	Financial Review (p. 17)
	Post	Life insurance products are, by their nature, long-term and the profit on this business is generated over a significant number of years. Accounting under IFRS does not, in Prudential's opinion, properly reflect the inherent value of these future profit streams. Prudential believes that embedded value reporting provides investors with a better measure of underlying profitability of the Group's long-term businesses and is a valuable supplement to statutory accounts.	Financial Review (p. 17)
	Post	Prudential believes that this format [for Group holding company cash flow table] gives a clearer presentation of the use of the Group's resources than the format of the statement required by IFRS.	Financial Review (p. 25)
Rentokil Initial	Post	Costs for 2005 were £13.7 million higher than 2004 primarily due to... and IFRS transition costs.	Financial Review (p. 22)
Reuters	Pre	Director's received ongoing training including...IFRS.	Corporate Governance (p. 29)
	Post	All directors receive ongoing training in matters that are relevant to their role on the Board, such as, for example, the implementation of, and accounting under, International Financial Reporting Standards.	Corporate Governance Report (p. 40)
Rio Tinto	Pre	We welcome the adoption of a single accounting convention by so many companies around the world.	Chief Executive's Report (p. 4)

Royal and Sun Alliance	Pre	Central expenses have increased in recent years primarily relating to the additional costs of regulatory projects such as the IFRS conversion...	Financial Review (p. 32)
	Post	While such a significant change in accounting basis can make it harder to understand how a business is really performing, I believe that the move to IFRS, combined with the changes in disclosure we have initiated ourselves, will make it easier to see how we are performing.	Financial Review (p. 27)
	Post	We now split the result between the Core Group (UK, International, Scandinavia and Group Re) and the US reflecting the way we manage the Group. This was not part of the conversion to IFRS but is how we look at and manage the business and is, I believe, more helpful in understanding the Group's results.	Financial Review (p. 28)
Royal Bank of Scotland Group	Pre	Central departmental costs and other corporate items at £595 million were £99 million or 20% higher than 2003. This is partly due to... expenditure on Group-wide projects such as International Accounting Standards...	Operating and Financial Review (p. 90)
Sage Group	Post	The Company proposes to make certain amendments to Article 85 (power to borrow money) to update the terminology used in Article 85 to the new terminology used by IFRS and appearing on consolidated balance sheets prepared under IFRS. The Company's borrowing limit is currently an amount equal to two times adjusted capital and reserves... In order to preserve the Company's borrowing power and ability to make acquisitions in the future, the Company proposes that this figure be increased to two and a half times adjusted total equity...	Directors' Report (p. 32)
J Sainsbury	Post	The Company also held a presentation on the anticipated impact of IFRS in April 2005.	Statement of Corporate Governance (p. 40) (Investor relations section)

Schroders	Pre	Whilst the Group remains on track to make the transition to IFRS, it is likely that the change will create concerns over comparability of results both over time and between different groups as the market seeks to understand the new basis of accounting. The Group believes that the transition can only be managed by clear and open communication with the market of the impact of the change on results.	Operating and Financial Review (p. 6)
Scottish Power	Post	The application of IFRS has introduced more complexity to the group's financial reporting processes principally in its treasury and energy management activities and management will continue to enhance processes and systems in these areas to support ongoing business needs.	Corporate Governance (p. 56)
Unilever	Post	UEx (Unilever Executive) are treated as... key personnel for IFRS purposes.	Corporate governance (p. 50)
Weir Group	Post	A carefully managed 100-day integration plan was executed by a cross-functional team that included sales and marketing, human resources, Lean production, technical, finance and IT, to ensure...conversion to IFRS reporting standards. (Referring to Weir Gabbioneta: integration into Weir Clear Liquid group of companies, acquisition of Pompe Gabbioneta).	Operational Review (p. 11)
Whitebread	Pre	During the year directors attended training courses and seminars, or received tailored training, on the following subjects...International Financial Reporting Standards.	Corporate Governance (p. 30)
	Post	During the year directors attended training courses and seminars, or received tailored training, on the following subjects...International Financial Reporting Standards.	Corporate Governance Report (p. 4)

Note: This table includes details of the additional comments about IFRS provided by the sample companies captured during the content analysis survey.