Winds of change in accounting practices in an emerging market: some observations and thoughts

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Abstract: In Turkey, publicly traded companies are required to comply with a new set of standards that are essentially similar to the International Financial Reporting Standards (IFRS) since 2005. In this study, we use the results of a survey carried out in Turkey with accounting or finance executives of publicly traded companies regarding their perceptions of the new set of standards and their expectations from the policy makers, compare the findings of global research with the survey results, and report our observations and opinion. The survey results suggest that there was lack of knowledge and experience for appropriate implementation – a common point raised globally as well. Early observations and findings reflect that, although a lot has been achieved on the way to convergence, more consensus and guidance from the national and international standard setters are necessary to fully realise the expected benefits of IFRS.

Keywords: International Financial Reporting Standard; IFRS; convergence; IFRS implementation; Turkey.

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1 Introduction

The way of doing business has changed substantially over the last three decades parallel to the technological, economic and sociological developments globally. Increased information access manifested itself in the increased international trade and investment. Global business activities, such as foreign direct investments (FDIs) and international capital market operations, are prevalent ways of doing business presently. Such advances in business practices necessitated preparation of compatible and high quality financial reporting.

Pressure from the business world compelled the accounting standard setters to converge into one set of high quality standards. To achieve this goal, the best standard among existing standards relating to business and reporting issues is determined and if such is not possible, a new standard is developed. The standard setting body in this case is the International Accounting Standards Board (IASB), and the set of accounting standards is called International Financial Reporting Standards (IFRS). Within this context, companies quoted in the European stock exchanges are required to prepare their financial statements according to IFRS effective from 1 January 2005. Apart from Europe, many countries take actions either to accept IFRS as the national standard or to adapt their national standards to IFRS (http://www.iasplus.com/country/useias.htm, 12 April 2007).

Thus, with the effects of European Union (EU) together with the globalisation in the world economy, the Capital Markets Board of Turkey (CMB) issued a new set of accounting standards that are essentially the same with IFRS, but which are significantly different from the previous standards. Therefore, a thorough understanding of the new standards by the management of the listed companies is necessary for fair presentation of the financial position and the results of operations.

Since the beginning of this century, global winds of convergence led the way to a single set of standards. As academicians in an emerging market, we wanted to determine how this wind affected the Turkish companies. Our aim in this study is first, to ascertain the readiness, i.e., self-assessed preparedness level of executives in Turkey during the transition period and compare the observations with those of the global counterparts. Secondly, we review the early results of the first year implementation to determine whether there are any salient common obstacles or advantages. In so doing, we compare our observations of a survey that was carried out in 2004 in Turkey among the financial executives with global studies to the same effect, and point out the common areas of benefits, expectations and issues. Hence, the paper purports to specify, as much as possible, the common experiences during the transition process as well as the expectations of the executives. In the following sections of the paper, first we provide an overview of convergence activities around the world. Secondly, we present the comparative results of international convergence studies and the study we carried out in Turkey. The third section continues with the discussions with respect to the first year implementation of IFRS (post-2005). Finally, we conclude the paper by highlighting the Turkish and international observations, and by stating our suggestions for future studies.

2 Overview of convergence

The inevitability of establishing accounting standards that will produce high quality and comparable financial statements led to the convergence of accounting standards. Within the convergence framework, 'the best standard' among the existing standards in a certain area is selected, if there is no consensus on a best standard, a new standard is developed. Thus, the aim of creating the highest quality set of standards is achieved.

Convergence is expected to bring better quality and comparability in international capital markets and relieve international companies from the burden of preparing different sets of financial statements (Brown and Howieson, 1998). A study performed in the United Arab Emirates also reports that comparability, reliability and the relevance of financial information is improved by the use of international standards (Aljifri and Khasharmeh, 2006). However, there are also doubts about using international standards. Uddin (2005) argues that the international standards may not be flexible enough to address national business and economic environments, they may create standards overload and most importantly require professional judgment that may shadow the fair presentation of the financial statements.

IASB (formerly International Accounting Standards Committee – IASC) takes the responsibility of developing IFRS. To accomplish its mission, IASB finalised certain improvement projects in the International Accounting Standards (IAS) and issued new IFRS. Although IASB does not currently have the power of enforcing the use of IFRS, various national capital market board regulators initiated the use of such standards in preparation of the financial statements (Holzmann and Robinson, 2004). As of the summer of 2001, 275 internationally listed companies were using IFRS in their financial statement preparation, whereas as of the same date, with the endorsement of IFRS by the European Commission, it was expected that approximately 7,000 companies would have been affected (Haller, 2002). Likewise, Australia and New Zealand adopted IFRS as their national standards effective from 2005 and 2007, respectively (http://www.iasb.org).

The first attempt of providing comparable financial information across Europe started after the Treaty Establishing the European Community (EEC) with the issuance of Fourth and Seventh Accounting Directives (Treaty of Rome). The main aim of those directives was to create equality among the financial statements and to provide comparable financial information across Europe. However, due to the differences in the national accounting systems within Europe, those directives ended up with various options in implementation, thus did not fully satisfied its mission. Therefore, the need of a further action towards convergence emerged. Instead of establishing a new 'European Accounting Board' to issue a new 'European Accounting Standards', EU preferred to support and be influential in IASB (IASC) (Haller, 2002). In 1995, the European Commission supported the use of IAS by the large companies in the preparation of their consolidated financial statements, within the framework of the 4th and 7th Directives. Emphasising the need to accelerate the integration of European capital markets, Lisbon European Council declared 1 January 2005 as the deadline for implementing the 'financial action plan' of the council. Finally, in July 2002, the European Parliament and the council of the EU required all publicly traded companies to apply IFRS starting 1 January 2005 [Regulation (EC) No. 1606, 19 July 2002[1]; Simga-Mugan and Akman, 2005].

The USA was not very much interested in the international convergence of financial accounting standards until towards the end of the 20th century. As being one of the most influential countries in accounting regulations and having extensive and stringent accounting rules, there was not any urgent need for global accounting standards in the US. However, increased cross border listings, international trade and investments urged the Financial Accounting Standards Board (FASB) to participate in the convergence activities as well.

FASB and IASB work together on some projects to promote a single set of global accounting standards. FASB states its objective of participating in the international projects as:

> "…to increase the international comparability and the quality of standards used in the USA. This objective is consistent with the FASB's obligation to its domestic constituents, who benefit from comparability of information across national borders. The FASB pursues that objective in cooperation with the IASB and national standard setters" (http://www.fasb.org/intl/, 12 April 2007).

Currently, international listed companies in the US can prepare their financial statements in accordance with their national accounting standards or IFRS, given that they provide a reconciliation of such standards and the US GAAP. On 28 September 2004, the chief accountant of Securities and Exchange Commission (SEC), stated that if:

> "… things continue as they have been going – if the IASB operates as a strong independent standard-setter and continues to develop and issue high quality standards, if the commitment to quality application of IFRS remains, and if good progress is made in accounting convergence and the development of an effective global financial reporting infrastructure" (http://www.sec.gov/news/speech/spch092804dtn.htm, 12 April 2007),

then SEC may eliminate the requirement of reconciliation. This speech portrays the acceptance of IFRS by the US and provides a future prospect for the IFRS as the global set of accounting standards.

Due to its political and commercial relations during and after the 1st World War, Turkish accounting system was extensively influenced by the German system. The Commercial Code of the Turkish Republic that was enacted after the establishment of the republic was based on German company and commercial laws. The accounting system continued to be influenced by German codes until the end of first half of the 20th century. After the 1950s, an influence of the US system was also felt on the accounting system (Simga-Mugan and Akman, 2005; Simga-Mugan, 1995).

It was not until the 1990s that a formal financial reporting system for the listed companies was enforced. CMB issued the first financial accounting standards for the listed companies in 1989 following the inauguration of the Istanbul Stock Exchange (ISE) in 1986. This set of CMB standards were similar to that of the IAS, including the assumptions of going concern, consistency, time period, unit of measure and the basic principles such as, cost, matching, conservatism, materiality, objectivity and full disclosure. However, there were very significant differences in measurement and disclosure issues. The significant differences, among others, were accounting for the effects of inflation under hyper-inflationary economies and accounting for long-term investments. Although Turkey had been experiencing considerable rates of inflation since 1984, financial statements were prepared at historical cost except for the revaluation of property, plant and equipment. Furthermore, long-term investments including subsidiaries and equity participations were carried at cost. In January 2002, CMB issued an amendment to the accounting standards, requiring the companies within the scope of CMB regulations to prepare consolidated financial statements and to apply inflation accounting effective from 1 January 2003. Thus, a major discrepancy between IFRS and CMB standards was eliminated.

The effect of convergence activities of accounting practices was felt in Turkey as well. As a developing country, Turkey attracted FDI and Turkish companies started to make investments outside Turkey in the late 1990s. The FDI flowing into Turkey between 2002–2005 was $15.407 million, whereas FDI flowing from Turkey during the same period was $2,611 million (http://www.unctad.org/sections/dite_dir/docs/wir06_fs_tr_en.pdf, 12 April 2007). Those investment activities together with international capital market transactions impelled national accounting system to move towards internationalism as well.

Furthermore, Turkey applied for the EU in 1959 and currently is a full member candidate country. With the resolution adopted by the European Parliament on 15 December 2004, the opening negotiations for full membership started on 3 October 2005. The relation with EU requires Turkey to adapt its financial reporting system along with many other legislative issues.

The above-cited developments with respect to Turkey led to the issuance of a new set of accounting standards by CMB in November 2003. This new set of standards was effective starting 1 January 2005[2] and covered the financial reporting of companies whose stocks were listed in ISE. The companies that are subject to CMB regulations, but not traded in ISE, continue to apply the older version of the standards. The new set of standards is essentially the same with IFRS except for the amendments made by IASB on IAS and newly issued IFRS in 2004. Thus, the differences between CMB standards and IFRS for the listed companies were eliminated to a great extent. As was mentioned before, there were differences from IFRS in certain measurement and disclosure issues, and some of the IFRS were not covered by the old standards (Simga-Mugan and Akman, 2005). Major issues that were covered in IFRS, but not in the older version of CMB standards (ex-CMB standards from now on), can be summarised as follows:

- impairment of assets (IAS 36)
- de-recognition of financial assets (IAS 39)
- provision for employee termination benefits other than lump sum termination indemnities (IAS 19)
- segment reporting (IAS 14)
- provisions, contingent liabilities and contingent assets (IAS 37)
- deferred taxation (IAS 12)
- hedge accounting (IAS 39).

In addition to the standards that were not present in ex-CMB standards, there were differences in the measurement of certain transactions, such as treatment of capitalisation of foreign exchange losses on property, plant and equipment, accounting for long-term contracts, capitalisation of research and development expenditures, and amortisation of goodwill. Finally, statement of changes in equity was not a part of primary financial statements according to the ex-CMB standards; the format of cash flow statement was rather different and the scope of related parties was not equivalent to that of IFRS scope. Therefore, one could expect certain difficulties in the transition period of the new CMB standards since most of the preparers were not thoroughly familiar with the new standards and the transition period was only about a year.

3 Pre-2005 studies

3.1 International studies

A number of studies and surveys have been performed to assess the potential for global convergence and the readiness of companies for IFRS. One of these surveys – A Survey of National Efforts to Promote and Achieve Convergence with IFRS (GAAP Convergence-2002) – executed by BDO, Deloitte Touche Tohmatsu, Ernst and Young, Grant Thornton, KPMG and PricewaterhouseCoopers (PWC) in 2002 – provides an overview of country intentions to achieve convergence with IFRS. Within the study, professionals in six largest accounting companies in 59 countries were surveyed. Study showed that 90% of the surveyed countries had intentions to converge with IFRS (Street, 2003).

After the requirement by the EU to use IFRS by the European listed companies, PWC performed a study to assess the readiness of European countries, involving 667 interviews in all EU member countries in 2002 (PricewaterhouseCoopers, 2002). The survey respondents agreed that IAS would be beneficial for the European capital markets and most of them believe they would be ready by 2005. However, at the time, almost

85% of Europe's listed companies had not adopted IFRS and most were prohibited from using IAS for their statutory reports by national law.

In the first quarter of 2004, PWC performed another study to again assess the readiness of companies in 16 European countries to use IFRS as the 2005 deadline approached (PricewaterhouseCoopers, 2004a). Although the survey results indicated that certain improvements took place since 2002, a vast majority of the 310 companies surveyed had a lot to do more. A similar study that was also carried by PWC in 2004 (Ready to Take the Plunge-Australia) in Australia presents more or less the same results. Australia adopted IFRS to be in effect by 1 January 2005 as well. Similar to the European companies, although almost 90% of Australian companies had at least some idea about IFRS, the majority had 'lots of work' to do before the effective date (PricewaterhouseCoopers, 2004b).

Ernst and Young conducted a survey during the first quarter of 2005 involving the listed companies in South Africa, to evaluate the readiness of South African companies. Among the respondents, 96% were able to define IFRS, indicating that they were mostly fully aware of the transition issue, while 41% pointed out that they were lagging behind in implementation. To assess the overall readiness, the respondents were asked whether they were on track for reporting per IFRS since IFRS would be mandatory for interim reporting as well. The results indicated that many companies were not prepared for that task (Ernst and Young, 2005).

3.2 The study in Turkey

In order to appraise the readiness of the executives of the listed companies for IFRS, we carried out an exploratory study utilising a survey questionnaire in 2004. The survey questionnaire was mailed to the executives of 298 companies that comprise the total number of companies traded in the stock exchange at the time. The survey questionnaire was conducted in Turkish and an English translation of the questions is provided in the Appendix. To increase the response rate, we called the relevant executives and for those who did not receive, the questionnaire was re-sent either via facsimile transmission or electronic mail. Altogether, we received 73 responses (24% response rate). Out of these, two responses were eliminated due to incomplete information and our analyses are based on 71 responses.

80% of the respondents were male and the average age was 42. The breakdown of respondents with respect to the position within the company and the industry the company belongs to is provided in Table 1.

Table 1 Respondent profile

Position within the company	*Frequency*	*Industry*	*%*
Chief accountant	44	Manufacturing	55.7
Finance director	11	Financial	20.0
Accounting supervisor	6	Other	24.3
Cost accounting supervisor	2	Total	100.0
Senior accounting staff	2		
Budget manager	3		
General manager	1		
Member of board of directors	1		
Total	70		

3.3 Comparative results of the studies

Earlier studies carried out by the accounting firms in collaboration with academicians inspired the questionnaire we utilised in 2004. Although there is a time gap between the studies, we believe that this limitation would not hinder comparison of major issues that surfaced.

3.3.1 Are the companies ready for IFRS?

We started the analysis with the above question to have a general idea of what percentage of executives believed that they were ready for IFRS in Turkey and in other countries as reflected in previous studies. The Turkish results indicated that 49% claimed that they could prepare their financial statements according to IFRS without any problems. Out of the 35 companies that felt fully prepared for IFRS, 11 were already preparing their financial statements in accordance with IAS/IFRS. However, three out of 14 companies already applying IAS/IFRS felt they were only partially prepared for the standards (Table 2). Of the non-users of IAS/IFRS, only 25% believed that they were not ready to apply the new standards. Interestingly, only 19% of non-user EU companies surveyed by PWC claimed that they were fully prepared for IFRS (PricewaterhouseCoopers, 2002).

Table 2 Current users of IFRS and their respective readiness

		Readiness of the company			
		Fully prepared	*Partially prepared*	*Not Prepared*	*Total*
Currently apply IFRS	No	24	19	14	57
		42.1%	33.3%	24.6%	100.0%
	Yes	11	3	–	14
		78.6%	21.4%		100.0%
	Total	35	22	14	71
		49.3%	31.0%	19.7%	100.0%

3.3.2 How well do you know IFRS?

The second question in the survey was related with the knowledge level of the executives about IFRS. The result of the Turkish study along with its European counterpart is presented in Table 3.

Table 3 How well do you know IFRS?

	Excellent	*Working knowledge*	*Few details*	*Insufficient*
2005-Ready or Not (PWC)				
Current users (14.7%)	35%	46%	12%	7%
Non-users (85.3%)	8%	40%	34%	18%
Turkish study				
Current users (19.7%)	43%	43%	14%	–
Non-users (80.3%)	11%	54%	15%	20%

It appears that the composition of current users and non-users of IFRS are quite similar. A striking difference is that the Turkish executives seem more confident than the European executives do. Specifically, none of the Turkish executives among the current user group believed that they had insufficient knowledge. The confidence, especially in the non-user group of Turkish executives, displays itself in comparison of 'working knowledge' and 'few details' categories, where 54% Turkish executives believed that they had 'working knowledge' of IFRS, whereas 40% of European executives had the same level of confidence (Table 3).

3.3.3 Is (will) IFRS (be) beneficial to your company?

As we mentioned in Section 2 of the paper, convergence of accounting standards is expected to bring benefits to companies in the international capital markets. To assess executives' perceptions, one of the survey questions asked whether they expect IFRS to be beneficial to their companies. The responses of Turkish executives along with the European counterparts are summarised in Table 4.

Table 4 Is (will) IFRS (be) beneficial to your company?

	Agree	*No opinion*	*Disagree*	*Don't know*
2005-Ready or Not (PWC)				
Current users	71%	18%	9%	2%
Non-users	41%	29%	29%	1%
Turkish study				
Current users	100%	–	–	N/A
Non-users	71%	26%	3%	N/A

As can be followed from the table, the benefits of using IFRS were mostly perceived by the current users. Strikingly, Turkish executives who currently used IFRS 100% believed in the benefits, whereas only 71% of the European executives believed that IFRS would be beneficial. The same phenomenon is observed in the comparison of non-user groups in Turkey and Europe as well. Although similar percentage of executives of non-user groups stated that they had no opinion, only 3% of the Turkish non-users were sceptical of the benefits of using IFRS.

3.4 Expectations and recommendations of the executives

In various open-ended questions, the executives stated their opinion regarding the changes that will be brought by the new standards. They also expressed their perception regarding the probable obstacles to the implementation of the new standards.

3.4.1 Expected changes in the financial statements

The responses to the open-ended question about the expectations with respect to the financial statement items/sections that would be affected by the new standards are presented in Table 5. The results are rather interesting in the sense that the Turkish executives did not seem to fully understand the implications of the new standards. As was stated earlier, in Turkey, the application of inflation accounting and the consolidation of subsidiaries came into effect at 1 January 2003 and only after one year, the IFRS based standards were issued. The responses show that the Turkish executives perceived the inflation accounting and consolidation as major parts of the IFRS based standards. We deduce this from the fact that 39% of the respondents stated that property plant and equipment, and 37% indicated that equity section of the balance sheet would change. Furthermore, 10% indicated that the application of inflation accounting would be new. However, comparison of ex-CMB and the new CMB standards reveal that the most important differences will arise in the areas of intangible assets, deferred taxes and financial instruments. The Turkish responses led us to believe that the full impact of the IFRS based standards was not fully comprehended. The responses to a similar question that was asked to European officers in the PWC study of 2005-Ready or Not reveal that deferred taxation, financial instruments, business combinations and employee pensions were judged as the significant areas of change (PricewaterhouseCoopers, 2002). As was mentioned before, PWC held another study in 2004 to assess the readiness of European countries and Australia. In those studies, the key technical issues appeared to be the accounting for financial instruments, revenue recognition, employee benefit schemes and deferred taxation (PricewaterhouseCoopers, 2004a, 2004b).

Furthermore, we analysed the expectations of Turkish executives, with respect to the financial position and the results of operations presented under the new and ex-CMB standards, 16.7% of executives who felt that they were not prepared for the new standards expected only few differences and 83.3% had no idea on the issue. This is another indication that full impact of the IFRS based standards were not yet conceived especially by those who were not prepared for such standards. In PWC study carried out in 2002, among the current users of IFRS, about 61% expected either very much or some differences, whereas 38% of non-users expected major differences in the IFRS based financial statements (PricewaterhouseCoopers, 2002).

Table 5 Expected changes

	Turkish	*PWC 2005-Ready or not*
Property plant and equipment	39%	
Equity	37%	
Long term investments	11%	
Current assets (especially inventories)	20%	
Deferred tax	7%	48%
Employee benefit schemes	4%	30%
Financial instruments	6%	46%
Leasing	6%	
Income statement items	8%	
Inflation accounting	10%	
Intangible assets	1%	
Business combinations	–	32%

3.4.2 Major obstacles during the transition period

Considering the fact that about 49% of the Turkish executives were fully ready to prepare the financial statements in accordance with the new standards, we also analysed whether those who did not feel fully ready had any official transition plans. Results were again interesting in the sense that about 77% of the executives who felt not-ready for IFRS based standards did not have official transition plans and only about 41% of partially prepared executives (13% of the total) had an official transition plan. Although majority of the respondents did not have an official transition plan, 65% believed that they would be ready by 1 January 2005. The results obtained by PWC in Europe and Australia also disclose that only 10% and 15% of the respondents in Europe and Australia, respectively, either had very little process of setting up an IFRS plan or had not started at all (PricewaterhouseCoopers, 2004a, 2004b). Contradictory comments of the executives regarding their plans and their confidence to meet the deadline augmented our scepticism as to the readiness of Turkish companies by 2005.

One of the open-ended questions asked the executives about the major obstacles that may occur during the transition period. The major obstacles listed by the Turkish respondents are presented in Table 6, while 8% of the respondents expected no obstacles.

Table 6 Obstacles during the transition period

Insufficient experience and knowledge	20%
Tax driven financial standards	18%
Insufficient information systems	17%
Insufficient training	15%
Lack of time	6%
Insufficiency of the uniform chart of accounts	4%
Lack of preliminary work	3%

As was mentioned in Section 2, Turkish accounting system was influenced by the German system therefore it is more of a code law system. Hence, until recently, the main aim of financial accounting was to prepare financial statements that would comply with the tax regulations rather than presenting the financial position and the results of operations fairly. Tax legislation still plays an important role in financial accounting, although CMB accounting standards emphasise fair representation. This dilemma of financial reporting is also apparent in the responses to the questionnaire, where 18% of the respondents saw the differences between the IFRS based standards and tax regulations as a major obstacle during the transition period.

Insufficient knowledge and experience were believed to be a major obstacle as can be seen from Table 6, which is accompanied by insufficient training (15%). That is an expected but interesting result since about 68.5% of the respondents claimed that they either perfectly or sufficiently knew about the new standards. These results again raise the question on the comprehension level of the executives of the IFRS based standards.

Somewhat similar results were obtained in the survey of 'GAAP Convergence-2002', in which major obstacles for convergence were found to be the complicated nature of IFRS (51%), tax driven nature of some national accounting rules (47%) and insufficient guidance (35%) (Street, 2003).

3.4.3 Recommendations to CMB

The respondents were also asked for their recommendations to CMB with respect to the issuance of accounting standards. Consistent with the expected obstacles, 17% of the respondents demanded and recommended CMB to offer timely training of the new accounting standards. Furthermore, again consistent with the expected obstacles, 15% of the respondents demanded CMB to take necessary actions to harmonise the financial reporting standards with tax legislation. Another recommendation, regarding issuance of accounting standards, was that the respondents expected concise and understandable standards. IFRS/IAS were also criticised in the international circles due its complexity. Considering that the new CMB standards are also an adaptation of IFRS, the complexity issue seems to continue in the Turkish standards as well.

Table 7 Recommendations to CMB

CMB should provide timely training.	17%
CMB standards should be harmonised with tax regulations.	15%
Standards should be concise and understandable.	14%
CMB should allow for sufficient transition period.	7%
CMB should have close relations with the companies.	6%
Standards should take into consideration the local and industrial issues.	4%

As was mentioned before, the new set of standards was issued in November 2003 and the companies were required to prepare their financial statements in accordance with such standards effective for the period starting from 1 January 2005. That left the companies with approximately 13 months for preparation. As can be followed from Table 7, 7% believed that some more time should have been allowed for transition. 'GAAP Convergence-2002' also emphasised the importance of sufficient lead time for the success of convergence and stated that without enough transition time for companies, the main aim of producing high quality financial statements would be at stake (Street, 2003).

3.4.4 Consulting required for the new standards

One of the survey questions was related with the issue of consulting services planned to be received for the implementation of the new standards. One of the most striking results of the study was obtained through this question. Only nine company executives that were mainly from large group companies claimed that the consulting will be provided from other sources, namely within their own corporate structure.

As presented in Table 8, 86% of the respondents replied that they would ask consulting from their current audit company, whereas only 4% plan to use the services of other audit companies. As will be discussed in the following sections of the paper, obtaining consultancy during the implementation of the new standards from the current audit company raises the very important issue of auditor independence. Ernst and Young, in their report, mention the need for an outside advisor, but states that as independence issues do not allow the IFRS implementation by their own auditors, the task should be submitted to other auditing firms or consultants (Ernst and Young, 2005).

Table 8 Sources of consulting

Current audit company	86%
Other audit company	4%
Academic institutions	4%
Chamber of independent accountants	3%
Other	14%

3.5 Implications of the Turkish study

The results of the survey had two major implications: the level of understanding of the new accounting standards was overstated by the respondents and the use of current auditors might infringe the independence of the audit company.

3.5.1 Level of understanding of the new standards

The results obtained through the survey and explained in the previous sections of the paper, indicate that although a good fraction of the respondents perceived themselves as ready for the new CMB standards that are based on IFRS, they did not seem to fully comprehend the full impact of those standards. Furthermore, it seems from the results that most companies did not have official transition plans for the implementation. Under such circumstances, it is natural to expect that the 2005 financial statements may not fairly present the financial position and results of operations of the entities per IFRS. As was also mentioned in Section 2, the major aim of convergence activities is to achieve comparable and 'high quality' financial statements around the world. Without sufficient knowledge of and experience with IFRS by the preparers, such an aim appears to be hard to achieve.

Generally, accounting standards do not address the full details of application that requires judgment from the management of entities. IFRS, especially with the latest changes, involve a great deal of management judgment. As judgment can be applied via thorough understanding of what is meant by the standards, incomplete comprehension of standards would lead to lower quality financial information.

Furthermore, in code law countries, which Turkey can be classified as one, standard setting and enforcement are primarily functions of governmental institutions. In such countries, there is a lower demand for high quality financial reporting and disclosure as the model is oriented towards tax offices and financial institutions. On the contrary, shareholder enforcement is an important impact on high quality financial statements in common law countries. Therefore, to increase the quality of the financial statements globally, it would not be enough to enforce foreign accounting rules, but rather its necessary to change the institutional factors within the environment (Ball et al., 2003). Ball et al. suggest standards alone do not guarantee the quality of financial information disclosed, rather the institutional factors such as the incentive of preparers, and regulations should be considered. The standards issued by IASB are widely regarded as a common law approach of transparent and timely disclosure (Ball et al., 2000) and most code law countries may not be prepared for such an approach. According to Zeghal and Mhedhbi (2006), countries that do not belong to common law environment have more difficulties in adopting IFRS hence IASB and national standard setters may have to be more supportive during the transition period.

The road towards global convergence of accounting standards around IFRS mostly depends on the acceptance of such standards within the USA and as was discussed before, such acceptance is contingent upon the continuing development of high quality standards by IASB. The preparation of financial statements in accordance with IFRS, but not deemed to be of high quality, may hinder the image of IFRS as high quality standards, thus may endanger the prospect of global convergence (Ball et al., 2003).

3.5.2 Audit independence

The recent accounting scandals including Enron, WorldCom, Parmelat and others instigated many discussions on the quality of independent auditing along with the quality of accounting standards. Many studies were performed to assess the factors that may lie behind the poor audit work. For instance, Bazerman et al. (2002) argue that doing bad audits by reputable companies can be associated with the ambiguity of auditing standards, familiarity with the clients, escalation and attachment to the client. Attachment to client is expected to occur since auditors are selected, fired and paid by their clients. Auditing standards require that auditors should perform the audit work being mentally independent from the entity being audited. When auditors are paid and can be fired by their clients, a real question of independence arises. The question of independence boosts, when audit companies perform non-attest work to their clients. Raghunandan et al. (2003) investigated the relationship between firms that issued restated financial statements and the magnitude of non-audit fees, fee ratio and total fees paid by the auditor. The results indicate no statistically significant relationship. Ashbaugh (2004) also indicates that the studies investigating the relation between the performance of non-attest assignments and breach of independence of auditors found no evidence of a significant relationship. However, financial statement users generally perceive non-attest work negatively with respect to auditor independence (Ashbaugh, 2004). For that reason, 2002 Sarbanes-Oxley Act limits the scope of non-attest work that could be performed by audit firms to their audit clients. A similar legislation is also present in Turkey, where

CMB restricts the performance of all types of consulting to current audit clients by the audit companies (CMB, 2003).

Within this framework, the results of the Turkish survey with respect to the question of the sources of consulting to be received during the implementation of the IFRS based accounting standards signals a very important potential problem of infringement of independence of audit companies. We should note that 86% of the respondents indicated that they intend to ask for consultancy from their current auditors, although such a practice is forbidden by CMB regulations. Therefore, CMB should exercise due care on the assessment of auditor independence and should take necessary actions to ensure that consulting practices are not negatively evaluated by the users of financial information. We should keep in mind that objectivity of audit reports is a critical factor for the success of capital markets (Bazerman et al., 1997).

4 Post-2005 discussions

At the time this paper was finalised, the companies already prepared their first IFRS financial statements for 2005. According to the study performed by Ernst and Young (2006), European companies were successful in meeting the deadlines for publishing their financial statements. Similarly, Turkish companies were able to publish their financial statements on time according to the timetable announced by the ISE. Therefore, we can state that one of the perceived obstacles, short transition period as stated in Table 6, did not materialise.

An important desired outcome of convergence appears to have been achieved as indicated by the fund managers. PWC conducted a survey in February 2006 with the fund managers, who are one of the major users of financial statements and their opinion is an important indicator of the usefulness of the use of IFRS. According to the survey, 76% of the fund managers agreed that financial statements published for 2005 were clear and understandable. Furthermore, a majority of the fund managers identified the key benefits of IFRS as the increased transparency and consistency of reporting (PricewaterhouseCoopers, 2006). Daske and Gebhardt (2006) also reported that the quality of financial reports increased significantly with the adoption of IFRS.

Although not anticipated by pre-2005 studies, a major criticism that appears after 2005 is the presentation of the profit of the companies. The study conducted by Ernst and Young in 2006 to report the initial observations on the implementation of IFRS states that the national identity of the financial statements with respect to the way of presentation is retained (Ernst and Young, 2006). Allister Wilson, a senior partner in Ernst and Young indicates that ‘implementation has been a resounding success, but has not necessarily brought greater comparability’ (Bruce, 2006).

To determine some existing varieties in income statements from different countries, we reviewed select companies in European countries (England, France, the Netherlands, Italy, Denmark) and Turkey. We selected the companies based on the size, use of IFRS and ease in downloading the statements from the internet. The financial statements reviewed were all manufacturing companies within the first 30 listed companies in their respective national capital markets in terms of market capitalisation. Altogether, we reviewed ten income statements. Most companies adopt the functional approach. However, no two income statement formats are the same. Companies include different revenue and expense items in their ‘operating income’, such as, share option charges, shares from associated companies, reversal of provisions, financial expenses and gains on disposals. Ernst and Young (2006) claim that the variety in the computation of 'operating income' is the result of the lack of a defined format of the financial statements in IFRS. Jobson (2006) further argues that this caused a shift in usage from income statement measures to balance sheet measures by the investors in their financial analysis.

Other major criticisms towards IFRS after its first year of implementation are the complexity of the standards and the required judgment in preparation of the financial statements, as was expected in pre-2005 studies. Ernst and Young (2006) states that the complexity in the measurement and recognition criteria, and the increased disclosure requirements threaten the decision usefulness of the financial reporting.

5 Conclusions

The accounting environment has gone a long way towards establishing accounting standards that would enable the presentation of comparable and high quality financial statements around the world. Turkey, along with the EU, Australia and many other countries has undertaken certain steps for the implementation of IFRS based accounting standards. A major step was to require the preparation of financial statements of listed companies in accordance with the new CMB accounting standards, which are essentially the same as the IFRS, starting 2005.

In this study, we first assessed the readiness of the listed company executives in Turkey and compared the situation with the global findings. Our main observation in Turkey is that, although most of the executives of the companies felt they were ready for the new standards, there seems to be lack of knowledge and experience for the precise implementation. This fact may hinder the ability of the new standards to produce high quality financial statements. Furthermore, since 86% of surveyed executives' intentions were to receive consulting from their current auditor, independence of auditors may be infringed. Thus, CMB should take the initiative to increase the familiarity and comprehension of the new standards by the preparers and beware of potential breach of audit independence in the coming financial reporting periods.

The second aim of the paper is to review the studies carried out following the adoption of IFRS in search of salient advantages and obstacles of convergence. Early observations and findings reflect that, although a lot has been achieved on the way to convergence, more consensus and guidance from the national and international setters are necessary to fully realise the expected benefits of IFRS. We believe that national and international standard setters could benefit from the findings of this exploratory study. CMB, as the standard setter for the listed companies, may utilise the findings to determine the areas where most help is needed by the financial statement preparers. CMB could provide timely training along with implementation guidance regarding specific complex standards and issues.

The present study and other global studies convey similar concerns regarding the accounting standards. Thus, another contribution of the paper is to highlight some problematic issues, such as judgmental measurement areas, disclosure of operating income and information overload that users of financial statements face. Hence, international standards setters might use these findings to respond to the need of international constituents in a timely manner. Future research is necessary to narrow down the debatable issues that need immediate action by IASB. Moreover, we also need studies that investigate whether IFRS statements are more comparable and understandable by all interested parties.

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Notes

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2 Capital Markets Board Communiqué XI-25; http://www.spk.gov.tr/teblig/files/SeriXI_No25.pdf, 12 April 2007.

Appendix

Dear Participant,

We would like to thank you for supporting accounting research by filling out this questionnaire. The purpose of our study is to ask the view of preparers on the newly issued CMB accounting standards that are based on IFRS and compare such view with international preparers. The results of the study is expected to develop accounting theory in Turkey, thus your participation is of utmost importance to us. Your responses will be kept strictly confidential.

1 Age: _____

2 Sex: ❑ F ❑ M

3 Education: ❑ Undergraduate ❑ Graduate ❑ PhD ❑ Other

4 Any professional certificate:
❑ Sworn financial advisor ❑ Independent accountant and financial advisor
❑ Independent accountant ❑ CFA
❑ CMA ❑ CPA ❑ Other

5 Your accounting experience: _________ years _________ months

6 How long have you been working with this company? ___ years __months

7 Your present position within the company: ___________________________

8 How long have you been in that position? ____________________________

9 The name of the company you are working for: ________________________

10 In which industry the company belongs to? ___________________________

11 Is the company's stocks are traded in ISE?

❑ Yes ❑ No

12 Is the company quoted at some other stock exchange?

❑ No ❑ Yes (Please indicate)

13 Does the company prepare consolidated financial statements?

❑ Yes ❑ No

14 Please indicate the name of your audit company: ______________________

15 How many shareholders does the company have? ______________________

16 How many employees does the company have? ______________________

17 Does the company have export sales? (If yes, please indicate the countries)

❑ No ❑ Yes (Please indicate)

18 Does the company have import purchases? (If yes, please indicate the countries)

❑ No ❑ Yes (Please indicate)

19 Does the company have foreign loans?

❑ Yes ❑ No

20 Does the company have subsidiaries and participations?

❑ Yes ❑ No

21 Does the company have foreign investments?

❑ Yes ❑ No

22 Do you use any other accounting standards other than CMB standards?

❑ No ❑ Yes (Please indicate)

23 Do you know that the companies listed in European capital markets are required to use IFRS by 1 January 2005?

❑ Yes ❑ No

24 How well do you know IFRS?

❑ Perfect ❑ Working knowledge ❑ Some details ❑ Few

25 How well do you know IFRS based CMB standards?

❑ Perfect ❑ Working knowledge ❑ Some details ❑ Few

26 Is the company ready to apply IFRS based CMB standards?

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

27 Would the company be ready to implement IFRS based CMB standards before 2005?

❑ Strongly agree ❑ Agree ❑ Disagree

❑ Strongly disagree ❑ No idea

28 Where would you get consulting services for the implementation of IFRS based CMB standards?

❑ Own audit company

❑ Other audit company

❑ Academic institutions

❑ Chamber of Independent Accountants and Advisors

❑ Other (please indicate) ________________________________

29 If the shares of the company are listed in European stock markets, will the company be ready for IFRS before 2005?

❑ Strongly agree ❑ Agree ❑ Disagree

❑ Strongly disagree ❑ No idea

30 Do you think that the use of IFRS based CMB standards will affect the views of shareholders and analysts towards the company?

❑ Yes ❑ No ❑ No idea

31 Did you assess the effects of the transition to new standards?

❑ Yes ❑ No ❑ No idea

32 Who is aware in the company about IFRS 2005?

❑ Audit Committee

❑ Accounting Department

❑ Board of Directors

❑ Top management

❑ Other (Please indicate ________________________________)

33 Who is aware in the company about IFRS based CMB standards?

❑ Audit Committee

❑ Accounting Department

❑ Board of Directors

❑ Top management

❑ Other (Please indicate ________________________________)

34 If you already prepare the financial statements in accordance with IFRS, do you think it was beneficial to the company?

❑ Agree ❑ Disagree ❑ No idea

35 Do you expect large differences in net income and total assets between the current accounting standards and IFRS based CMB standards?

❑ Very much ❑ Some ❑ Few

❑ None ❑ No Idea

36 In which financial statement items/sections do you expect the largest differences through the use of IFRS based CMB standards?

____

____

____

____

____

37 How much time it is needed for the transition to IFRS based CMB standards?

❑ More than one year ❑ Less than one year ❑ No idea

38 Do you have an official transition plan for the implementation of IFRS based CMB standards?

❑ Yes ❑ No

39 What are the major obstacles during the transition to IFRS based CMB standards?

____

____

____

____

40 Do you think IFRS based CMB standards will be beneficial to the integration of ISE and European capital markets?

❑ Strongly agree ❑ Agree ❑ Disagree

❑ Strongly disagree ❑ No idea

41 How well are the other relevant parties are ready for IFRS based CMB standards?

➢ Audit companies

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

➢ SPK and IMKB

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

➢ Financial institutions and analysts

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

➢ Other listed companies

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

➢ Other governmental institutions

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

➢ Courts

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

➢ Tax offices

❑ Fully prepared ❑ Partially prepared ❑ Not prepared

42 What should be function of accounting regulators in the future?

	Agree	*Disagree*	*No idea*
• Change national standards to converge with international standards	❑	❑	❑
• Should be influential at IASB during the issuance of new standards and changing the current standards	❑	❑	❑
• Should adopt national standards	❑	❑	❑

43 What would you like to recommend to CMB with respect to the issuance of accounting standards?

____

____

____

44 Did/would the IFRS based CMB standards affected your strategic management decisions?

❑ Very much ❑ Some ❑ Few

❑ None ❑ No idea

45 Do/would you use IFRS based accounting standards in your management reports?

❑ Very much ❑ Some ❑ Few

❑ None ❑ No idea

We would like to thank your efforts and time for filling out this questionnaire. Should you have any further questions please do not hesitate to contact us.

Regards,

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