

## POST-IMPLEMENTATION REVIEW OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTION IN AUSTRALIA

### Background

- 1 In 2002, the Financial Reporting Council (FRC) gave a broad strategic direction to the AASB requiring the adoption of pronouncements issued by the IASB – the International Financial Reporting Standards (IFRS).
- 2 In line with the European Union (EU) timetable, it was decided that IFRS would be used as the basis for Australian financial reports starting with annual reporting periods beginning on or after 1 January 2005.
- 3 To assist comparability across entities and transfer of accounting skills across private and public sectors, the AASB decided to continue with its transaction neutral approach. For-profit entities would apply IFRS and non-for-profit entities (both private and public entities) would apply IFRS to the extent feasible.
- 4 In performing its standard-setting functions, the AASB must be mindful of the overall benefits associated with adopting IFRS in the context of the objectives of Part 12 of the *Australian Securities and Investments Commission Act 2001 (ASIC Act)*<sup>1</sup>.
- 5 With that in mind, as agreed by the Board as part of the research work program, AASB staff have commenced a post-implementation review of IFRS adoption in Australia.

### Scope of the research

#### *Research objective*

- 6 The post-implementation review of IFRS is aimed at:
  - (a) Assessing the extent to which it has met the objects of Part 12 of the *ASIC Act*; and
  - (b) Evaluating the costs and benefits of IFRS adoption, in respect of both for-profit and not-for-profit entities.

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<sup>1</sup> The objects of Part 12 of the *ASIC Act* are:

- (a) To facilitate the development of accounting standards that require the provision of financial information that:
  - (i) allow users to make and evaluate decisions about allocating scarce resources; and
  - (ii) assists directors to discharge their obligations in relation to financial reporting; and
  - (iii) is relevant to assessing performance, financial position, financing and investment; and
  - (iv) is relevant and reliable; and
  - (v) facilitates comparability; and
  - (vi) is readily understandable; and
- (b) to facilitate the Australian economy by:
  - (i) Reducing the cost of capital; and
  - (ii) Enabling Australian entities to compete effectively overseas; and
  - (iii) Having accounting standards that are clearly stated and easy to understand; and
- (c) to maintain investor confidence in the Australian economy (including its capital markets).

### ***Research planning and phases***

- 7 As IFRS have been adopted in Australia as the foundation for the standards applying to all types of entities, including both for-profit and not-for-profit entities, the review will be conducted for all sectors, with much of the work being divided into phases.
- 8 The initial phase of the review will focus on Tier 1 for-profit entities and the review will be conducted for other entities including Tier 1 not-for-profit entities and Tier-2 entities (as defined in AASB 1053 *Application of Tiers of Australian Accounting Standards*) in other phases.
- 9 The basis for addressing the post-implementation review in phases is that the various constituencies may have different perspectives, given that Tier 1 for-profit entities are essentially applying ‘unadulterated’ IFRS, whereas Tier 1 not-for-profit entities and Tier-2 entities are applying IFRS amended in some way by the AASB.
- 10 Focusing on different constituencies in different phases will enable the review’s research design to better cater for each constituency through tailored survey instruments and outreach activities.
- 11 The post-implementation review in respect of not-for-profit entities is interrelated with the AASB’s other work on considering whether changes are needed to the *Process for Modifying IFRS for Not-for-profit (NFP) Entities* and the post-implementation review of the Reduced Disclosure Regime (RDR). Accordingly, staff will need to coordinate aspects of the IFRS post-implementation review with these other related ongoing projects.
- 12 The following table shows the nature of the activities at the core of three projects – the IFRS post-implementation review; reconsideration of the Process for modifying IFRS for NFP entities; and post-implementation review of RDR, as they affect Tier 1 for-profit entities; Tier-2 entities; and Not-for-profit entities.

	<b>Post-implementation review of IFRS adoption</b>	<b>Process for modifying IFRS for NFP entities</b>	<b>Post-implementation review of Reduced Disclosure Regime</b>
Tier 1 for-profit entities	Consider impacts of full IFRS adoption		
Tier 2	Consider impacts of full IFRS as the foundation for Tier 2		Developing Key Disclosure Areas, Core Disclosure Areas and Supporting Disclosure Areas to determine those requirements that would not need to be applied by Tier-2 entities
Not-for-profit entities	Consider impacts of IFRS as foundation for NFP requirements	Reconsider the process applied in determining any modifications of IFRS for NFP	

### ***Research method***

- 13 Much of the initial constituent input will be gathered by inviting constituents to complete a survey. The survey instruments will be developed and pilot tested before the survey is made available, including being targeted at particular constituent groups.
- 14 Direct outreach activities will also be conducted, including interviews and meetings to further discuss and clarify responses to the survey.
- 15 A review on academic research will be conducted. In particular, the review will focus on the impact of IFRS adoption on financial reports and the costs and benefit of IFRS adoption in Australia.

### ***Research outputs***

- 16 Research findings will be published in one or more AASB Research Reports. More targeted reports are also expected to be made on the findings for presentation to the FRC and the AASB's Minister.

### ***Research outcomes***

- 17 The possible outcomes arise from the research report are:
  - (a) No further action needed after issuing the research report;
  - (b) Follow-up research in specific areas identified from the findings; and/or
  - (c) Make recommendations on whether Australia retains its existing use of IFRS as the foundation for all of its standards for general purpose financial reports.

### ***Project timetable***

- 18 As mentioned, the review will be conducted in different phases: a) Tier 1 for-profit entities; and b) not-for-profit entities and Tier-2 entities.

### ***Review on Tier 1 for-profit entities***

- 19 The steps and estimated timing for completing a review on Tier-1 for-profit entities provided in the following table:

Action	Estimated Timing
1. Develop survey instruments <ol style="list-style-type: none"><li>a. Tier 1 for-profit entities</li><li>b. Users</li><li>c. Auditors</li><li>d. Others</li></ol>	July-August 2015
2. Inviting participants <ul style="list-style-type: none"><li>• Survey instruments to be available on the AASB website and emailed to constituents</li></ul>	September-November 2015

Action	Estimated Timing
3. Direct outreach activities	September- November 2015
4. Data analysis	December 2015 – February 2016
5. Literature review	April – May 2016
6. Prepare a written report <ul style="list-style-type: none"> <li>Finalising and summarising findings from the survey, interviews and literature review</li> </ul>	March – May 2016

Month	1	2	3	4	5	6	7	8	9	10
Developing survey instruments										
Survey / Outreach										
Data analyses										
Literature review										
Report writing										

*Review on Tier 1 not-for-profit entities and Tier-2 entities*

- 20 Staff are in the process of developing timetables for other phases of the review, i.e. not-for-profit entities and Tier-2 entities, and ensuring that they dovetail with the concurrent work on the projects addressing the *Process for Modifying IFRS for NFP Entities* and the post-implementation review of the Reduced Disclosure Regime.

## Appendix A: Literature Review

- 1 The purpose of literature review is to provide an overview and highlight the main findings from the academic literature to assist the evaluation of the impact of the adoption of IFRS in Australia.

### Evidence on benefits of mandatory IFRS adoption in Australia

- 2 A search of the academic literature revealed that most published studies provide evidence on benefits of mandatory IFRS adoption.
- 3 Several studies provide evidence that mandatory IFRS adoption in Australia has improved quality of financial reporting. Chalmers, Clinch and Godfrey (2011) find that the value relevance of earnings increases followed by IFRS adoption. Further, they find that levels of earnings persistence increase upon IFRS adoption, which indicates improvement in quality of financial reporting. Similarly, Chua, Cheong and Gould (2012) find that there is a reduction on earnings management for income smoothing and the value relevance of financial statement information has improved, especially for non-financial firms. Further, a number of studies find that analysts forecast accuracy improves as a result of IFRS adoption improving quality of financial reporting (Bissessur and Hodgson 2012; Cheong and Masum 2010; Cotter, Tarcar and Wee 2012; Horton, Serafeim and Serafeim 2013; Tan, Wang and Welkerm 2011).
- 4 Research also provides evidence that mandatory IFRS adoption enhanced capital markets and investor confidence, which lead to reduction in cost of capital. For example, Hong, Hung and Lobo (2014) find a decrease in initial public offering (IPO) underpricing following mandatory IFRS adoption. The findings suggest that IFRS adoption increases the quality of financial information and improving financial comparability and thus reduces information asymmetry among participants in the IPO process. Manyara and Benuto (2014) find that trading volume has increased. Specifically, they find the percentage of ASX-traded companies that were cross-listed on some foreign exchange increased in the post IFRS period, and the average trading volumes increased from the pre-IFRS period to the post-IFRS period.
- 5 Studies also show that mandatory IFRS adoption enabled Australian entities to compete effectively overseas. For example, Manyara and Benuto (2014) provide evidence that there were more ASX-listed companies that were cross-listed on some foreign exchange in the post-IFRS adoption period than the pre-IFRS adoption period. Further, Tan, Wang and Welkerm (2011) show that mandatory IFRS adoption has attracted more foreign analysts following and improving foreign analysts' forecast accuracy.
- 6 Research also shows that mandatory IFRS adoption has resulted in improving corporate governance, for example Bryce, Ali and Mather (2014) provides evidence that audit committees are generally more effective in enhancing accounting quality under IFRS than previous Australian GAAP.
- 7 Although there is evidence from academic literature showing benefits of mandatory IFRS adoption in Australia, there is also research providing evidence that mandatory IFRS adoption do not provide much benefit. For example, Goodwin, Ahmed and

Heaney (2006) find that IFRS earnings and equity are not more value relevant than AGAAP earnings. Similarly, Bryce, Ali and Mather (2014) find that accounting quality is not significantly enhanced after adoption of IFRS in Australia. One explanation provided was that Australia has been using principles-based accounting standards, thus transitioning to IFRS may have not made much difference. Ahmed, Neel and Wang (2013) find that there has been an increasing in income smoothing after mandatory IFRS adoption. They find that there has been a significant increase in aggressive reporting of accruals for IFRS firms. Jeanjean and Stolowy (2008) conclude that the pervasiveness of earnings management did not decline after the introduction of IFRS.

### **Evidence on costs of mandatory IFRS adoption in Australia**

- 8 Little research has examined the cost of mandatory IFRS adoption. George, Ferguson and Spear (2013) investigated the cost of mandatory IFRS mandatory by focusing on audit costs in the post-IFRS adoption period. The paper finds that the audit costs had increased significantly due to greater exposure to audit complexity after mandatory IFRS adoption.

### **Evidence on impact of mandatory IFRS adoption on non-for-profit organization in Australia**

- 9 There is limited research on non-for-profit organization in Australia regarding the IFRS adoption experience. Pilcher and Dean (2009) conducted a survey and interview with local government in Australia. They find that IFRS do not detract from internal decisions for larger councils. However, smaller councils had to spend more time on complying with IFRS and various other legislative demands often results in downplaying management accounting issues. Further interview evidence suggests that reporting under an IFRS regime does not add value to the management of local government. However, this research was done in 2006, only one year after the adoption of IFRS, further research is warranted.

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