Changes in External Reporting

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Abstract
Globalization and cross border business transactions have encouraged the need to move towards a single set of financial reporting standards. The introduction of International Financial Reporting Standards (IFRS) marked a significant departure from United States (U.S.) Generally Accepted Accounting Principles (GAAP) and most countries' reporting requirements. With the globalization of accounting rules, accounting convergence to IFRS may be essential to other countries and regions in near future. This paper examines whether there are any possible impact on companies for external reporting in Hong Kong with the adoption of IFRS. In this study, a qualitative semi-structured interview was conducted; and the data was then analyzed. It is found that IFRS reduces the complexity of financial reporting and improves the transparency of financial reporting. The findings suggest that computer software is crucial and is required to be modified and updated to facilitate the external reporting process.

Introduction

Different countries have different accounting standards. For instance, in U.S., GAAP had been used for many years. In recent years, corporate reporting regulations have substantial changes in response to corporate reporting scandals (Leuz, 2010). Consequently, it is suggested that globalization of accounting rules, IFRS may be required. IFRS set out the recognition, measurement, presentation and disclosure requirements etc.

Accounting convergence is the process of narrowing differences between IFRS and the standards retained by individual countries (Ball, 2006). More than 100 nations have adopted IFRS either partially or fully for domestic listed companies. On 1 January 2005 and in Year 2007, Australia and New Zealand adopted the IFRS respectively. In recent years, Chile and Korea adopted IFRS in Year 2009; Brazil in Year 2010; India, Japan, and Canada in Year 2011; and Malaysia in Year 2012. More countries are committed to adopt IFRS in future; however, Mala and Chand (2012) study revealed that International Accounting Standards Board (IASB) faces pressures from different parties, such as, financial institutions, regulators and the government to review its rules on Fair Value Accounting.

In very near future, some countries, for example, U.S. will adopt IFRS. The IASB and Financial Accounting Standards Board convergence project can be divided into two stages. The first stage is the removal of differences between U.S. GAAP and IFRS, for instance, the accounting treatments of non-monetary exchanges, discontinued operations, income taxes and interim reporting. The second stage of the convergence project involves the major pieces or areas of the improved accounting guidance, for instance, the revenue recognition and purchase method procedures, and the share based payments etc. The main objective of the convergence is to improve the overall quality of standards that enables the U.S. GAAP and IFRS are as similar as possible across jurisdictions (Schipper, 2011). Concern arises when companies apply different accounting standards across jurisdictions or countries as it will be extremely difficult for the public to compare the financial performance and financial position of the companies. For example, for accrual basis accounting, Income Statement is the focus through matching principle under U.S. GAAP while Balance Sheet is the focus through fair value measurement under IFRS. For depreciation, a depreciation rate is used for a single asset under U.S. GAAP while components of a single asset may be depreciated at different rates. For contingent liability, it is recognized when probable and if it can be reasonably estimated under U.S. GAAP while the contingent liability is recognized when more likely than not under IFRS. For impairment of assets, assets are written down when the current value exceeds the undiscounted cash flows of the assets and no reversal of write down is allowed under U.S. GAAP while impairment is recorded when the current value exceeds the fair value of the asset and impairment of charges can be recovered under IFRS. For research and development, expense is recorded when incurred under U.S. GAAP while capitalization is allowed under certain conditions under IFRS. For long-lived asset valuation, the assets are recorded at cost under U.S. GAAP while the assets are recorded at either at cost or fair market value under IFRS. In Hong Kong, in view of the importance of the convergence of the accounting rules, the Hong Kong Accounting Standards has been revised and updated from time to time. This study aims to examine the impact on companies for external reporting in Hong Kong with the adoption of IFRS.

Literature Review

Researchers conducted studies on the impact of implementation of IFRS in EU countries. Paananen and Lin (2009) study concluded that accounting information quality has worsened with the IFRS adoption. However, Ballas, Skoutela and Tzoras (2010) study indicated that implementation of IFRS may enhance accounting information quality at the firm level in Greece. Only few studies were conducted to study the impact of IFRS adoption in Asia region. Emenyonu and Gray (1996) conducted an empirical study in five major countries, France, Germany, U.K., U.S., and Japan to test the impact of efforts to minimize the accounting diversity over the past twenty years. Twenty six accounting measurement issues were tested. The findings indicated that there had been an increment of only 10.8% in harmonization, for example, in the area of consolidation method, investments in associates, treatment of gains or losses on the disposal of property, plant and equipment, treatment of gains or losses on the disposal of current investments, and accounting for extraordinary and exceptional items. However, a number of issues, for example, the treatment of goodwill, costing of inventories, depreciation method, valuation of long term investments, treatment of borrowing costs, basis for providing for deferred taxes and the method of determining the pension cost, had been significantly decreased in the harmonization. Pang and Bewley (2010), another study conducted in Asia region, investigated the impact of IFRS convergence in private sector in China. The findings indicated that there is a long way to converge to IFRS, so what about Hong Kong?

Cascino and Gassen (2010) study indicated that with the implementation of IFRS, comparability is enhanced. Reading the financial statements may give insights to investors and general public about the financial situations of the entities for current period and across different periods. Therefore, in this study, one of the objectives is to examine whether comparability is enhanced with the implementation of IFRS in Hong Kong.

There are numbers of benefits with the adoption of IFRS, such as, better accounting quality, better earnings quality, market efficiency, increased liquidity and lower cost of equity capital etc. Basu (1997) and Ahmed, Neel, and Wang (2010) studies found out that a sample of more than 1,600 companies in twenty one countries exhibited better accrual management and timely loss recognition after the IFRS adoption. Barth, Landsman, and Lang (2008) findings also indicated that the accounting quality was improved. Christensen, Lee and Walker (2008) and Gassen and Sellhorn (2006) studies showed that significant improvements were found in the earnings quality with the adoption of IFRS. Beuselinck (2009) study revealed that the efficiency of stock prices was improved and the trading volumes were increased (Bruggemann 2009) if the firms executed and complied with the IFRS disclosures requirements. Karamanou and Nishiotis (2009) study revealed that the cost of capital was reduced with positive returns.

In Brown's 2011 study, the findings indicated that there were internal benefits to multinational companies with subsidiaries operate in different countries. It is common that multinational companies headquartered in, for example, U.S. with subsidiary in Hong Kong. Brown, Beekes and Verhoeven (2011) study also revealed that the corporate governance at country and firm levels of the multinational companies have significant impact on the firm's transparency, disclosure policy, financial policy, quality of its accounting numbers and choice of auditor.

An important goal of reporting regulation is to protect small and unsophisticated individual investors against the better informed insiders and promoters. In 1930s, the U.S. securities regulations were introduced to deal with the disclosure requirements (Brandeis, 1914; Loss and Seligman, 2001; Mahoney, 2009). In U.K. and U.S., the important goal for reporting regulation is for debt contracting, especially in dividend restrictions (Watts, 1977; Watts and Zimmerman, 1986; Leuz, Deller and Stubenrath, 1998; Kothari, Ramanna, and Skinner, 2009) and protecting creditors by restricting dividends and other payments to residual claimants. In many countries, an important goal of financial regulation is to preserve the stability of the financial system; and thus, disclosure requirements play a critical role. Also, the company may have substantial difference in terms of profit and loss, especially for the first year of convergence from local GAAP to IFRS due to the different accounting treatments for the accounts, such as, investment property; property, plant, and equipment; and inventories etc between local GAAP and IFRS, therefore, besides disclosure, accounting systems may be updated accordingly.

This study also examines, whether the complexity of financial reporting may be reduced, the transparency of financial reporting may be increased due to the disclosure requirements, and the needs to update the accounting systems in Hong Kong.

Methodology

Focus group discussion instead of individual interviews was used in this study as focus group interviews can collect more in-depth qualitative information. Participants are in a more relaxing and comfortable environment to interact with the researcher. Also, participants can freely express and exchange their ideas and thoughts among each other. Most importantly, the time and cost incurred for group interviews are relatively shorter than for individual interviews.

Focus group was therefore used to gather information about participants' perceptions related to companies external reporting in Hong Kong with the adoption of IFRS. Three focus groups, each in size of four participants that composed of two male and two female, were conducted. Each focus group interview was conducted by the researcher with four participants that lasted for approximately one hour. In order to ensure the consistency across the three focus groups, semi-structured questions were asked (Neumark-Sztainer and Perry, 1999); and those questions were reviewed for content to ensure that participants understood the topic areas to avoid ambiguity. The discussion topics included: "Benefits of IFRS adoption, as well as Problems or Concerns of

IFRS adoption etc". Some of the key findings and implications from this study are outlined below.

Findings and Results

Participants shared their views about trainings provided by the company and expressed their ideas about updating the systems that may facilitate the reporting process. Below are the findings from the discussions.

Researcher: "Is there any IFRS training provided by the company?"
Participant 1: "No training is provided by the company, therefore, I do not know much about the IFRS standards."
Participant 4: "I attended the IFRS workshop provided by the company; however, the selected topics were not relevant for my company's external reporting purpose."
Participant 3: "The in-house trainer assumed that we were familiar with the IFRS standards. I think series of workshops and seminars may consolidate our understanding."
Participant 2: "A series of workshops and seminars definitely enhance my understanding of the standards."
Participant 8: "My employer wants me to have a general awareness about IFRS; however, no training is provided by the company. I talked with my employer and he informed me that the training cost will be reimbursed. However, so far, I have not attended any training or workshop due to the busy work schedule."
Participant 5: "I know, some professional bodies also offered seminars on the updates once a while."
Participant 6: "Some accounting firms provided and reimbursed the staff attending short courses on new IFRS."
Participant 9: "I attended the training provided by the company; however, I think trainers should select topics that will be implemented and effective in the coming year, so that I can, at least, fulfill the reporting requirements and meet the reporting deadline."
Participant 10: "I also attended the workshop organized by the company, and I agree that trainers may select the topics that have substantial impact on reporting at the company's level; however, it may therefore be difficult that the selected topics or discussions meet everyone's needs; unless tailor made."

Researcher: "Do you think it is necessary for the company to offer tailor made trainings that meet the company's needs for reporting purpose?"
Participant 4: "Definitely, if tailor made courses or trainings are provided, it facilitates the staff preparing the reports and statements accordingly."
Participant 3: "Some accounting firms or professional bodies offered seminars on updated IFRS. By the way, the systems should also support for the updated accounting treatments, for instance, goodwill and pension etc."
Participant 2: "Agree. For example, for pension, there is a limitation on the value of the net pension asset that can be recorded under IFRS."
Participant 1: "Yes. Also, IFRS permits the revaluation to fair value of some intangible assets; property, plant, and equipment; and investment property and inventories in certain industries."
Participant 5: "I agree as tailor made courses can meet the needs of the company's reporting requirements."

Participant 6: "Tailor made training provided by the in house trainer is the best as the company can identify the needs of the staff and the training delivery mechanisms specific to the company, such as, web training, and classroom training etc."
Participant 11: "I think the company should arrange for trainings that meet its reporting purpose."
Participant 12: "Apart from arranging tailor made training courses, systems for external reporting should be updated. For example, some of the investments are now required to be reported by using fair value; as a result, the information technology team should support the changes of the systems for reporting."

Researcher: "Do you think it is necessary for the company to update the accounting systems or software?"
Participant 2: "Company should update the accounting system, as for example, under IFRS, the total change in fair value of the available for sales debt instruments is separated into two parts, with the exchange gain or loss on the amortized cost is recognized in the income statement, and the remaining portion is reported in the other comprehensive income, net of tax."
Participant 4: "Good communication between system people (technician) and accountant is important in order to update the reporting system."
Participant 5: "Updating the software that supports the reporting is extremely important; otherwise, we may not be able to report those items correctly. Software that supports and fulfills the disclosure requirements also plays a crucial role for external reporting."
Participant 6: "Small sized companies may not be able to afford to update or purchase the software. The management may request the staff to update the reports manually."
Participant 8: "It may cost a lot for the company to update or purchase the software. Companies may balance the costs and benefits. The management may seek help from consultants or professionals to file the reports for compliance purpose."
Participant 7: "It takes time, manpower, and money to do the update."

Besides the above findings, participants also expressed that the convergence of IFRS streamlines the accounting reporting process, reduces the complexity of financial reporting, and enhances the global operation. In addition, the convergence of IFRS improves the transparency of financial reporting. With better financial information to shareholders and general public, the comparability of financial statements across companies over years is substantially enhanced. However, substantial costs, such as, additional cost to recruit staff who are familiar with IFRS; additional cost to upgrade the IT infrastructure to support the reporting and disclosure requirements; and higher audit fee especially during the first year of conversion to IFRS may be incurred.

Conclusions

The large demand of applying the IFRS is because the corporations seek access to international public equity markets and global investment opportunities. However, accounting standards differ from countries to countries due to economic and social differences; and many of these differences will not be disappeared immediately even though these countries may adopt the IFRS. In conclusion, the findings suggested adequate training that includes a series of workshops and seminars to staff is necessary. In addition, if possible, tailor made training courses together with the update of the accounting systems or software facilitate the reporting process.

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