

International Accounting coursework

You are required to identify key issues facing a UK company of your choice in preparing for the implementation of international accounting standards in 2005

Recent international accounting scandals like Enron have meant that strict reforms have been put in place to make sure that circumstances like Enron don't happen again. All accounting boards globally have made great efforts to harmonise certain areas, so by all companies adopting international accounting standards (IAS), prevention of such scandals should be made easier as for setters standards are.

With the EU stating that all listed companies have to use international accounting standards (IAS) by 2005, most companies have started to do something about preparation for the transition. This move is probably ranked as the biggest administrative headache for financial directors of quoted companies.

The majority of companies within the UK will suffer from the same problems during the conversion to IAS. But different industries within the UK will find some of the standards particularly difficult to deal with. The smaller listed companies may also suffer because of the size of their company, compared to larger organisation.

In a recent ICAEW survey it was stated that, 'A third of respondents were either, 'not aware' or, 'not at all aware' of the publication of the relevant EU regulation on the application of IAS' Also less than half of the respondents felt they were aware of the effects IAS would have on their company or financial statements. This shows that UK companies may not be aware of the preparation needed for the transition to IAS.

Certain industries may suffer significantly as a result of certain new standards and rules. Therefore all companies and industries need to be aware of the problems that may arise from moving to international accounting standards.

The transition from UK accounting norm to IAS can cause problems to the majority of listed companies. The problems can roughly be divided into those resulting from competence, costs, and access to data required for the financial statements and into those caused by external matter. Looking at the bulk of factors effecting problems on average, the main cause of problems to all listed companies will be parallel application of national regulations and the standards. Problems for companies will be the ongoing reform and revision work of the standards as well as their practical application. Some problems may also arise from personnel competence

One of the major problems that will affect all companies is the deadline. Most financial directors have underestimated how big this problem may be. There are things that financial directors will have to do that can't wait until 2005. This is because although there is a deadline for UK companies at the end of 2005, companies who produce interim results will have to produce earlier. Also for a lot of companies whose year end fall at different times, they may have to produce their accounts at a more earlier time. The majority of companies will have to produce comparatives for a year earlier, which means that some companies may have start using IAS's as early as

January 2004!! The financial Services Authority has also said that it will require companies to disclose where they are in their preparations for the IAS next year.

The majority of IAS's are based upon the accounting principles. UK financial standards are fairly similar. This may lead to UK companies not preparing for the transition enough.

Some companies may find themselves significantly behind companies who already use some IAS's. This may lead to companies finding the transition simple, whilst other companies find the move substantially difficult.

The introduction of the standards, or the so called conversion project, is estimated as lasting approximately 12-18 months, depending on the size of the company or group and on the complexity of the group structure. The duration on the transition is also effected by the quality of resource allocation the company have. If the existing personnel alongside their regular duties carry out the transition, the project will be prolonged. It is most likely that big companies will organise the conversion on a project basis, the project of which will be monitored. Major additional expenses will arise from salaries, training and conversion IT systems. Companies will need to have carried out all training of staff to deal with the new standards by the end of 2003. Therefore all staff will be properly trained and ready to apply the new standards leading to less chance of problems

A recent article claimed that, 'Half of UK accountants have still not received training in international accounting standards, as complacency threatens to undermine UK conversion to IAS' (www.financialdirector.co.uk - IAS training crisis looms – 23/10/2003) The article expresses the concern that within just 3 months UK companies must produce comparatives, yet 50% of accountants had not yet received any training. It also claimed that the problem steamed from a widespread complacency towards IAS. As 20% of accountants believed that IAS was not relevant to their job.

Mark Vaessen, head of IAS advisory services at KPMG said, 'Training is the single biggest challenge for everyone, both for the accounting firms and our clients. If someone has not done the training, they better make sure that they get the training in place.'

The IASB has been criticised for failing to give sector-specific practise on the implementation of accounting standards. Manfred Wiegand global utilities leader at pricewaterhouse cooper argued in an article in 'Financial Management' that the body should have issued detailed information on the impact of the new regulations on particular industries. He felt that oil; gas and utilities industries will find themselves behind in their preparations. Companies like ----- may find the move to IAS's a major problem. One report by Pricewaterhouse cooper said that some companies could run into several million pounds debt.

The main challenge for companies like ----- is accounting for the cost of exploration and decommissioning. An example is that decommissioning of a power station was traditionally accrued year by year, with a full accrual at the end of the life of the plant. Under IAS's these liabilities must be recognised once the plants construction is

finished. The introduction of fair-value accounting is expected to trigger large swings in reported profits reflecting fluctuations in derivative values.

Weigand also warned that, 'lack of awareness across the broader financial community could create investor concern and share price volatility' (Financial Management (date))

With some companies having to use IAS's within 6 weeks, problem may arise from some accounting standards not being finalised yet. Controversial standards to be introduced like performance reporting will not be ready for 2005 users. This is an indicator that the international accounting process is not going as smoothly as expected.

This lateness indicates that problems may have arisen when exposure drafts have been issued. This may have resulted in the International accounting standards boards having to further alter the standards, which takes more time. This problem may affect UK companies as they have gone from an old familiar rulebook, to one that hasn't even been finished yet. This is causing a certain amount of difficulty for even the largest companies. Most of their effort has gone into finding out what the rules actually are, and how they will effect the reported profit and loss, balance sheet and cash flow statement. The main cause of the IASB's problems is that they are revising existing standards, and drawing up new ones at the same time that companies are preparing for their transition. What makes it problematic is that companies must comply with the existing standards during their transition phase. How can these organisations be expected to start producing their comparatives using the new standards when research found that around 50% of accountants had still not received a copy of the finalised completed standards.

There has been a lot of necessary focus on standards, after problems have occurred during finalisation. The standards on financial instruments (IAS 39 and IAS32) are good examples of this. Paul Grant from accountancy age says, 'The board faces massive opposition to its proposals on these standards, particularly in relation to the issue of derivatives and hedging from banks and financial institutes'

IAS39 is the standard, which will be the biggest challenge to the UK banks like the royal bank of Scotland. This is because although the IASB are committed to writing principal – based system, (which UK companies will understand) this standard seems like a more rules based system. This is based upon the US model for financial instruments, and may cause problems for the companies who are more used to standards based upon the principles. The standard will force companies to treat shares as a cost on the balance sheet. In recent weeks European banks have said that they would like to continue to use favourable accounting treatments for derivatives. The insurance sector of the UK market has also expressed its problems with the standard. They claim that there are fears that the standard will cause more volatility from year to year. All these problems with the standard are the reason why the standard has still not been finalised.

Some of the standards are more complicated than UK financial standards, which may cause problems for companies when they start to use the new standard. An example of

this is IAS12 on income taxes. This standard is much more complicated than the UK version, requiring more time and effort by companies when applying them.

UK companies with foreign subsidiaries may find IAS21 a problem within their accounts. IAS21 states that transactions should be translated on the date of the transaction. Therefore the income statement is translated at the average exchange rate. This can lead to inconsistencies, and make comparisons different. This may create huge problems for groups like ASDA who have subsidiaries with the US giant Wal-Mart.

UK companies currently treat goodwill by amortising it over 20 years. The IASB are now introducing the use of an 'Annual Impairment Test'. This will involve companies assessing annually if the value of the goodwill has changed over the year. They will justify this with sales. If the goodwill value goes down, it is charged as an expense against profit. UK companies who are comfortable with the method of amortisation may see this method as long-winded. Also companies will be reluctant to devalue goodwill, as this will produce distortion.

The indication of potential problems has lead financial advisors increasing their prices. This will consequently add to the increasing expenses generated by the transition to international standards.

The IASB has issued its first standard to help companies move from national standards to international standards. This standards was produced in June 2003 and, 'Sets out the basis for transition for any company from its current national standards to those of the IASB' (Accountancy Age – Get ready for the big switch – 6/12/2003) This standard shows that the IASB realise how difficult it will be for companies to move to international standards. Some associations and companies have also recognised the potential problem IAS can cause, and have therefore issued advice for UK companies. ICAEW centre for business performance addressed the issue by printing, 'The Convergence Handbook'. The Accounting Standards Board (ASB) issued a press release following the publication, in which the chairman Mary Keegan urged constituents to respond. Advice on international standards was also unveiled by KPMG in the form of a checklist designed to help companies meet international accounting regulations. 'The hundred club' which comprises of the financial directors of the 100 largest companies listed in the London stock exchange has set up a committee to address the IAS issues.

The move to IAS's is going to cause a variety of problems for different companies and industries. Some companies will suffer more by a direct consequence of certain standards. Where as, others will simply suffer from lack of preparation and training. These two factors will be the key to whether or not companies have a disastrous or successful transition to international standards.

Moving to international standards will benefit UK companies in a number of ways. It will reduce cost for multinational companies who will no longer have to reconcile financial statements in an increasing number of jurisdictions. It will make it easier for investors to make valid conclusions, and it will improve global communication.

There is no getting away from the fact that a truly global economy must have global accounting standards. It is important that IAS will need to continue developing in order to meet the needs of the changing business environment. If IAS were a success among listed companies, more widespread adoption would be inevitable. Requiring it of other non-listed companies might only speed up and simplify the transition.