THE GROWING IMPORTANCE OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

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Abstract: *This paper highlights the importance, development, and evolution of International Financial Reporting Standards (IFRS), emphasizing some relevant issues in contemporary accounting, such as the need for a globally recognized financial reporting system and a conceptual base of different accounting measurement approaches in order to increase transparency and comparability in financial reporting. The first section of the paper illustrates the main reasons for the changes in financial reporting that are required in order to satisfy the information needs of both existing and potential investors of business entities in global capital markets. The subsequent section describes the main purpose and role of financial accounting, followed by a description of different ways of regulating financial reporting emphasizing the increased role of the standard-setting activities of private-sector bodies, such as the International Accounting Standards Board (IASB). This section also reveals that the standards published by the IASB are gaining ever wider acceptance and recognition in today's globalized world economy, although this also illustrates the growing future importance of IFRS and the IASB's work in several areas. The next part of this section presents the main advantages, features, and stages of the standard-setting process of the IASB, providing evidence about how investors can use IASB's standards as a valuable predictive device. The third section of the paper introduces some major problems associated with contemporary accounting measurement issues, for example delivering new measurement concepts in financial reporting. This section also establishes that measurement is fundamental to accounting, and for this reason the improvement of measurement concepts must be emphasized in financial reporting. In the last section the paper assesses the increased role of reporting under IFRS today and argues that the constant improvement of standard-setting contributes to satisfying the needs of investors. The main finding of this paper is that the continuous and marked improvement in standard-setting by the IFRS Foundation enhances the quality and usefulness of financial reporting.*

Keywords: financial reporting; International Financial Reporting Standards; conceptual framework; accounting measurement

JEL classification: M40; M41

1. Introduction

One of the central questions in accounting is how to identify the stakeholders of financial reporting, since the groups identified as stakeholders change and expand in line with social and economic changes (Lakatos, 2013). Sztanó (2015) claims that communication at a corporate level becomes more intense as globalization is

accelerating and international economic relations are growing. According to Beke (2009), a unified and harmonized accounting system helps increase transparency, overtness, predictability in valuation and decision-making.

As the pace of globalization and cross-border financial activity increases, capital markets become more interdependent, and there is a greater need for the development of internationally accepted standards. The International Financial Reporting Standards (IFRS) and its development can be a particularly useful device to promote a well-established and secure international regulatory environment. IFRS satisfies today's accounting and disclosure purposes, and it contributes to the improved transparency of global financial reporting. Effective financial reporting and good corporate governance is fundamental to investor confidence, therefore standards-setting and their ongoing improvement respond to changes and developments in the markets and the information needs of investors (Richard, 2008). Over the past few decades stock market capitalization has increased considerably worldwide, and an increasing number of business entities are considering listing their shares in foreign markets to gain equity at a lower cost. The adoption of IFRS can be very advantageous for these companies, as a high quality, transparent standard, accompanied by converging corporate governance standards, can cease added costs of compliance with different jurisdictions. Nonetheless, the convergence of disclosure requirements provided by IFRS offers high-level disclosure requirements that investors pursue (Pine, 2010).

Since accounting measurement concerns have become more and more relevant nowadays, besides the continuous improvement of each standard there is a need for updating conceptual framework for financial reporting, as well. In connection with this, Barth (2014) notes that the International Accounting Standards Board's (IASB) Conceptual Framework published in 2010 does not identify the purpose and definition of measurement, nor does it include a conceptual base for choosing among different measurement methods.

2. Literature Review

Accounting can be defined as a process of identifying, measuring, and communicating economic information in order to allow knowledgeable judgements and efficient decisions by the users of the information. Another view might suggest accounting is a service activity, and its main role is to provide quantitative information (mainly financial) about business entities through financial reports. Financial accounting is the branch of accounting intended for users outside the business entity. Basically, the regulation of financial reporting is designed for external users, for example to supply investors with useful information; however, the needs of different users are likely to be very diverse (Alexander and Nobes, 2013). According to the IASB's Conceptual Framework for Financial Reporting 2010, the primary users of financial reporting include present and potential investors, and creditors, who use financial information to make economic decisions (IFRS Foundation, 2010).

Financial reporting can be regulated in several ways, comprising legislation (for example acts or commercial codes), rules issued by departments of government, or by committees operating under their control, rules of stock exchanges or governmental regulators of stock exchanges, and accounting guidelines or standards issued by committees of the accountancy profession or independent

private-sector bodies representing the public interest. In this sense a financial reporting or accounting standard is a document containing a series of instructions on a particular topic of financial reporting. The standard is written in the private (non-governmental) sector and is intended to be obeyed in full. Nowadays it can be evidenced that the standards published by the IASB are receiving greater and greater recognition and acceptance worldwide. The IASB's predecessor, the International Accounting Standards Committee (IASC), was established in 1973. The members were the accountancy bodies of the following countries: Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, Ireland, and the United States. In 2001 the IASC was reorganized, and replaced by the IFRS Foundation. The main operating arm remained the IASB, accompanied by other organizations. By the 2000s, the number of member bodies was over 140, from over 100 countries. The members of the IASB are appointed by trustees from the world's financial community representing the public interest. The IASC's International Accounting Standards (IAS) were adopted by the IASB; the new standards are referred to as International Financial Reporting Standards, and together both IAS and IFRS are referred to as IFRS. Since countries influenced by the Anglo-American tradition are the most acquainted with setting accounting standards in the private sector, most standards closely correspond to those of the United States and United Kingdom (Alexander and Nobes, 2013). Figure 1 represents the three-tier structure of IFRS Foundation.

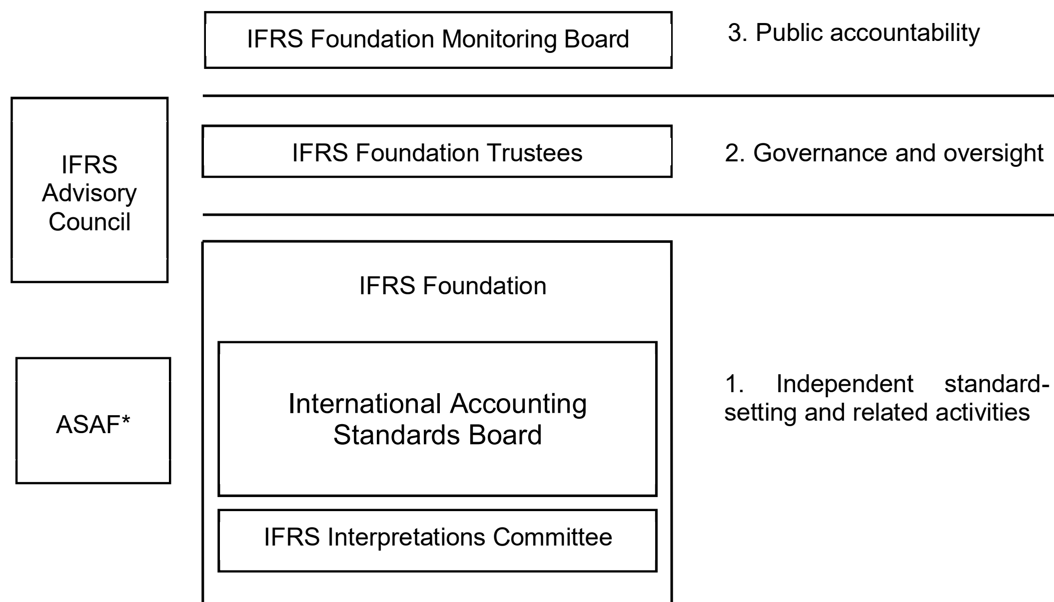

Figure 1: The three-tier structure of IFRS Foundation
Source: edited by the authors based on IFRS Foundation (2015a:3)

According to IAS 1 paragraph 15, it is required that financial statements must present fairly the financial position, performance and cash flows of a business entity. In general this is called the 'true and fair view' requirement, meaning that fair

presentation entails faithful representation of the effects of transactions (Alexander and Nobes, 2013; IFRS Foundation, 2007). The IASB's Conceptual Framework defines this requirement as meaning that financial information is useful when it is relevant and faithfully represented (IFRS Foundation, 2010).

Nowadays the growing importance of IFRS and the IASB's work can be perceived in three main areas: adoption of IFRS as national rules, influence on national regulators, and voluntary adoption of IFRS by different business entities. For example by the 2000s, large Swiss groups, such as Nestlé, Roche, and Novartis, were using IFRS for their consolidated financial statements. The IASC had been negotiating with major stock market regulators through the International Organization of Securities Commissions (IOSCO) since the late 1980s. The main goal was to make IFRS a global financial reporting system that is accepted on all stock markets, especially in the case of foreign corporations. Also, in 2000 IOSCO recommended acceptance of IFRS to its members for any foreign business entities listed on the stock exchanges that they regulate (Alexander and Nobes, 2013).

An important step was taken in 2002 when the European Union adopted legislation that requires listed business entities in Europe to prepare their consolidated financial statements under IFRS from 2005. Australia followed this rule for that year, and so did Canada for 2011. Regarding compliance with IFRS, the same applies to China and Japan as well. In 2008, the Securities and Exchange Commission of the United States declared it was considering adopting IFRS from 2014 onward; however, full acceptance is still quite uncertain (Alexander and Nobes, 2013; Mirza et al., 2008). Zeff (2012) concludes that one of the challenges currently facing the IASB as the global accounting standard setter is a need for the Board to inspire securities market regulators to facilitate listed companies' compliance with IFRS. As stated by Pine (2010), international regulatory organizations, such as the IFRS Foundation and the IOSCO should foster IFRS and identify how to retain high quality corporate governance standards.

The main purpose of the IASB is to develop standards ensuring transparency, accountability, and efficiency for global financial markets. The public interest is served by raising trust, growth and longstanding financial stability. Under IFRS, transparency means enhancing the international comparability and quality of financial information, which enables investors and other market participants to make efficient economic decisions. IFRS might contribute to a strengthening of accountability by reducing the information gap between stakeholders and business organizations, and this system can help investors identify opportunities and risks, which improves capital allocation worldwide (IFRS Foundation, 2016).

In the process of standard-setting there is an independent standard-setting board overseen by a geographically and professionally diverse body of trustees, who are accountable to a Monitoring Board. During this process an external IFRS Advisory Council, an Accounting Standards Advisory Forum of national standard-setters, and an IFRS Interpretations Committee can offer guidance when divergence arises. The due process is open, participatory, and transparent. Throughout the whole procedure, engagement with investors, regulators, business leaders, and the global accountancy profession is ensured (IFRS Foundation, 2015a). The study of Choi et al. (2013) provides evidence that the introduction of IFRS in the United Kingdom resulted in accounting numbers which are more useful to investors for prediction and valuation purposes. Taken together, their results proved that IASB was successful in creating standards which are more useful to investors as a

predictive tool (Choi et al., 2013).

3. The Need for New Measurement Concepts in Financial Reporting

Currently several measurement bases can be used in the financial statements prepared in accordance with IFRS, including historical cost, current cost, realisable (settlement) value, and present value. Although the most common measurement basis is historical cost under IFRS, numerous assets and liabilities are permitted or required to be measured at fair value, for example investment properties and many financial instruments (IFRS Foundation, 2010; Milburn, 2013). One of the most significant problems associated with contemporary accounting measurement issues is the area of fair valuation, and this can provide a decent example of the need for new measurement concepts in financial reporting (Barth, 2014). According to Milburn (2013) there are extensively contradictory opinions on measurement issues with theories supporting them, and these differences of opinion have made standard-setting for financial reporting complicated and have resulted in inconsistencies.

Barth (2014) examines subsequent measurement of individual assets and liabilities and concludes that fair value measurement is more consistent with existing concepts than modified or unmodified historical cost. It is also revealed that unmodified historical cost is consistent with some concepts, but nowadays the generally used modified historical cost is mostly not consistent. Unmodified historical cost means cost-based amounts that have not been changed since initial measurement, while modified historical cost is a cost-based amount that has been modified as a result of, for example, amortization and impairment (Barth, 2014). In IFRS 13 paragraph 9 fair value is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (IFRS Foundation, 2011).

The IASB's Conceptual Framework for Financial Reporting 2010 describes the objective of, and the concepts for financial reporting. Primarily it is used to support the IASB to develop standards, and assist preparers to improve accounting policies when no standard applies to a particular transaction, or when a standard allows different choices among accounting policies, and it can also assist other users to interpret standards. Nevertheless, the Conceptual Framework needs to be revised for several reasons, including the fact that certain significant areas are not covered, the guidance in some areas is not clear, and some aspects of the Conceptual Framework are outdated. In relation to this the Exposure Draft ED/2015/03 Conceptual Framework for Financial Reporting, published by the IASB in May 2015, declares that the overall objective of revising the Framework is to improve financial reporting by providing a clearer, more comprehensive, and more advanced concept. The Draft also addresses the point that one of the key areas not covered in enough detail in the existing Framework is measurement (IFRS Foundation, 2015b).

Since measurement is essential to accounting, the lack of measurement concepts can be a main weakness in improving financial reporting. Financial reports describe economic transactions in words and numbers; however, measurement is about the numbers, and the IASB's Framework published in 2010 only lists some measurements used in standards without any explanation. Although this Framework identifies the concepts underlying financial reporting to provide a basis

for standard setters to make decisions, but it is impossible without conceptual guidance on how to evaluate measurement bases in different circumstances. In summary, numerous measurements are used in financial reporting nowadays, not only historical cost, but other bases as well. For example, fair value is not mentioned in the Framework, but is used for several financial assets and liabilities, and some nonfinancial assets. Even if the measurement methods were presented in their entirety, without concepts underlying their use, the Framework would be incomplete; consequently giving more emphasis to measurement concepts in financial reporting is very necessary (Barth, 2014).

4. Conclusion and Discussion

This paper has examined and illustrated the main purposes and evolution of financial reporting in an international approach. As a result of the fact that financial activity across borders is increasing, the role of the International Financial Reporting Standards published by the International Accounting Standards Board has today become more and more significant. Based on the related literature we have scrutinized, we can conclude that the IFRS Foundation and the permanent improvement of standard-setting efficiently contribute to the international regulation of financial reporting and to satisfying the information requirements of investors worldwide. In accordance with the key findings presented in the paper, the development of different measurement concepts should be emphasised as the intention to provide continuous improvements in financial reporting strengthens at the international level.

In another view, since accounting is a knowledge-intensive business service activity, its regulation should be reconsidered on an ongoing basis, and this approach can provide a basis for further investigations in this field (Máté et al., 2016). Besides, the different valuation purposes and methods described by Choi et al. (2013) and Kiss (2015), together with their results, can also be treated as a good starting point for supplementary discussions on the implementation of various corporate governance and reporting issues.

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