CHANGES AND IMPLICATIONS IN THE AUDITING PROCEDURE FROM THE IMPLEMENTATION OF INTERNATIONAL ACCOUNTING STANDARDS AND INTERNATIONAL FINANCIAL REPORTING STANDARDS

Abstract

The application of International Accounting Standards (IAS)\(^1\) and International Financial Reporting Standards (IFRS)\(^2\) aims to contribute to worldwide uniformity and identical demonstration of enterprises' accounting achievement. The compliance to IFRS bears changes to businesses' accounts and financial statements' presentation, to accounts' entry treatment and to auditing procedure. Changes have occurred to the auditing authorities due to IFRS enforcement. The CPA board has been replaced by the Capital Market Committee, which is responsible to conduct audit control to enterprises adopting IFRS. This paper approaches a comparison of the auditing standards in act and the changes which will result in the auditing procedure due to IAS and IFRS implementation.

JEL Classification: M40, M41, M42.
Key words: International Accounting Standards, International Financial Reporting Standards, Auditing, Financial Statements.

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\(^1\) IAS is a framework of Accounting Standards, Rules, Methods and Processes generally accepted, the establishment of which leads to a uniformity of financial statements structure and consequently to precise true and uniform information of financial statements' users.

\(^2\) International Accounting Standards that was published afterwards March 2001 are called International Financial Reporting Standards IFRS. Those who had been published at period 1973-2001 are named International Accounting Standards.
1. Introduction

Pressures for the international harmonization of accounting have grown rapidly since the early '70s when the International Accounting Standards Committee (IASC)\(^3\) was established, along with the development of stock markets internationally and the growth of international investment (Street et al., 2001). The common basis for financial reporting based on high quality global standards provides a platform for efficient cross border investment both within and beyond the European Union. As a result, the globalization of the world economy has led companies around the world to conform their financial reporting to the rules laid down by the International Accounting Standards Board (IASB)\(^4\). The aim of the Board is to get into law a core set of standards that constitute a comprehensive, generally accepted basis of accounting. IFRS must be of high quality and result in comparability, transparency and full disclosure.

IFRS are the codification of the accounting principles, rules and policies which have to be followed from accountants and to be fully audited from auditors through the preparation of financial statements (Vlachos et al., 2003).

The purpose of this paper is to report on a comparative analysis between current auditing principles and the ones imposed by IFRS. Also, some of the basic changes in the financial statements are outlined.

2. Changes to Financial Statements

Financial Statements are a structured financial representation of the financial position and the transactions undertaken by an enterprise. Comparability and transparency of financial statements are the main reasons for the adoption of IFRS. IFRS 1 aims to meet the above mentioned reasons and more specifically to ensure comparability with the enterprise’s own financial statements of previous periods, as well as with the financial statements of other enterprises of the same period (Chartered Certified Accountants, 1998). According to IFRS 1, a complete set of financial statements includes the following components: a) balance sheet, b) income statement, c) statement of changes in equity, d) cash flow statement and e) accounting policies and explanatory notes.

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\(^{3}\) IASC was established in the 29/6/1973 as a result of an agreement of the accounting authorities of Australia, Canada, France, Germany, Japan, Mexico, Holland, United Kingdom Ireland and USA. The work of IASC is carried out by a council constituted by delegations of 13 countries and 4 organisations that are interested for the presentation of financial statements.

\(^{4}\) The International Accounting Standards Board is responsible exclusively for the development of the International Accounting Standards. In order to fulfil its work it takes into consideration the published accounting models and plans from several countries from which it draws the knowledge to build up accounting standards for the essential subjects.
The remainder of the paper reviews the changes to the financial statements and to the auditing procedure through the implementation of IFRS. The summary and the conclusion are followed by statements about directions for future research.

i) Balance Sheet

One of the main objectives of IFRS 1 is to provide a framework within which an entity assesses how to present fairly the effects of transactions and other events (European Financial Reporting Group – EFRAG). The balance sheet according to IFRS is more concise, smaller in size and in analysis than its former presentation. Additionally, IFRS do not require a specific way of presentation of accounts neither a specific description of accounts on the presumption that the enterprise follows the same way of presentation in each financial year. Every country may adopt an indicative balance sheet draft as the Hellenic Committee of Standardization and Auditing (HCSA) and the Capital Market Committee have indicated the form of financial statements for the Greek enterprises registered in the Athens Stock Exchange Market. Auditors should check all the components of assets and liabilities in order to find out that all the components are classified properly on the balance sheet.

Some of the basic changes required to comply with IFRS are the following: i) minority interests should not be presented in equity, ii) liabilities should be classified as current or non-current, iii) the balance sheet should be cross-referenced to the notes (Adopting IFRS).

ii) Income statement

The income statement should be presented in the format that IFRS 1 requires. As a minimum, the account of the income statement should include line items which present the following amounts: a) revenue, b) the results of operating activities, c) finance costs, d) share of profits and losses of associates and joint ventures accounted for using the equity method, e) tax expense, f) profit or loss from ordinary activities, g) extraordinary items, h) minority interest and i) net profit or loss for the period.

The income statement can be presented with two alternative ways; either expenses are classified by nature or by function. Also, the characterization of an expense as extraordinary follows various rules and for that reason the profits from assets’ sales and transactions’ differences are classified in a different way (Chartered Certified Accountants, 1998).

iii) Statement of changes in equity

An enterprise should present, as a separate component of its financial statements, a statement showing: a) the net profit or loss for the period, b) each item of income and expense, gain or loss which, as required by other standards, is recognized directly in equity, and the total of these items, and c) the cumulative effect of changes in accounting policy and the correction of
fundamental errors dealt with under the Benchmark treatments in IAS 8.
Changes in an enterprise’s equity between two balance sheet dates reflect the increase or decrease in its net assets or wealth during the period, under the particular measurement principles adopted and disclosed in the financial statements. Except for changes resulting from transactions with shareholders, such as capital contributions and dividends, the overall change in equity represents the total gains and losses generated by the enterprises activities during the period.

iv) Cash Flow Statement

IFRS 7 sets outs the requirements for the presentation of the cash flow statement and related disclosures. It states that cash flow information is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilize those cash flows. The objective of this standard is to require the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events. The cash flow statement should report cash flows during the period classified by operating, investing and financing activities (Chartered Certified Accountants, 1998).

v. Notes to the Financial Statements

Notes to the financial statements should be presented in a systematic manner. Each item on the face of the balance sheet, income statement and cash flow statement should be cross – referenced to any related information in the notes. Notes to the financial statements include narrative descriptions or more detailed analyses of amounts showing on the face of the balance sheet, income statement, cash flow statement and statement of changes in equity, as well as additional information such as contingent liabilities and commitments. The components of the notes are the following ones: a) statement of compliance with IFRS, b) statement of the measurement basis and accounting policies applied, c) supporting information for items presented on the face of each financial statement in the order in which each line item and each financial statement is presented and d) other disclosures, including: i) contingencies, commitments and other financial disclosures, and ii) non – financial disclosures.
3. Auditing changes for specific accounts of the balance sheet statement

It should be mentioned that a lot of changes are made through the implementation of IFRS. It does not only change the way of calculating specific accounts on the face of the balance sheet but also affects the auditing procedure. Furthermore, this paper highlights these changes under the scope of auditing.

i) Inventories

According to the existing accounting policy inventories are stated at the lower of cost and market value. The inventories' cost may be determined by one of the following methods:

1. Individualised Cost Method is applied for inventories and services the cost of which is not in succession interchangeable or it is produced and separated for specific work.

2. Cost of in succession interchangeable inventories or inventories not produced nor separated for specific work: In these cases the methods of cost accounting that are applied are the FIFO (First - In - First - Out) and the median cost method.

3. Median Cost Method. The cost of inventories emanates from the medium cost of purchases or production. (Cost of the remaining inventories of previous period + value of purchases of period) / total quantities used.

4. An alternative method of cost accounting for in succession interchangeable inventories or inventories that are not produced nor separated for specific work is the Last - In - First - Out (LIFO) method.

Through the implementation of IFRS, inventories are recorded at net realizable value. Additionally, by IFRS the valuation of inventories includes an allocation of fixed indirect production costs (for example, depreciation of factory buildings) (Adopting IFRS, pp 35 & 63).

ii) Property, plant and equipment

Up till now, property, plant and equipment are recorded at purchase or construction cost. By IFRS, they are stated at their fair value. All the costs that are directly attributable to the acquisition, construction or production are capitalised.

By existing accounting policy, when, at the balance sheet date, property, plant and equipment shows a permanent impairment in value, it is written down to the lower value. This accounting policy is reviewed by IFRS, where there is no concept of "permanent impairment". Assets are written down when recoverable amount is less than carrying amount (Adopting IFRS, pp 56).

iii) Investments

Financial fixed assets include investments in unconsolidated subsidiaries, associated companies and other companies, financial receivables held for
investment purposes, treasury stock and other securities. The receivable accounts are held for investment reasons, as well as the treasury stock and other investment titles. According to IFRS, treasury stock should be presented as a deduction from equity as required by IAS 32, rather than an investment.

Up till now, investments in unconsolidated subsidiaries, in companies in which the Group exercises joint control with other partners and associated companies, are normally accounted for using the equity method. Also, investments in other companies are valued at cost and a permanent impairment in value is provided as a direct reduction of the investment account.

On the other hand, IFRS regard that unconsolidated subsidiaries should be consolidated. Additionally, investments in other companies should be measured at fair value as available for sale assets under IAS 39.

An auditor through the auditing procedure should realize if the securities as they are recorded have been estimated correctly and will notice if any miscalculation has been done for their evaluation. Securities are measured at fair value as available for sale or at amortized cost, rather than at cost. By IFRS, financial assets are impaired if their carrying amount is greater than their recoverable amount. Managements' role is to assess at each balance sheet whether there is any objective evidence that an asset may be impaired and to estimate the recoverable amount of that asset.

As far as, current assets are regarded, the auditor should take into account the method for calculating their value. Current assets also include investments and securities acquired as a temporary investment and by existing principles and valued at the lower of cost and market, cost being determined on Individualised Cost or LIFO or Median Cost or FIFO basis. By IFRS, securities are classified as financial assets at fair value through profit or loss, trading assets are measured at fair value (Adopting IFRS, pp 60).

v) Intangible Assets

According to the existing accounting policy, goodwill is included in the category of intangible assets. By IFRS, goodwill is appeared separately in the financial statements and does not deal with other intangible assets. Goodwill should not be amortized but should be tested for impairment at the date of transition and then at least annually. Amortization charged before date of transition is not restated. The auditor through the auditing procedure should check the separate presentation of goodwill in the financial statements and not being incorporated with other intangible assets.

It should be mentioned that by IFRS charges cannot be deferred because they are expected to benefit future periods. Only costs that meet the definition of an asset can be capitalised. Expenses that benefit future periods are carried in the direct results. Such kinds of expenses are: research expenses, expenses of foundation and first settlement, development costs, advertising expenses (Adopting IFRS, pp 58).
4. Auditing changes for other accounts

i) Earnings per share

As far as the presentation of earnings per share in the financial statements is concerned, IFRS foresee the presentation of basic and isolated earnings per share in the income statement. The above mentioned earnings should be stated by exactly the same way through all the accounting periods in the financial statements. The enterprise in order to provide better information to the users of financial statements should make known the amounts which were used for the calculation of the above mentioned earnings per share.

According to the existing standards, there was no obligation to the calculation and the presentation of the earnings per share in the financial statements. The auditor during the audit should compare and verify the amounts which were used for the calculation of earning per share.

The reduction of the earnings in a lot of enterprises is coming into light, and perhaps this constitutes great reason of worry through the implementation of IFRS (Kakridis, A, 2005: B11). A lot of questions arise to the auditors for issues which demand immediate explanations such as: a) which earnings should be used for distributed dividends and reserves?, b) The rules which do not allow the earnings distribution for which equity capital and first settlement expenses should be calculated (Paraskevopoulos G., 2003).

ii) Deferred income taxes

According to the existing accounting policy, income taxes were calculated through the distribution of profits. On the contrary, income tax is recognised under IFRS as an expense and goes straight to the income statement.

The adoption of IFRS could result in the creation of more differences between accounting and tax results. The auditor should focus on these differences and find out if they have been caused because of inefficient tax planning. Under these circumstances, the auditor should notice if the enterprise has adopted an efficient tax planning that could anticipate ways of recognizing, solving and recording the deferred tax differences under IFRS (Vlachos et al, 2003).

IAS 12 requires deferred tax to be calculated on temporary differences, not timing differences. It has detailed rules in specific areas that may result in differences in the tax assets and liabilities that are recognized. The auditor should investigate if the recorded taxes in the financial statements are precise and if the tax rate and the tax base are the right ones.

Deferred tax liabilities are recorded regardless of the probability that a future tax payment may be required. Deferred tax asset and liabilities should be offset if they relate to the same tax jurisdiction. Also, deferred tax assets should not be classified as current assets. They should be disclosed as a non current separate item on the statement and face of the balance sheet.
iii) Group Accounting

Before the implementation of IFRS, entities or subsidiaries whose operations are not homogeneous with those of the Group have been excluded from the scope of consolidation. Entities, for which it would be not practicable to obtain the necessary information on a timely basis or without disproportionate expense, have not been consolidated. IAS 27, does not permit the exclusion of subsidiaries that have non – homogeneous operations.

According to IFRS, assets and liabilities, costs and revenues of the subsidiaries consolidated companies are recorded in the financial statements ignoring the acquisition percentage. Investments are eliminated from the stockholders’ equity of subsidiaries companies. The share of stockholders and the results arising during company’s operation which are attributed to minority rights are recorded separately in the consolidated financial statements. The minority rights should not be recorded in the share equity capital.

Also, a negative decline of the sharecapital should be recognized straight in income (revenue or earnings) and be presented in the balance sheet. Additionally, the profit recorded on intercompany sales of plant and equipment produced and sold at prices in line with market condition should be eliminated on consolidation in accordance with IAS 27.

iv) Foreign Currency Translation

Foreign subsidiaries’ balance sheets are translated into euros by applying year – end exchange rates. Foreign subsidiaries’ income statements are translated using average exchange rates. Exchange differences resulting from the translation of opening stockholders’ equity at current exchange rates and at the exchange rates used at the end of the previous year, as well as differences between net income expressed at average exchange rates, are reflected in stockholders’ equity as ‘cumulative’ translation adjustments. Such reserves relating to investments in subsidiaries or associated companies are included in the income statement when the investments are sold to third parties. Resulting exchange gains and losses are included in the income statement. The existing accounting policy complies with IFRS but should be expanded to describe how each subsidiary’s measurement currency is determined.

Derivative financial instruments, including foreign exchange contracts, should initially be recognised in the balance sheet at cost and subsequently remeasured at their fair value. Certain derivatives are designated as either: 1) a hedge of the fair value of a recognised asset or liability or of a firm commitment (fair value hedge), 2) a hedge of a forecasted transaction (cash flow hedge), or 3) a hedge of a net investment in a foreign entity on the date a derivative contract is entered into.

Changes in the fair value of derivatives that are highly effective should be recognised in the income statement. Where the forecasted transaction results in the recognition of an asset or of a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial
measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity should be transferred to the income statement and classified as revenue or expense in the same period during which the hedged firm commitment or forecasted transaction affects the income statement. Certain derivative transactions are not included in IAS 39 and therefore, should be recognised in the income statement.

v) Provisions

According to the existing accounting policy, restructuring reserves include the costs to carry out corporate reorganisation and restructuring plans; they are provided in the year in which the company formally decides to implement such plans, where such costs can be reasonably estimated. Under IFRS, the provision for restructuring costs should be recognised only when there is a legal or constructive obligation.

IAS 37 imposes (permits) the recognition of certain provisions as tax expenses in the future, while it requires detailed information in the notes of financial statements for liabilities which do not meet the criteria for accounting recognition. During audit, auditors should check if all the requirements of IAS 37 are fulfilled.

vi) Investor’s Briefing

1) Ways of briefing
   a) Press Publication of Concise Financial Statements
   b) Publication in the Internet and in the official web page of enterprise of analytic Financial Statements with the Auditor’s Report

2) Reference to the Board of Directors report and Notes to the Financial Statements

3) The type of reports and the Auditors’ certificates, which can express:
   a) Conform opinion
   b) Exception of
   g) Accent
   d) Negative opinion

5. Problems from the application of IAS and IFRS in Greece

The main problems than the application of IAS and IFRS in Greece, according to Price Water House Coopers concerned:

A) In the delayed decision-making by the Responsible Authorities with regard to the obligation of publication (content and time frame).

B) In the difficulty of collection and treatment of required information (especially in groups with a lot of affiliated companies).

C) In the lack of specialised executives with experience in IAS / IFRS application.
D) In the underestimation of the challenge's difficulty by all the involved institutions (companies, supervisory authorities, auditors).

According to 2190/1920 act, enterprises are obliged to annual financial statements publication of at least twenty days before the annual regular general assembly of shareholders, however according to the 360/1985 act, enterprises listed in the Athens Stock Exchange Market (ASEM) are compelled to publish concise financial statements at the latest up to two months afterwards the end of financial year (unless if complete financial statements have been published till then).

None of all these had changed in the IAS/IFRS assembly, resulting to confusion of the market as for what and up to when they are the register in the ASEM companies compelled to publish. The particular problem had been more complicated from the make that the IAS/IFRS do not forecast concise annual economic situations. If the register in the ASEM companies had chosen alternative to publish concise economic situation of the fourth quarter of the year, in compliance to the IAS ("Interim Financial Reporting"), these would have not being audited, and therefore these financial statements would have been differed from the final, complete statements. Moreover, according to the PWHC the allowed by the law period of two months for the annual financial statements' complication is judged insufficient, because the increased volume of information compared to the Hellenic General Accounting Plan (HGAP). The provisional solution of the one month extension offered extraordinarily in 2006 by the Capital Market Committee, should -according to the PWHC – lead to modification of the relative law, to legitimize this solution.

6. Other issues relevant to the application of IAS and IFRS in Greece

i) Financial Statements compliance to the IAS/IFRS

The Capital Market Committee is responsible for the compliance of the registered companies with the IAS / IFRS. According to the findings of PWHC, exceptionally vast inhomogeneousness has been recorded in the annual financial statements of 2005. The practical experience of company led to the conclusion that "there is a great number of financial statements that do not include all the required notifications" by the IAS/IFRS.

The specialisation of executives in the supervisory institutions, in the enterprises, in the auditing companies, as well as the improvement and upgrade of information systems that are used by the registered companies, will contribute to resolve the problem.

ii) Profits Distribution and Reserve Funds

With legislative regulation of the Ministry of Finance, it was distorting allowed to companies that realised loses from the first application of IAS /IFRS -because of the social security issue, the doubtful accounts etc.– to ignore the
prediction the 2190 act on relative weakness of dividend distribution. Moreover, the Hellenic Committee of Standardization and Auditing (HCSA), has reported in recent directive that the tax free reserve funds are calculated on the produced profits, according to the IAS /IFRS, without clarifying if this interpretation has been acceptable by the tax authorities. The obligatory by the legislation dividend payment as percentage of profits – the highest, from the 35% of annual profits or the 6% of capita stock – will force the companies to distribute profits which potentially will reflect their cash liquidity. The PWHC proposes the suppression of this obligation, with the relative decision to let on the discreet facility of each enterprise (SID: 1594748).

7. Conclusions

The changes that will occur in the accounting procedure because of the implementation of the IFRS, obviously will affect the auditing procedure in theoretical and practical level.

Auditors should adjust the auditing procedure on the basis of IAS and IFRS regulations in order to exercise effectively enterprises’ audit, ensuring validity, completely evidence and representation of reality in their financial charts (Paraskeuopoulos G., 2003:18).

With the implementation of IAS and IFRS in Greece, auditors would be obliged to report, either that the company has applied the IAS and IFRS or that it has not applied them. The auditors’ remarks would be restricted on the estimation matters the company has made, or on the omissions of significant information of the company’s financial charts (Cotsilinis K., 2003:15). The attempt of this paper was to furnish a comparative approach of the changes that will occur from the implementation of the IAS and IFRS in the economic charts and financial statements, and underline the changes and the impacts on the auditing procedure.

8. References

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