

## *Original Paper*

# International Accounting Standards (IAS). Transition of Existing to New Accounting Standards in a Rapid Changing Environment.

## The Impact of Adoption of New Accounting Standards in the

## Developed Economies in European Union.

## Conclusions, Expectations and Perspectives

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### ***Abstract***

*Adopting a set of accounting standards on a global level derives from the growing globalization of international economies. However, the transition from old to new ones is challenging in a rapidly changing economic environment. This article presents an assessment of IFRS 8 (Operating Segments) adoption, after replacing IAS 14 (Segment Reporting), and examines the impact occurred in the developed economies within the EU, with relevant considerations referring to the current COVID-19 global pandemic situation.*

*This study analyzes the effect of this controversial standard on segment reporting and attempts to identify the determinants of changes in disclosure practices. Based on a four country sample, the current research identifies specific significant financial information changes, although segmentation remains relatively stable. Furthermore, the study includes relevant considerations on reporting, as reflected from current COVID-19 pandemic.*

*The present research includes a historical reference to the development of the accounting standards under examination. Conclusions, expectations, and future perspectives are also presented in the paper.*

## Keywords

*IFRS, Segment Reporting, Segment Information, CODM (Chief Operating Decision Maker), GAAP (General Accepted Accounting Principles)*

## 1. Literature Review

### 1.1 Global Adoption of Accounting Standards and Relevant Questions over Their Implementation

The impetus for the global adoption of a set of accounting standards stems from the increasing globalization of international economies over the last two decades (Barth et al., 2008). With this growing interest in cross-border transactions and investment, various researchers, such as Ball et al., have questioned the essential quality of the financial information published in applying IFRSs due to the lack of adequate enforcement mechanisms and adverse information incentives. In contrast, other researchers such as Cairns have identified problems with compliance with international standards at the initial stage of implementation, thus challenging their transparency (Daske & Gebhardt, 2006).

Certain entities and groups must report detailed financial information by a business or geographical area in their financial statements' notes. Additional disclosures are required for "primary" and "secondary" segment reporting formats where applicable. Several studies demonstrate that segment information upscale. Additional statements' informative quality, no matter if disclosures are mandatory or not (Venkataraman, 2001; Allioualla & Laurin, 2002; Berger & Hann, 2003; Ettredge et al., 2005).

IAS 14 (Segment Reporting) as a segment information standard has been replaced by IFRS 8 (Operating Segments) for preparers of consolidated financial information under international financial reporting standards (IFRS) on 1 January 2009 (or earlier for early adopters). The primary purpose of introducing IFRS 8 was to reduce differences among IFRS and US GAAP.

The table below presents the timetable of the initial adoption of IAS 14 and subsequent replacement from IFRS 8:

**Table 1. Timetable of IAS 14 Adoption and Replacement of IFRS 8**

March 1980	Exposure Draft E15 Reporting Financial Information by Segment
August 1981	IAS 14 – Financial Information Segment Reporting
1 <sup>st</sup> January 1983	Effective date of IAS 14 (1981)
1994	IAS 14 (1981) was reformatted
December 1995	Exposure Draft E51 Reporting Financial Information by Segment
August 1997	IAS 14 Segment Reporting
1 July 1998	Effective date of IAS 14 (1997)
30 November 2006	IAS 14 is superseded by IFRS 8 Operating Segments effective for annual periods beginning 1 January 2009

(Online source: IAS PLUS, available at: <https://www.iasplus.com/en/standards/ias/ias14>)

IFRS 8 considers appropriate for disclosing the information regularly provided to CODM (Chief Operating Decision Maker), having in mind how difficult it is for the company to gather and disclose relevant information (IFRS 8, par. 7).

Among others, the main advantages of IFRS 8 as expected from IASB and specialists are the following (Nichols N. et al. 2013):

- 1) Increased both the number and the including information of reportable segments
- 2) Drive the stakeholders to see a company's reporting segments according to managements' view
- 3) Increase consistency and direct lineage between reporting analysis and the management decisions,
- 4) Reporting demands relatively lower costs (proprietary costs).
- 5) Preparation of information/disclosures of segment reporting now produces less cost and much more efficiency, due to now relevant disclosures are readily available.

However, improvements expected are threatened by a certain number of factors (Nichols et al., 2013). Under IFRS 8, companies are no longer obliged to choose between the activity or the geographical areas to define their main sectors. Given the existing variances among various management structures, this will increase comparability issues among various company segments. Reduced understandability and reliability of any report based on segment disclosures are also very probable to occur. Moreover, no further geographic information will be obtaining the key elements.

Meanwhile, COVID-19 pandemic which occurred nowadays is a unique and rare event. Considering that relevant effects are pervasive to the whole economy, financial statements and disclosures have been heavily affected (Deloitte, 2019). In the present study, our primary focus on this ongoing situation is to provide preliminary literature of the impact on the companies' financial position and subsequently to their financial statements by highlighting specific useful considerations.

Concluding, this "managerial approach" of disclosure for segment reporting has been heavily criticized mainly due to the lack of more formal criteria (Nelson, 2003). Therefore, we will analyze how has the conversion from IAS 14 to IFRS 8 affected corporate disclosures in Europe.

## 2. Methodology

This chapter explains the research methodology used for testing the proposed set of hypotheses concerning the impact of conversion between the two accounting standards.

This study identifies the specific regulatory change/update impact on the EU's financial disclosures.

Predefined and structured data collection techniques have followed the quantitative methodological approach. This methodological approach demonstrates the results from a statistically acceptable sample to ensure the generalizability of the findings.

The questions under investigation are reflected in the main areas that qualify the new accounting principle (e.g., the information volume, which is reflected by the number of words in the disclosures & the designation of the CODM (Chief Operation Decision Maker)).

As mentioned above, in the areas of interest, we have also included in parallel (and at each question)

the following aspects of interest, e.g., the impact of the size of the entity and the country.

Data was collected for the last period that each entity issued financial information based on IAS 14 (2008) and the first based on IFRS 8 (2009).

For the final sample, companies were randomly selected from a list of EU companies, as indexed on the Credit safe financial information database.

Data collection was done manually to ensure the data's completeness and reliability since we could identify any missing information; we could identify any early adoption cases. At the same time, we could also identify – and exclude - cases where the financial statements could be heavily impacted by other reasons (e.g. fire disaster) and could result in misstated statistical results.

### *2.1 Size and Sample Selection*

To examine the impact within the EU area, we have selected among the financial most potent economies of France, Germany, Italy & the UK. It should be noted that BREXIT was not finalized when preparing the relevant article.

Considering the fact that from a small sample size will derive a limited number of observations, we have proceeded in calculating a statistically acceptable sample size as follows:

Representative Sample Size = 50% Distribution/(% of Marginal Error / Level of confidence) <sup>2</sup>

Level of confidence was selected to 50% and the standard deviation to 0,5.

From the above, we have concluded to a sample size of 93 companies, which for rounding purposes we have selected 100 companies by allocating 25 companies to the four countries under examination to have an equal number of observations per country.

## **3. Results**

Concluding, identified variations essentially reflect the country's diverse background and the environment under examination, reflecting differences in the political, economic, social, cultural, technological, legal, and business environment. In more detail, we have the following:

Counting the number of words is considered to be an objective and strait method to assess the quality of financial information (Pearson, 2010; Saunders et al., 2015)

Following the analysis, there is a significant increase in the volume of the information under IFRS 8.

From the total sample of 100 entities, the average number of words increases by 50 per entity according to IFRS 8 (to 643 – Sig.0.017 p<0.05), a fact which was identified both in bigger and smaller entities with a relatively more significant increase in bigger ones by 51 (to 758 – Sig.0.093, p<0.10) compared to smaller ones.

**Table 2. Volume of Information Segment Disclosure (Per Country)**

Average number of words	N	IAS 14	IFRS 8	Sig.
Total sample	160	593	643	0.017**
Bigger Entities	84	707	758	0.091*
Smaller Entities	76	473	513	0.092*
UK	40	502	578	0.027**
Germany	40	571	643	0.041**
France	40	620	656	0.505
Italy	40	676	675	0.912

\* p<0.10, \*\* p<0.05, \*\*\* p<0.01

This is a positive change, as more information is disclosed, which could probably lead to increased information to the financial statements' users.

In addition, there are also differences between smaller and larger companies, with an increase of 51 words for larger companies and 40 for smaller ones on average.

At the country level there are also differences, but only for the UK (increase by 76, p <0.05, .027) and Germany (increase by 72 p <0.05, .041) appear to be statistically significant.

These results are the first indication that the introduction of IFRS 8 affects countries to a different degree.

### 3.1 CODM Recognition

The CODM recognition is one of the main aspects that characterise the introduction of IFRS 8 (ESMA, 2015). The CODM responsibilities include, among others, the decision making for significant operational and strategic matters.

From our analysis and work performed, we have concluded that according to IAS 14 CODM is designated in 3 entities as the B.o.D., while according to IFRS8 this occurred in 96 entities, a significant increase. The increase occurred both in bigger (from 3 entities to 61 entities in bigger entities – sig<0,0001 – p<0,01) and smaller entities (from 0 to 31 in smaller entities – sig<0,0001 – p<0,01).

Further to that, no significant variances among the countries under examination occurred. A significant increase in all countries occurred in relevant identification, but without any notable variances among them from which a potential conclusion would occur.

### 3.2 Pandemic Considerations over Financial Reporting

The pandemic led to an unprecedented lockdown of the global economy, which is still ongoing. The priority of the governments and the society is to enforce health structures having an ultimate target to save lives by protecting at the same time the economic environment at the level that this does not impose a threat to health (Deloitte, 2019).

It is evident that the pandemic's impact has infected the financial reporting in various areas and in different ways. Going concern assumption has become even more critical and complicated since the effect has a great variety to the present and future results and the financial position pending mainly to the industry they operate. The significant negative effect occurred to the airline and tourism industry, while the more extensive food retailers (e.g., supermarkets & pharmaceutical groups etc.) were significantly benefited. Financial covenants, Impairment of assets, and potential liquidity considerations are also certain indicative areas that need to be reassessed during the financial statements' preparation.

Similar considerations on financial reporting under the view of COVID-19 derive from IFAC where professional accountants will have an additional task since they will be asked to produce, analyse and deliver information upon which critical decisions will be made. It will be required during the preparation of financial information and disclosures to do it in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately. Moreover, once again, professional judgement will be demanded to represent the facts accurately and entirely in all material aspects (IFAC, 2020)

By specifying the impact of the pandemic in disclosures referring to IFRS 8, the segment provides reports from the manager's viewpoint, but due to the COVID-19, a system based financial reporting that considers interim reporting rather than long-term based reporting concepts have been introduced (Ali Khazaal Jabbar et al., 2020).

#### **4. Conclusion**

The aim of the current study was to examine the impact of the transition to the new accounting standard from IAS 14 to IFRS 8 in developed entities within EE Conclusions, Expectations and Perspectives.

A general conclusion that resulted is that the introduction of IFRS 8 had a significant impact on both positive and negative tone.

In more details, the significant increase in the number of words under IFRS 8 is an indicator of the increased quantity of disclosures, which is undoubtedly considered to be a clear positive impact.

Management approach disclosures were expected to increase the integrity and to make more comprehensive the management decision-making process. From the results of this research, we have confirmed the increase in the number of entities which identify the CODM. However, in most cases, it should also be mentioned as the B.o.D. without any further information.

Covid-19 pandemic had a significant impact on society and the economy and affected significantly and the preparation of financial statements and relevant disclosures. Attention should be drawn to specific areas. It is certainly difficult to predict when the pandemic will end and subsequently, when the economic environment is going to return to the previous status.

#### 4.1 Limitations and Future Research

The specific study referred to the examination in the four biggest economies of the EU on the impact of adopting new accounting standards. Since this is a comparison study, similarities and differences are recognized. However, the results of this study could be generalized (projected) only in countries with similar characteristics.

This study could be considered as a useful source of information for subsequent studies/essays related to adopting other accounting standards and examining countries with fundamental differences.

As Covid-19 pandemic continues, the future sequences in society and economy cannot yet be reliable estimated. As such, further considerations are still to be identified during the preparation of the financial statements.

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