EARLY OBSERVATIONS ON THE QUALITY OF IFRS REPORTS: EVIDENCE FROM TURKEY

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ABSTRACT

Integration of the world economies has mandated the global inception and recognition of IFRS not only for large companies but also for SMEs. We examine wide-ranging real-life IFRS practices experienced in the world while devoting a particular focus to Turkey. We show that although the countries seriously considering the practice of IFRS confronted some severe obstacles, the conduct of IFRS will return the businesses operating in those jurisdictions as significant cost savings.

JEL: M41, M48.

KEYWORDS: IFRS, Financial reporting, Convergence, Harmonization, SMEs

INTRODUCTION

The United Nations Conference on Trade and Development (UNCTAD) signifies the importance of companies' possessing such accounting infrastructures that are (a) promptly responsive to the changes in and (b) all the way prepared for the promulgation of any sophisticated standards. It points that developing countries and the countries in transition yet lack a rigorous foundation to build the International Financial Reporting Standards (IFRS) on. Developed countries that have been long aware of the difficulties of weak accounting system have already construed the advisable infrastructure (UNCTAD, 2008).

The international adaptation process to IFRS actually started in 1973, with the agreement of 16 professional associations across Japan, Mexico, Australia, Canada, Germany, France, Holland, England and the U.S. to build 'International Accounting Standards Committee (IASC)'. IASC was to be named 'International Accounting Standards Board (IASB)' later on. The process accelerated with the introduction of a regulation by 'International Organization of Securities Commissions (IOSCO)' in May 2000 to require all the listed (quoted or publicly held) companies to exercise the IASC standards. The process has been further advanced by the decision of the European Union (EU) in 2002. This decision was geared towards the enforcement of IFRS on rather the consolidated accounts of all the listed companies residing within the EU (UNCTAD, 2008).

Until now, over 110 countries across the globe have acknowledged and started to implement IFRS (Selimoğlu, 2008). The countries that will initiate the enforcement through completing the synchronization with IFRS enclose Japan, India, Korea, the majority of South and Central America as well as Canada (PwC, 2009). It is high likely that one of the most influential transition processes to IFRS will be observed in the U.S. in the foreseeable future (PwC, 2009). At present, although there is not any binding rule yet obliging companies to enforce IFRS in the U.S., many of them consider that the harmonization with (convergence to) IFRS will be soon ensured in absolute terms anyway, and have therefore started to work on this platform already (PwC, 2009). In addition, the process on the harmonization of generally accepted accounting standards in the U.S. (U.S. GAAP) with IFRS is still continuing (PwC, 2009). However, 2016 rather than 2014 is often cited as the anticipated year for the transition to IFRS there (PwC, 2009). Therefore, a considerable amount of time is yet needed for the completion of the transition cycle not only for the developing but for the developed countries as well.

This paper aims to investigate the early observations on the quality of IFRS reports with a particular focus to Turkey. We argue that although the countries seriously considering the practice of IFRS confronted some severe obstacles, the conduct of IFRS will return the businesses operating in those countries as significant cost savings. We present the literature and document the real-life IFRS cases of wide-ranging countries involving Turkey in accomplishing our research objective.

The remainder of the paper is hence organized as follows. The second section provides the recent topical literature. The third section presents the observations on early IFRS reports, involving the relevance of IFRS for SMEs. The fourth section makes recommendations for any improvement in the transition process. And the fifth section concludes the paper.

LITERATURE REVIEW

The transition to IFRS brought up serious debates about the quality of the financial reports prepared under IFRS, particularly in the legal environments with weak enforcement mechanisms (Ball *et al.*, 2003). It is argued that the usage of a common accounting standard set would lead to a greater degree of comparability, transparency, relevance and reliability in financial reporting, which is expected to improve the quality of the reported accounting numbers (e.g. Psaros and Trotman, 2004; Armstrong *et al.*, 2009). On the other hand, it is also argued that since IFRS is a principle-based standard set with minimum implementation guidance, professional judgment will play a considerable role in its implementation. This may raise managerial opportunism issue. Some researchers therefore contend that in case of even little changes in the enforcement mechanisms, the mandatory IFRS adoption would give a rise to a notable decrease in the level of the accounting quality (e.g. Barth *et al.*, 2006; Ahmed *et al.*, 2010).

There is no a single measure yet which could be followed in examining the quality of financial reports. In the literature, the quality of financial reporting has been measured by the proxies such as relevance, earnings management, financial restatements, and timeliness (e.g. Barth *et al.*, 2008; Cohen *et al.*, 2004). These proxies are well recognized quality attributes. Mainly, the quality of financial reporting might be considered as a betterment in the prospects and an improvement in the presentation of the accounting numbers disclosed in the financial reports aligning the reported figures with the actual economic performance of the firm.

Although there are many theoretical and empirical studies on the quality of financial reporting, the arguments and findings of these studies are mixed. In some studies a significant enhancement in the quality of financial reports under IFRS is supported, while no improvement is documented to have been observed in some others. For instance, according to Barth *et al.* (2008), IFRS betters the quality of financial reports in terms of less earnings management, more timely loss recognition, and higher value relevance in voluntary adoption of the standards. Similarly, Christensen *et al.* (2008) conclude that IFRS results in less earnings management and more timely loss recognition in both voluntary and mandatory adoptions. Daske and Gebhardt (2006) show that there is a significant increase in the disclosure quality of Austrian, German and Swiss firms after their recognitions of IFRS.

In addition, Daske *et al.* (2008) document that IFRS brings along higher accounting quality through increasing the liquidity in the capital markets. Prather-Kinsey *et al.* (2008) suggest the improvement of the financial reporting quality under IFRS only for the companies in the jurisdictions with civil laws. The sampled countries had a relatively lower quality accounting regime before their adoptions of the standards. Moreover, Iatridis (2010) points that the implementation of IFRS reinforces the quality of financial reporting through mitigating the information asymmetry and lessening the earnings manipulation. Similarly, Chen *et al.* (2010) show that IFRS promotes the level of accounting quality along with a less earnings management.

In contrast to the above-cited examinations, there are also studies that rather suggest the inappropriacy of IFRS. For instance, Garcia and Pope (2009) conclude that the mandatory IFRS adoption would not provide any significant betterment in the quality of financial reporting without having an effective enforcement mechanism in place. Ahmed *et al.*'s (2010) preliminary findings show that the accounting quality of financial reports prepared in concordance with IFRS may decrease in terms of earnings smoothness, accrual-based earnings management, and timeliness of loss recognition relative to gain recognition.

Similar to Lainez and Gasca (2006), Alali and Cao (2010) document that because of the cultural differences, IFRS might not be applied in all the countries appropriately. The scholars argue that these differences may obviate the comparability of the financial reports to a sizeable degree. They further argue that IFRS is subject to the absence of a common enforcement body. The reason is that once IASB sets the standards it leaves their enforcements to the hands of the national judicial authorities, which may induce severe inconsistencies in their interpretations and exercises among the implementers. Therefore IFRS might not warrant a unique quality in financial reporting in all the countries, at least in equal measures.

Overall, previous empirical studies show that the quality of financial reporting made in accordance with IFRS relies on the other legal constituents to a reasonably high degree. Without having a robust enforcement mechanism, IFRS would fail to provide a high quality financial reporting. This would be particularly the case for the jurisdictions that had suffered from a poor quality accounting system before their inceptions of IFRS. Furthermore, due to other institutional, legal and cultural effects, any betterment in the quality of financial reporting may not be recorded in the same level for all the countries involved. The next section presents the observations on early IFRS reports, involving the relevance of IFRS for SMEs.

OBSERVATIONS ON EARLY IFRS REPORTS

Background: Motivations and Expectations

In order to understand the degree of success in IFRS implementations, various methods have been employed to measure the harmonization of the accounting standards (Çankaya, 2007). These standards serve to project IFRS implementations in a sense (Çankaya, 2007). H-index, I-index, C-index, T-index and C-index (Conservatism Index) are the most well known indices among all (Çankaya, 2007). We will devote our focus to the issues resulting from the practical implementations of IFRS rather than the theoretical considerations. This is because the objective of this paper is to study the early observations of IFRS practices throughout the world, including Turkey. Understanding the motivations driving countries to adopt IFRS is the key to understanding the expectations from IFRS. In this respect, we first present the motivations for and then the expectations from IFRS as follows.

UNCTAD conducts research on uncovering the issues pertinent to the enforcement of IFRS in various territories. One of these focused on Brazil, Germany, India, Jamaica, Kenya, Pakistan, South Africa and Turkey. These countries deserve attention for their individual approaches. For instance, German companies started to prepare their financial statements in accordance with international accounting standards (IAS) in the beginning of 90s. India preferred to adapt IFRS to seize its own economic realities. Kenya considered the implementation of the standards in 1998 while Jamaica started to do so 4 years later, in 2002. Pakistan began to follow IAS as early as 1993. South Africa experienced a similar process in the same year. In Turkey, the transition period can be said to have started in 2003, which might be considered as quite recent (UNCTAD, 2008).

In the above-mentioned countries, motivations inspiring works on the commencement of IFRS vary significantly. For instance, in Germany, convergence to IFRS was rather progressive. Rather than to comply with the dictates by the national regulators, a vast majority of the large companies first started to prepare their financial statements in concordance with IAS, so as to enter foreign markets and thereby to augment their market shares. In other words, without any legal obligation imposed upon them, companies in Germany voluntarily tended to draft their financial reports in parallel to IAS. In 1998, German authorities that were aware of this tendency placed an option to allow the listed companies to prepare their financial statements as compatible with IAS. Thus, in order to encourage the harmonization process, the voluntary implementation of IFRS attained rather a legal identity. Following the EU decision suggesting the enforcement of '2002 regulations' governing IAS, it has become mandatory for the listed firms to prepare their consolidated financial statements in compliance with IFRS. The German case constitutes a nice example to reflect the EU perspective, and reveals the tendency towards IFRS (UNCTAD, 2008).

Other countries or the leading financial institutions in them had various motivations for choosing IFRS. The Brazilian Central Bank for instance was willing to rise investor confidence through the assurance of the firms' comparabilities in the nation. Kenya considered the severe financial crisis it experienced in the 80s and 90s as an opportunity for enhancing the corporate financial reporting quality in the nation. India wanted to apply IFRS for convergence purposes, while Jamaica's aim was to be in congruity with the other Caribbean countries. The essential aim for Turkey, Pakistan and South Africa in exercising IFRS was to warrant the synchronization (comparability) of corporate financial statements across a globally accepted scale (UNCTAD, 2008).

The motivations sorted out so far indeed led the countries to set certain expectations from IFRS. Should an ethical and truly homogenous set of financial reporting standards be established and strictly enforced by the countries across the globe, we expect to have at least six main benefits as follows. First, incremental costs which originate from companies to concurrently operate different accounting practices will be eliminated. These accounting practices feature conflicting or bifurcating prospects. Second, the requirements of the companies to adjust their consolidated financial statements will be removed. This applies to those which either have subsidiaries abroad or are in the position of a subsidiary of a parent company domiciled abroad (İbiş and Özkan (2006) in the Communiqué by Capital Markets Board of Turkey (SPK) at www.spk.gov.tr).

Third, harsh interest costs emanating from the risks associated with the investments may be mitigated. This is particularly the case for the investors and creditors. Fourth, the burden on the translation of the corporate financial statements in compliance with the foreign countries' own accounting practices all the time will be alleviated. This is important for the local businesses that are eager to grow up through obtaining funding abroad. Fifth, (a) the consolidation of the financial statements of multinational enterprises as well as (b) the evaluation on the performance of cross-border operations will be facilitated. Sixth, some obstructive (*ex ante)* barriers on the corporations' engagements of their economic collaborations with the foreign alliances may also be removed (İbiş and Özkan (2006) in the Communiqué by Capital Markets Board of Turkey (SPK) at www.spk.gov.tr).

All the above-mentioned points suggest that the conduct of IFRS will return businesses as cost savings in a wide-ranging spectrum, involving temporal, administrative, technical, managerial or literally monetary dimensions. Some countries seriously considering to practise IFRS confronted however severe obstacles. We present those observed hitherto in enforcing IFRS. For the purposes of typicality, we brand the problem types as institutional, practical and technical issues (UNCTAD, 2008). The next sub-section discusses the institutional issues.

Institutional Issues

Institutional framework might render influential on accounting quality. Paglietti (2009) argues that the degree of the institutional framework could act as a contributing factor in setting accounting quality together with the quality profile of international standards such as IFRS.

We know by experience that, should the definition of the purviews, authorities and responsibilities of different institutions be unclear, or should the coordination mechanism among them not properly work, legal regulations may well overlap, exhibit inconsistencies or even self-conflict. The lack of the material coherence in the regulating mechanisms causes severe misunderstandings and flaws in the course of IFRS implementation.

Prior research suggests that many legal regulations on corporate reporting became effective considerably earlier than the introduction of IFRS, as were in the cases of Indian Corporate Law issued in 1956, South African Corporate Law issued in 1973, and Turkish Commercial Law issued in 1957. However, as there is no arrangement or amendment made in the given countries' legislations towards the inception of IFRS, it remains still not to have attained any rigorous legal structure or background in those territories. Furthermore, in some countries such as Turkey, as a result of the wordings by the imperative provisions, corporate laws may mandate businesses operating in different industries to prepare different financial statements. Beside the 'legal gap' (unfoundedness) and 'integrity' issues, these lead to a significant incompliance burden for the implementers (UNCTAD, 2008).

Some countries started to make considerable legal arrangements. For instance, In South Africa, in the financial reporting and presentation of the financial statements, progress began on the use of national GAAP recommended by 'Accounting Principles Board' in the nation. The legal foundation the transitioning process relied on was the corporate law which was issued in 1973 and amended in 1992. In Jamaica, although compliance with IFRS was not expressly indicated, companies there were yet obligated to follow GAAP –issued by the 'Institute of Charted Accountants of Jamaica'. The legal foundation the transitioning process drew on was the newly promulgated corporate law having come into force in 1994. This implies that, transition to IFRS was implicitly provisioned in the nation (UNCTAD, 2008).

Indian case also deserves attention. We see that such authorities as 'Indian Capital Markets Board', 'Central Bank' and 'Insurance Regulation and Development Agency' adopted the conduct of financial reporting in accordance with the accounting standards. It is the 'Institute of Charted Accountants of India' which publishes them. This structure suggests the recognition of the mastery by a professional body nationwide. Some hardships persisted despite this pertinent linkage though. For example, the Institute of Charted Accountants of India recently issued a standard on leasing based on the IAS. However, 'Leasing Companies Association' argued that the issued standard will severely harm the leasing operators, and it therefore filed a lawsuit to suspend the enforcement (UNCTAD, 2008).

There are some notable differences, of varying degrees, between the current legislations and even the preceding regulations geared towards the harmonization with IFRS. For instance, IFRS 4 stipulated that insurance undertakings are required to set provisions based on their past experiences in the insurance contracts. However, in the *ad hoc* practices, we often see that industry or sector averages rather than historical information are used. A similar disparity applies to the banking sector as well, wherein central banks require banks to account for loss provisions given some predetermined proportional values (UNCTAD, 2008).

IFRS was designed for the preparation of general-purpose financial statements and for making financial reporting. However, case studies across different countries highlight a need for the preparation of special-purpose IFRS-based corporate financial statements as well. Without this, an alternative financial reporting set by a certain sector regulator or entity rather than IFRS may bring about some misunderstandings. For instance, in Turkey, the Banking Regulation and Supervision Agency (BRSA) oversees the banking sector, and the accounting standards it sets are followed by the financial institutions, involving not only banks but also the financial holdings (UNCTAD, 2008).

In the case of Pakistan, the Pakistan Central Bank which is the regulating authority for all the banks in the country determines the form requirements banks have to comply with. These requirements govern the financial statements and notes, regardless of whether they are prepared in concordance with IFRS or not. Likewise, in South Africa, legal arrangements made for the (banking and insurance) transactions of banks and insurance undertakings are subject to special framework. The legislations pertaining to these two important legs of the financial sector are different from those belonging to the other industries as are in Turkey (UNCTAD, 2008). The next sub-section discusses the enforcement issues.

Enforcement Issues

In practice, the implementation charge of IFRS may be concurrently given to more than one party involved. For instance, in the case of Germany, 'Bilanzkontrollgesetz [BilKoG]' (German Accounting Enforcement Law) which came into force in 2004 presented a bilateral implementation system. One of the legs is 'Deutsche Prüfstelle für Rechnungslegung [DPR] e.V.' (German Financial Reporting Enforcement Panel) which consists of 15 professional and industrial associations. The overheads of DPR are covered by the listed companies in Germany. The other leg is 'Bundesanstalt für Finanzdienstleistungsaufsicht [BaFin]' (Federal Financial Supervisory Authority). BaFin is such a well endowed supreme board that is entitled to, concurrently, monitor and review businesses running their operations in the banking, insurance or capital markets (UNCTAD, 2008).

The Panel has been developed to meet the specific need for oversight and reconciliation, and thus to serve as an expert body. Its role is to audit the consolidated and solo financial statements of the listed companies. It may directly report to BaFin in the case of an unsolved issue in regard to the business under review. An interesting aspect of this tiered administrative arrangement is that, while private sector organizations might also give an opinion on a subject that requires rather a considerable technical expertise, the ultimate responsibility to implement the course remains in the hands of a public authority (UNCTAD, 2008).

In the case of India, the Institute of Charted Accountants plays an active role in reinforcing the implementation of financial reporting of the companies in the nation. This institute developed a specialized sub-committee named 'Financial Reporting Review Board'. The Board examines financial statements belonging to different companies as well as striving to synchronize their financial reports with the accounting standards. Should the board determine any caveat either in the compliance with the accounting standards or in any other implementation issues, it informs its supervisory body (the Institute) or directly refers the matter to another concerning venue (UNCTAD, 2008).

In the case of South Africa, 'GAAP Review Panel' operates as the institution in charge entitled to and responsible for assuring the harmonization of financial reporting standards. The Panel features a collective prospect, because it is composed of the Institute of Charted Accountants of South Africa and Johannesburg Stock Exchange. Before this panel, there was actually no legitimate basis for the financial reporting standards (UNCTAD, 2008). The next sub-section discusses the technical issues.

Technical Issues

The most serious imperfection in the implementation of IFRS perhaps lies in the absence of the accountants and auditors who are able to practice IFRS along with IAS. For instance, in the case of

Kenya, although the effective date of IAS coming into force goes back to 1999, the number of the accountants available to conduct them has remained too far from adequate. IFRS training is not only required in Kenya but all over the world. It seems that, training issue would be severely distressing in Turkey, too (UNCTAD, 2008).

Another technical problem is the fundamental and frequent amendments in the existing IFRS, and expecting the implementers to have an immediate accommodation of these changes. For instance, while Kenya and India were trying to internalize IFRS on one hand, they had to once baffle with an IASB decision requiring amendments in 13 different standards. As a result, over 20 standards have been permanently impacted. Considering the limited financial resources, the modifications on IFRS put an unnecessary pressure on the technical capacity. That these amendments may have to pass through a separate process before becoming binding across the nations/regions further spoils the emerging technical issue. In this context, the 'Institute of Charted Accountants of Pakistan (ICAP)' gave a binding resolution. It suggested that, should any standard once be adopted by the Institute and approved by the Securities and Exchange Commission (SECP), unless otherwise stated, IASB shall not need the approval of any further authorization for the amendments it may undertake on the issued standard later (UNCTAD, 2008).

Another technical problem is how to measure the fair value mentioned in IFRS. IFRS considers the fair value as an indicator fundamental to the preparation of the financial statements. As the Indian and Kenya cases apparently indicate, in the countries where the trade volume is relatively low and the liquidity of the capital markets is inadequate, it will be difficult to obtain such a fair value that is recognized by all the transacting parties involved. These concerns could impact not only the preparers but the auditors. As a matter of fact, auditors have already encountered severe problems in the identification of the fair value from time to time (UNCTAD, 2008).

In the case of Germany, the classification (presentation) of the financial instruments that are issued in compliance with IAS 32 (e.g. buyback right) relies on German internal legislation (e.g. Handelsgesetzbuch [HGB]). HGB, the German Commercial Code, stands at the very center of the German GAAP. Should the financial instruments be classified as compatible to IAS 32, some of the accounting items -those normally to be treated as equity by German GAAP- will rather appear as liabilities in the corporate balance sheets. This will increase the share of debt financing while reducing the share of the equity financing in a corporate balance sheet prepared in accordance with IFRS. Therefore, many German firms feel already discouraged from implementing the referred standard, despite the legitimacy of the presentation of the financial instruments (UNCTAD, 2008).

A similar issue has arisen in the course of the implementation of IAS 17. IAS 17 governs leasing transactions. In particular, such institutions as banks and insurance undertakings that cover a great volume of financial service needs were forced to redefine some leases as operational, so as to assure synchronization with the standards. One of the considerable drawbacks of the redefinition is, once again, the reduction in the degree of equity which plays a key role in the capital adequacy regulations [e.g. the degree of capital adequacy ratio] (UNCTAD, 2008).

Technical issues are not even restricted to the above-mentioned problems. For instance, IAS 16 which stipulates the treatment of fixed assets favors a component approach rather than full depreciation. This approach implies a totally new experience for the wide-ranging practitioners who used to make financial reporting based on the consummation of the entire value of the fixed worth. A great deal of highly technical consulting service may therefore be needed, in figuring out for example how to (i) depreciate fixed assets through partitioning them and hence to (ii) diminish their book values in connection with a pro-rata basis (UNCTAD, 2008). The next sub-section discusses the issues that are of particular relevance to Turkey.

Issues That Are of Particular Relevance to Turkey

We see that different firm types are governed by different authorized bodies, and more importantly, under different legislations in Turkey. For instance, insurance undertakings are administered by the Undersecretariat of Treasury (UTT). They are audited for their insurance-related operations by the Insurance Supervision Board (ISB). Banks or financial companies (e.g. factoring firms, leasing firms) are mainly reviewed by BRSA for their ordinary activities. However, in case a particular insurance undertaking, bank, or financial company is publicly listed, it will be also subject to the review by the Capital Markets Board (CMB) for its capital markets-related operations. BRSA and CMB are the supreme boards with autonomies in their jurisdictions, while ISB acts as a body of UTT.

CMB performs the execution charge -monitoring and oversight- at the crossroad of rendering the harmonization of the listed companies with the financial reporting standards. More clearly, CMB is entitled to regulate, monitor and supervise the companies that are publicly held, and/or whose stocks are traded in the stock markets along with IFRS.

Companies that are publicly owned but whose stocks are not traded in the market are governed by Communiqué XI/No.1 along with its amendments. This communiqué is known as ‘old standards’ as they are not compatible with IFRS. Companies that are publicly held and whose stocks are publicly traded are subject to Communiqué XI/No.25 and its amendments. This communiqué can be pronounced as ‘new or current standards’ as they are largely compatible with IFRS. Communiqués become effective once published in the official gazette. CMB governs not only the issue, but also the conduct of these regulations. Table 1 presents the reporting requirements of companies operating in Turkey (UNCTAD, 2008).

Table 1: Reporting Requirements of Various Companies Operating in Turkey

Type	Code
Companies that are publicly held but not traded in the stock exchange	Communiqué XI/No.1 & its amendments by Capital Markets Board (known as old standards)
Companies that are both publicly held and traded in the stock exchange	Communiqué XI/No.25 & its amendments by Capital Markets Board (known as new standards)
Brokerage firms (investment houses)	Communiqué XI/No.25 & its amendments by Capital Markets Board (known as new standards)
Banks and financial institutions with similar capacities	Turkish accounting standards
Insurance undertakings	Communiqué by Undersecretariat of Treasury

Source: adapted from UNCTAD (2008, p.136).

Table 1 points to the persisting institutional problem (e.g. overlap of powers/legislations, lacking coordination, inconsistency) mentioned before. The conflict (dichotomy) between the two above-mentioned communiqués by CMB alone raises technical issues too. We can break them into two: disclosure and measurement problems. We will first discuss disclosure matters as follows.

First, in IFRS/IAS (new communiqué), related (associated) parties are meant to include a broad stakeholder group, while in the old communiqué, related parties are particularly referred to as subsidiaries, equity investments and stockholders. Second, unlike IFRS/IAS, old communiqué does not obligate any disclosure on the fair value of financial assets and liabilities excluding marketable securities. Third, unlike IFRS/IAS, the statement of shareholders’ equity is not a mandated financial statement by the old communiqué. Fourth, in IFRS/IAS, cash flows are detailed by activity type in the cash flow statements, while there is no such a classification in the old communiqué (UNCTAD, 2008).

On measurement or valuation, there are certain differences between the new and the old communiqués as follows. First, unlike IFRS/IAS which treats foreign exchange losses emanating from the acquisition of

PPE (plant, property and equipment) as period expenses, the old communiqué treats them as assets through capitalization. Second, unlike IFRS/IAS which treats research and organization costs as period expenses, they are treated as assets through capitalization in the old communiqué. Third, unlike IFRS/IAS, all lease types are treated as operational leases in the old communiqué. Fourth, unlike IFRS/IAS which mandates the companies to consider the present values of the pension liabilities, the old communiqué does not bring out such a covenant as a must (UNCTAD, 2008).

It is the banking law that administers banks and financial holdings with several financial companies in Turkey. BRSA is entitled to audit them as mentioned. Following a resolution by BRSA issued in November 2006, in terms of financial disclosure, banks and financial institutions with similar capacities have started to be codified by Turkish Accounting Standards (TAS). TAS is issued and published by Turkish Accounting Standards Board [TASB] (UNCTAD, 2008). TAS is in the form of literal translations of IFRS into turkish.

Before referring to TAS as the legitimate venue for corporate financial reporting, BRSA used to mandate banks to present their financial statements based on the form requirements set by itself. Therefore, BRSA was indeed the first supreme board to expressly encourage convergence into IFRS. Such practices will surely assure and accelerate the harmonization with IFRS (UNCTAD, 2008).

Obstacles are not restricted to the said issues though. Cultural adaptation of the implementers towards IFRS should not be underestimated for instance. Lainez and Gasca (2006) investigate the role of the cultural effects on the synchronization process within the European Union (EU) territory. The scholars control for valuation and disclosure practices through sampling 150 companies across 15 EU Member States. They document that culture is an influential factor governing convergence towards a common financial information disclosure setup. The findings by the given scholars are also supported by the recent studies (e.g. Alali and Cao (2010)). The next sub-section discusses the relevance of IFRS for Small and Medium-Sized Enterprises (SMEs).

SMEs and IFRS

According to IASB, unlike large-scale firms, SMEs (a) are neither listed nor publicly held, (b) are not built in the form of financial organizations, (c) do not deliver any public services, (d) are not *per se* important in the countries they operate, (e) have no accountability obligations to the public, and (f) are obligated to present general rather than specific-purpose financial statements (Demir, 2007). Thus, by definition, while the users of SMEs' financial statements pay attention to the parameters such as short-term cash flows or liquidity, capital market analysts or investors of the large companies devote their concentrations rather to the financial indicators such as long-term cash flows, dividends or corporate value (Aslan (2007) in Sivaram (2006)). To IASB, IFRS for SMEs would be appropriate for the organizations with a number of staff around 50 (Demir, 2007).

Nonetheless, SMEs, just as large companies, may also be in need of the preparation and reporting of international financial statements. This need could emanate from wide-ranging stances or motivations. Among them are for instance (a) willingness to obtain international loans from banks or other financial institutions, (ii) willingness to maintain relationships with foreign suppliers, (iii) requirements by the credit-rating institutions on (SMEs') having transparent financial statements in concordance with Basel II, or (iv) the structures of SMEs' foreign customer networks (Demir, 2007).

Full-set IFRS has been designed for large corporations. It failed to address to the issues of SMEs however. IASB therefore issued an accounting set, 'IFRS for SMEs', to the public for the particular use of SMEs. Consideration of SMEs was quite a wise breakthrough since they account for the vast majority (% 95) of all the enterprises (TASB, 2009). In other words, every 95 firms out of 100 is SME.

IFRS for SMEs, as the name implies, is a catch-all standard set. It has been prepared considering the particular needs and capacities of relatively smaller businesses (TASB, 2009). In the preparation of this standard set, full-set IFRS was indeed taken as the role model. Particularly, (i) the principles regulating identification as well as recording of asset, liability, equity, expense and income values in the full-set IFRS have been simplified, (ii) the sections that do not directly pertain to SMEs have been precluded from the full-set IFRS, and (iii) the scope of the mandatory disclosures mentioned in the full-set IFRS has been narrowed (TASB, 2009).

Along with the aim to further alleviate the financial reporting burden on SMEs, it has been settled that the revision of the 'IFRS for SMEs' will be made on a triennial basis, rather than interim or annual periods (TASB, 2009). As mentioned, even though 'IFRS for SMEs' was envisaged as a separate vein of standards, SMEs will still have the chance to prepare their financial reports in accordance with full-set IFRS as well, should they prefer or need to do so (Demir, 2007). We see that encompassing the above-specified prospects, work on the harmonization and implementation of IFRS for SMEs is also accelerating in Turkey in full force. The next section points to some lessons to draw from the on-going exercises of IFRS across various countries.

RECOMMENDATIONS FOR IMPROVEMENT

The preceding sections have suggested that a robust enforcement mechanism as well as a concurrent consideration of institutional, practical, technical, legal and cultural constituents are all needed for IFRS to warrant a high quality financial reporting regime for its implementers. Considering the countries with varying economic development levels, the following fourteen points by UNCTAD (2008) are strongly advisable in improving IFRS applications.

First, with the transition plan designated for the convergence to IFRS, its influence over users, preparers, trainers (including academicians) and other beneficiaries should be well managed. Second, the application of IFRS requires a rigorous preparation stage both at macro (country) and micro (company) levels. Training of personnel, updating information technologies, or outsourcing some consultancy services on the maintenance of IFRS are among such emerging issues. The German case suggests that companies are in need of 1 to 1,5 years for a proper execution of IFRS. Third, the complete transition plan should be specified. This plan involves the process *beginning with* the identification of the sizes and the types of businesses reporting their financial statements on solo or consolidated basis *until* the final stage of how to perform IFRS on the spot. Case studies by UNCTAD point that SMEs are already facing hardships even in the preparation of general-purpose financial statements (UNCTAD, 2008).

Fourth, the countries converging to IFRS-based financial reporting may have special requirements, should their economies be under a hyper- or stationary- (chronic) inflation pressure. Fifth, IFRS execution programs should also contract the readiness of the related professional accounting agents, since a successful IFRS conduct would not function without their supports. These acting bodies can offer training programs on IFRS from the early to the advanced stages at every point needed throughout the transition period. Sixth, national accounting firms can contribute to the harmonization of IFRS not only on a national scale but also on an international level. For instance, in South Africa, 'Accountancy Technical Common Forum' which was established to counteract probable inconsistencies defines the technical conditions for financial reporting. Members of this forum have the chance to observe concurrent implementation across the globe. With such approaches, dialogs among all the firms delivering accounting services both at national or transnational levels will considerably increase. And IFRS implementations will feature a systematic integrity (UNCTAD, 2008).

Seventh, a concurrent monitoring program among auditors may provide the proper information flow. This flow is necessary for observing various issues related to reporting financial statements and auditing process. Eight, preparers, users, regulators and professional accounting bodies had better give feedback on IFRS implementation process to IASB which is the worldwide regulating agency. This feedback would not only be of *ad hoc* or *ex post*, but *a priori* character. That is, feedback could not only be given immediately following the finalization of the standards, but even before, when they are just in draft versions. Any proactive interaction with IASB even in the course of the preparation of the standards will breed mitigation on the probable requests for the amendments and/or the comments after the issuance of the standards. Ninth, the incorporation of IFRS and IAS modules into the curricula of accounting programs of universities will shorten the transition period by simplifying the implementation of IFRS. In this respect, coordination of universities' accounting programs together with professional qualifications and professional arrangements is needed (UNCTAD, 2008).

Tenth, the lack of expertise in IFRS will impact not only the private sector, but other institutions and entities delivering public services as well, enclosing the regulators at the foremost. Eleventh, every country is unique. Transition from national GAAP-based reporting to IFRS-based reporting may require clarification or interpretation owing to this uniqueness (e.g. existence of a high degree of unregistered economy in a country such as Turkey). Twelfth, any differences or inconsistencies between *IFRS* which is effective on an international level and *IFRS* which is adapted to a national scale should be avoided. Thirteenth, positive contributions to the process of IFRS would be facilitated if the relevant authorities show inclination to share their enforcement powers. And fourteenth, regional and cross-border development banks may play quite an active and constructive role in the systematic implementation of IFRS through providing necessary fund transfer to the economies of the emerging countries or the countries in transition (UNCTAD, 2008). The next section concludes the paper.

CONCLUDING COMMENTS

Integration of the world economies has mandated the global inception and recognition of IFRS not only for large companies but also for SMEs. This paper aimed to investigate the early observations on the quality of IFRS reports with a particular focus to Turkey. We argued that although the countries seriously considering the practice of IFRS confronted some severe obstacles, the conduct of IFRS will return the businesses operating in those countries as significant cost savings. We presented the relevant literature and documented the real-life IFRS cases of wide-ranging countries involving Turkey in accomplishing our research objective.

We have shown that companies can have considerable benefits with the enforcement of IFRS as follows. First, the degree of the productivity will increase through less reporting costs. Second, the financing/funding needs will be satisfied through risen credibility. Third, the way for more investments will be paved through a reduced amount of risk exposure and hence less funding costs. Fourth, the degree of the profitability will increase through risen credibility, augmented market share and generated synergy. These points purport to be cost savings to the businesses that implement IFRS in their jurisdictions.

We have also shown that there is the possibility of significant inconsistency issues between IFRS and the legislations currently in force in the countries implementing it. These issues might be of wide-ranging characters. We have suggested a number of ways to overcome these emerging problems. These remedies all combine to recommend a strict understanding, recognition, cooperation, coherence and integrity of IFRS within and among the countries that are willing to implement it. Availability of a robust enforcement mechanism as well as a concurrent consideration of institutional, practical, technical, legal and cultural constituents are indeed all needed for IFRS to warrant a high quality financial reporting regime for its implementers.

In the near future, we expect that (a) TAS will apply to any business in Turkey irrespective of their types, and that (b) TASB will be the sole authority for maintaining the standards and overseeing the businesses as for their implementations of the standards in due diligence. We draw our expectations on a concrete basis, the upcoming (draft) commercial code, which is expected to be passed from the parliament and thereby be legalized soon (UNCTAD, 2008).

This paper is not without its caveats. It presents early evidence on the implementation of IFRS across the globe. It might be misleading for instance to conclude on the advantages or disadvantages of IFRS considering quite a limited time span. We need to wait for a reasonably long time to make sure that IFRS will have satisfied our expectations of itself or failed to do so.

The problems encountered and the solutions suggested for the better exercise of IFRS in this paper may corroborate the scholarly studies on the global accounting harmonization. Empirical and applied research on IFRS may provide documentations on the comparability of the particular prospects of IFRS with the legislations remaining in force before IFRS.

We have diagnosed the typical problems experienced so far in implementing IFRS, sorted them out and made several recommendations on how to solve them. In this respect, our paper might also lead the practitioners/implementers to thoroughly review the convergence progress and to further improve it as much as possible by taking the necessary cautions.

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ACKNOWLEDGEMENT

This paper is the extended, largely amended and translated version of the paper that we first presented at XIII^th Turkish Accounting Standards Symposium in Cyprus on November the 19^th, 2009, and represented at Muhasebe Gündemi 2010 (The Accounting Agenda 2010) on February the 26^th, 2010 in Izmir city of Turkey. We thank all the participants in both the symposia for their contributions.

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