Chapter 7

IFRS Adoption in the EU and the Challenge of Nomenclature Evidence from the UK, France, and Germany

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ABSTRACT

Since the adoption of International Financial Reporting Standards (IFRS) and the subsequent directive by the European Union (EU), all companies operating in the EU are required to report their consolidated financial statements in line with the IFRS. This study examines the consolidated financial statements of the top 170 listed companies in three major EU stock exchanges (UK, France, and Germany) and uncovered a disparity in the use of common nomenclatures. The findings reveal that inconsistencies in the application of terminologies such as statement of financial position instead of balance sheet and sequence of arrangement of assets in order of liquidity constitute the main differences for entities operating in the three countries. Such differences pose an imminent challenge in the comparability and interpretation of financial results.

1. INTRODUCTION

Starting from the 2005 financial year¹, all companies listed in the European Union stock markets are required to present their consolidated financial statements in compliance with the IFRS. The endorsement of the IFRS by the European Commission (EC) follows a long process of debate, negotiation and extensive consultation with the European Financial Reporting Advisory Group, a body charged with the enormous responsibility of advising the EC on accounting standards. Thus under this agreement, compliance with the IFRS becomes mandatory rather than optional for all publicly listed firms.

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The main purpose of enforcement of the IFRS by the EU on companies within its domain is to protect investors and promote market confidence (CESR, 2003). In addition, the adoption of IFRS should improve the international comparability of financial reporting and enhance harmonisation. However, if the implementation of the Standard is perceived to be non-value creating to European shareholders, then the purpose of adopting IFRS will be self-defeating. Hence, the road to convergence of nation members’ accounting systems into a harmonised form through the adoption of IFRS can be quite challenging (Alp & Ustundag, 2007). The major challenge is the implementation of the Standards such that all member nations freely accept the legal and professional obligations to comply wholly, rather than their domestic national standards (Wong, 2004). Such compliance will be reflected in strict adherence to the provisions and guidelines of the IFRS, with punitive measures put in place to ensure compliance and discourage dissidence by firms.

Prior research in the harmonisation of EU accounting practices, particularly in the UK, France and Germany, has focused on differences in methods of stock valuation; depreciation; treatments of goodwill; research and development; valuation of fixed assets; and treatment of extraordinary or exceptional items of listed companies in the three countries (Emenyonu & Gray, 1992; Kvaal & Nobes, 2010). In essence, these studies examined the pattern of usage of assets and profit measurement practices by large companies in France, Germany and the UK. Their findings indicate significant differences in the measurement and treatment of a number of key items among the three countries. The differences confirm the assertion that the measurement provisions of the EC Fourth Directive (Nobes, 2010) are inherently flexible.

In fact, the adoption of the IFRS since 2005 does not in itself give a blanket assurance that all companies in the EU countries will implement the Standards as required. As noted by Christensen & Nikolaev (2008) and Chen et al (2014), countries may still be influenced by their traditional GAAP practices rather than follow the dictates of the IFRS and listed companies in the EU may be influenced by general accounting conservatism in their country of operation or incorporation. Thorell and Whittington (1994) observe that although French and German accounting reporting traditions reflect the EU format, they have different rules for the balance sheet and the profit and loss account. They require detailed statutory prescription of formats, disclosures and options to meet the needs of divergent national regulation and practice. The differences in the accounting system of the three countries are even more apparent in the extent of their requirements in disclosing important items. For instance, whilst France and UK have similar strict regulations on environmental disclosure, Germany offers a distinctively different and less stringent requirement (Barbu et al, 2014). Such national influence on accounting reporting requirement is apparent in the application of the IFRS among the respective countries (Nobes, 2006), despite signing up to a global and regional compliance.

According to Nobes (2006), differences in financial reporting between the UK and Germany are palpable and significant; and such differences reflect the purpose of their preparation and use. For instance, published accounts of German companies are used for fiscal purposes and require strict emphasis on historical costs, as increases in asset values lead to a higher tax charge. In addition, a significant proportion of the shares of large German listed companies is held through the intermediation of banks and other large companies, some of which have representatives on their boards of directors.

Furthermore, while assets impairment is tax deductible in Germany, this is not allowable in the UK. In contrast, the UK GAAP places greater importance on investors by its emphasis on reporting to the shareholders who have no other direct source of information about the company except for those disclosed in financial statements. Since investors’ protection measures are considered to be high in English Com-