International Review of Business Research Papers
Vol. 5 No. 3 April 2009 Pp. 100-110

IAS/IFRS ADOPTION BY ITALIAN LISTED COMPANIES: FIRST EMPIRICAL EVIDENCES

Alessandro Cortesi*, Elena Montani**, Patrizia Tettamanzi***

The present study concentrates on companies listed on the Milan Stock Exchange and on their consolidated financial statements, which, starting from the financial year 2005, have to be prepared and published according to the international accounting standards instead of the national ones. The research shown in the following pages is the result of a descriptive statistical analysis that can be defined as the first step of the study. The aim is to identify the main impacts on the most important financial statement items (Equity and Net Income) of the transition from the Italian to the international accounting system. The following steps will be to focus on Italian listed companies belonging to furniture and fashion industry sectors in order investigate the treatment of intangible assets according to IAS 38 – Intangible Assets and IAS 36 – Impairment of Assets, comparing the two sectors.

Field of research: Financial Reporting

1. Introduction

The aim of this work is to make a preliminary investigation into the adoption of the IAS/IFRS (*International Accounting Standards / International Financial Reporting Standards*) by Italian companies listed on the Milan Stock Exchange. For that purpose, the impact on Equity and Net Income of the transition from domestic accounting rules to international standards has been analysed.The authors' objective is to investigate the changes in the way business operations are accounted and presented due to the transition to IAS/IFRS through:

- the analysis of the main differences of treatment of key financial statements items;
- the analysis of the global impacts on both Equity and Net Income, with reference to the sampled companies;
- the analysis of the impact of each accounting standard on Equity and Net Income.

* Prof. Alessandro Cortesi, Ph. D., Full Professor, Università Carlo Cattaneo, Castellanza (VA) Italy email: acortesi@liuc.it

** Elena Montani, Ph. D. Student, Università Carlo Cattaneo, Castellanza (VA) Italy email: emontani@liuc.it

*** Prof. Patrizia Tettamanzi, Ph. D., Associate Professor, Università Carlo Cattaneo, Castellanza (VA) Italy email: ptettamanzi@liuc.it

2. Legislature And Literature Review

Italian Civil Code, in its V° Book, regulates the standards which economic operators must comply with in issuing financial statements and which are described in the Italian Accounting Principles (issued by OIC, *Organismo Italiano di Contabilità*). The different options allowed by EU regulations and national GAAPs make the comparison of EU companies' financial statements difficult or anyhow not straight forward. International harmonisation acts are needed as a consequence of company market and foreign investors expansion. IAS/IFRS is a body of accounting standards suitable to international markets' needs, which are issued by IASB (*International Accounting Standards Board*). EU Regulation n. 1606/2002 forced EU listed companies to issue consolidated financial statements based on international accounting standards. Italian L.D. n. 38/2005 outlines which kind of companies must apply international accounting standards: for listed companies IFRS implementation is mandatory from 2005 for consolidated financial statements and from 2006 for separate financial statements.

EU Countries have adopted international accounting standards following different timetables and different effects (Tokar, 2005). Accounting theory highlights how financial reporting, thanks to an effective and immediate disclosure, can reduce differences in disclosure itself. (Frankel & Li, 2004). Traditional approach to disclosures is very different from the one applied by IAS/IFRS. Surveys on International accounting standards underlined how accounting is affected by the environment (Hopwood, 1994) and that there is a clear relationship between accounting quality and environment itself (Soderstrom & Sun, 2007). There are arguments suggesting that reporting quality is influenced by firms' reporting incentives (Leuz, 2003). The economic consequences of mandatory IFRS reporting around the world have been examined (Daske, Hail, Leuz & Verdi, 2008), as well as the increase in quality of financial reporting due to the use of IFRSs (Barth, Landsman & Lang, 2008).

Several compared studies show differences between Anglo-Saxon and continental Europe accounting systems (Nobes & Parker, 2004). This paper describes the application of international accounting standards in Italy which belongs to continental Europe. Empirical evidences regarding IAS/IFRS and related effects on different EU countries have been collected by empirical investigation of these new standards' effects on financial statements reporting (Delvaille, Ebbers, Saccon, 2005; Haller & Eierle, 2004; Jermakovicz, 2004; Ormrod & Taylor, 2004; Richard, 2004; Sucher & Jindrichovska, 2004; Vellam, 2004). Analysis have been made also about management processes (Cantino and Devalle, 2005) and about the use and importance of fair value according to IFRS for assets and liabilities measurement (Cairns, 2006; Hitz, 2007). In the literature, many analyses have been carried out on the main differences in the treatment of financial statements items between national and international accounting standards. The empirical part of this paper focuses on specific IASs/IFRSs, which have been chosen because they appeared to be the most significant ones in terms of impacts on most of the considered companies and the most cited ones in the explanatory notes attached to the examined financial statements. Of all the standards investigated in this work, table 1 summarises four relevant key points about different treatments and subsequent impact on Equity (E) and Net Income (NI) related to the IFRS inspiring principles of fair value and of the substance over form. The above mentioned effects are due to the application of: IAS 16 – *Property, Plant and Equipment;* IAS 17 – *Leases*; IAS 36 –*Impairment of Assets* and IAS 38 – *Intangible Assets*.

Table 1 – Analysis of the differences of treatment of key financial statements items

KEY ITEMS	IAS/IFRS	Italian GAAP
TANGIBLE ASSETS	First evaluation is based on purchase and production cost, minus accumulated depreciation and impairment losses. *Fair value* reassessment is allowed.	First evaluation is based on purchase or production cost, minus accumulated depreciation and impairment losses. No reassessment is allowed, unless specific bylaw.
	IAS 16	Art. 2426 C.C., OIC 16
LEASED ASSETS	It's possible to apply financial or operating lease criterion. Financial leasing can be accounted by assets capitalization, while operating leasing is posted as a cost in the income statement.	Operating lease accounting criterion is applied. Additional Notes need to highlight the effects of the financial methodology on Equity, on Net Income and on Cash Flow.
	IAS 17	Art. 2427 C.C., comma n. 22
INTANGIBLE ASSETS	Can be booked only if there will be future economical advantages, coming from the business itself and effecting the company and only if their cost can be determined. If the useful life is defined, the assets must be amortised on a systematic basis based on the useful life.	Capitalization of costs of setting up, installation and expansion are allowed as well as R&D and advertising. They must be amortised based on the useful life, usually within five years.
	IAS 38	Art. 2426 C.C., OIC 24
INTANGIBLE ASSETS – IMPAIRMENT TEST	An intangible asset with indefinite useful life (e.g. goodwill) must not be amortised; but the asset value must be reassessed in each period or when there is a clear impairment loss.	It is required to indicate in the Notes to the Accounts the effects of the impairment test instead of the amortisation of intangible assets with indefinite useful life.
	IAS 36	OIC 1

3. Methodology And Research Design

Based on the analysis of regulations, literature and on the different treatment of financial statements items, the following hypothesis have been stated:

1) IAS/IFRS application produces an increase of Equity and Net Income as well as an increase of ROE, due to higher impacts on NI than on E.
2) Higher effects on Equity and Net Income are due to the application of the following standards: IAS 2,16,17, 18, 19, 27, 32, 36, 38, 39.
3) IAS 16: produces higher assets values.
   IAS 16 allows for the adoption of fair value model for property, plant and equipment evaluation. The effect will probably be a higher asset evaluation as well as an increase in Equity due to increased reassessment reserves; a decrease in Net Income due to the correspondingly increased annual depreciation rate.
4) IAS 17: produces higher assets and liabilities values.
   IAS 17 allows for the adoption of the financial leasing methodology. Such methodology will have a modest effect with reference to both Equity and Net Income. In the balance sheet the exceeding value of the leased good is partially covered by the financing debt registration. In the income statement the lower cost due to the leasing removal is balanced by depreciation and interest expenses accounting.
5) IAS 38/36: produces a higher value of goodwill and intangible assets with undefined useful lives as well as a decrease of multi-year costs.
   IAS 38 allows for the adoption of the fair value model for intangible assets evaluation. Goodwill, brands and other intangible assets with undefined useful lives are not subject to systematic amortisation but are liable for annual impairment tests ruled by IAS 36. The effect in the year of transition will probably be a higher Equity value due to an increase in asset values and reassessment reserves, a higher Net Income due to goodwill amortisation removal counterbalanced by a lower Net Income due to multi-year cost charges booking (not capitalisable any longer).

The starting point of this research were the companies listed in Milan Stock Exchange, updated February, 5^{th} 2008, each market segment included. Official financial statements of each sample company have been downloaded from their own websites. Companies, where one or more financial statements or explanatory notes about IAS/IFRS transition were not available, have been outcast. Total amount of analysed companies is 160. Table 2 shows selection criteria.

Table 2 – Sample selection

Total number of listed companies	**278**
- Financial entities	- 42
- Further exclusions (government owned companies, financial holdings, companies part of a group)	- 58
Total number of eligible companies	**178**
- Companies with no financial statements or IAS/IFRS prospects available	18

Total number of assessed companies	**160**

For this analysis several descriptive statistical tools have been used, such as simple means, percentages and graphics. IAS/IFRS impacts have been identified through the analysis of financial statements and their attached reports related to IAS/IFRS transition. Financial statements reference periods are:

- 31/12/2004 for companies required to issue their financial statements according to IAS/IFRS starting from 2005 and, therefore, to reclassify for comparison purposes 2004 financial statements data according to the same standards;
- 31/12/2005 for companies required to issue their financial statements according to IAS/IFRS starting from 2006 and, therefore, to reclassify 2005 financial statements data according to the same standards;
- other closing dates for companies closing the books in dates different from 31/12.

Global IAS/IFRS impact and impacts of each single accounting standard have been considered for the following items:

1. average value of the impacts (both means of absolute values and means of +/- values) on Equity and Net Income;
2. average value (percentage) of the impacts on Equity compared with Equity itself;
3. average value (percentage) of the impacts on Net Income compared with Net Income itself.

4. Discussion Of Findings

The tables below show the average impacts of each single relevant standard on Equity (table 3) and on Net Income (table 4), both in terms of absolute values and percentage values, for the sample companies.

Table 3 – Average impacts of each accounting standard on Equity

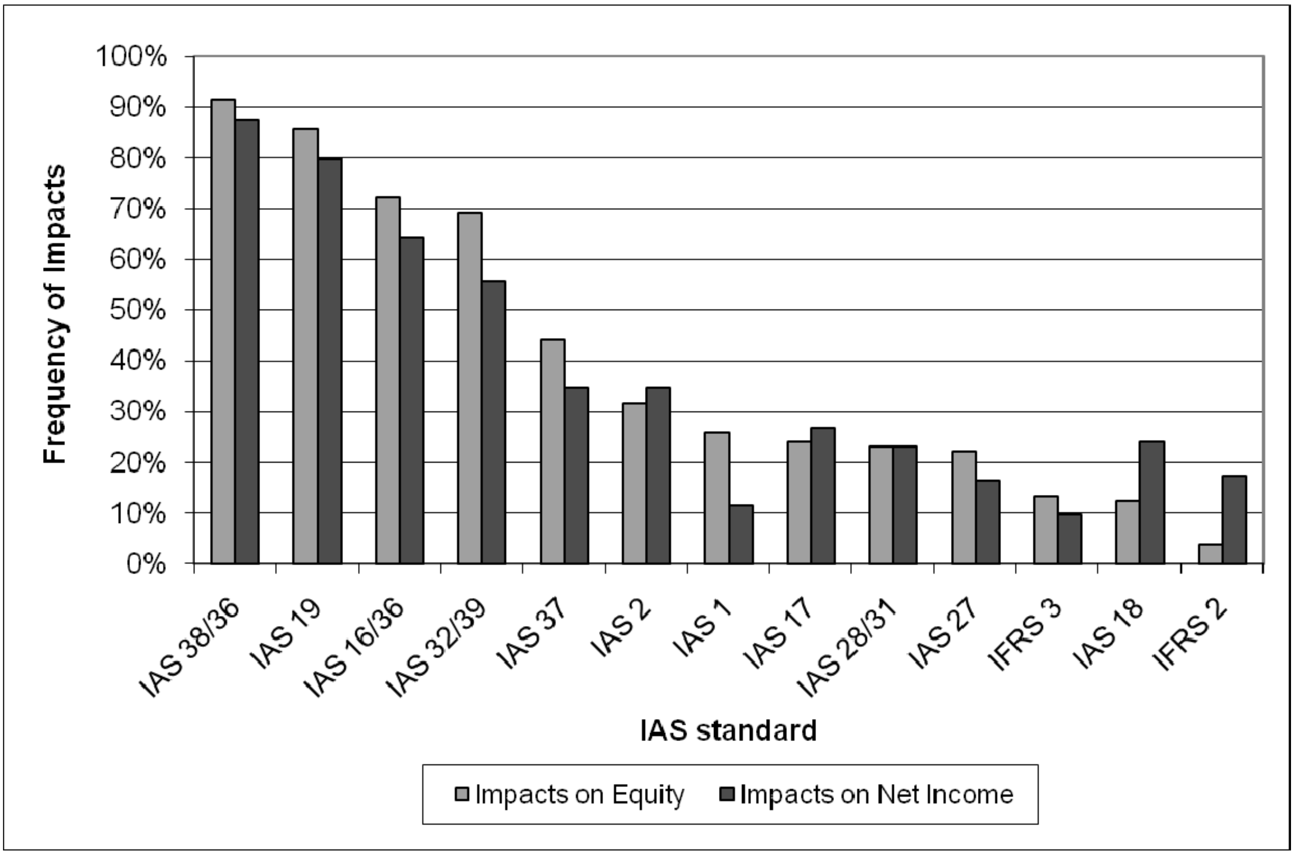
Average impact		**on E**			
		mean of abs. val.		**mean of +/- val.**	
Standard	**Description**	**m€**	**% on PN**	**m€**	**% on PN**
IAS 38/36	Intangible Assets	22,5	5,0%	15,6	3,5%
IAS 16/36	Property, Plant & Equipment	18,3	4,1%	12,1	2,7%
IAS 27	Consolidated and Separate Financial Statements	15,2	3,4%	6,7	1,5%
IAS 19	Employees benefits	10,3	2,3%	(8,3)	(1,9%)
IAS 32/39	Financial instruments	10,0	2,2%	(7,0)	(1,6%)
IAS 18	Revenue	8,9	2,0%	(8,3)	(1,9%)
IAS 37	Provisions, Contingent Liabilities & Assets	5,1	1,2%	0,4	0,1%
IAS 28/31	Investments in Associates / Joint Ventures	5,1	1,2%	1,6	0,4%
IAS 1	Presentation of Financial Statements (own shares)	3,8	0,8%	(3,6)	(0,8%)
IFRS 3	Business Combinations	2,7	0,6%	(1,3)	(0,3%)
IAS 2/11	Inventories	2,3	0,5%	1,6	0,4%
IAS 17	Leases	2,2	0,5%	(1,6)	(0,4%)
IFRS 2	Share-based Payment	0,1	0,0%	0,0	0,0%
IAS/IFRS	Total impact	40,7	9,1%	7,9	2,6%

Table 4 – Average impacts of each accounting standard on Net Income

Average Impact		on NI			
		mean of abs.val.		Mean of val. +/-	
Standard	**Description**	**m€**	**% on RN**	**m€**	**% on RN**
IAS 38/36	Intangible Assets	10,6	16,0%	9,9	14,9%
IAS 27	Consolidated and Separate Financial Statements	10,0	15,1%	9,2	13,9%
IAS 32/39	Financial instruments	7,2	10,9%	(6,7)	(10,2%)
IAS 37	Provisions, Contingent Li-abilities & Assets	3,7	5,6%	(1,8)	(2,7%)
IAS 18	Revenue	3,3	5,1%	(3,0)	(4,6%)
IAS 16/36	Property, Plant & Equipment	3,2	4,8%	0,6	1,0%
IAS 19	Employees benefits	1,2	1,9%	0,5	0,7%
IAS 2/11	Inventories	1,2	1,8%	1,0	1,6%
IAS 17	Leases	1,0	1,4%	(0,2)	(0,4%)
IFRS 3	Business Combinations	0,9	1,3%	0,6	0,9%
IAS 28/31	Investments in Associates / Joint Ventures	0,5	0,7%	(0,2)	(0,3%)
IFRS 2	Share-based Payment	0,2	0,3%	(0,2)	(0,3%)
IAS 1	Presentation of Financial Statements (own shares)	0,1	0,1%	0,0	0,0%
IAS/IFRS	Total impact	19,5	29,4%	10,2	15,4%

IAS/IFRS impacts are not negligible both on Equity and Net Income: in terms of absolute value, global average impact on Equity is 9,1%, and on Net Income is 29,4%. Taking into consideration +/- values it must be noticed that the impacts are still positive, but lower compared to the absolute value amounts, because of the balancing effect of impacts of opposite sign on different companies. The impact frequencies of each single standard on all the 160 companies of the sample are summarised in graphic 1 in form of histograms, in % values both on Equity and Net Income.

Graphic 1 – Frequency of impacts on different companies



Accounting standards which had a relevant impact on a significant number of companies, are the following: IAS 38, IAS 36, IAS 19 with frequency higher than 80%; IAS 16, IAS 32, IAS 39 with frequency higher than 50%. Here below IAS 16, IAS 17, IAS 36 and IAS 38 are investigated through the reading of financial statements explanatory notes, where the reasons for the various item adjustments due to the transition to international accounting standards are reported and described. Adjustments related to the adoption of IAS 16 and IAS 36 are mainly due to following reasons:

- according to Italian GAAPs, lands pertinent to buildings were depreciated together with the buildings themselves, while according to IAS/IFRS they must be classified separately and cannot be depreciated any longer;
- several companies decided to use the fair value method to evaluate property, plant and equipment, on the base of experts' reports, as allowed by IAS/IFRS: a significant change to the formerly used cost model;
- according to IAS/IFRS the initial value of an asset is made of its purchase cost plus all the directly attributable costs, including costs of dismantling/removing it at the end of its life and of restoring the site on which it is located (which were not included according to Italian GAAPs); charges on income statement of the capitalised assets must be made all along their useful lives through their depreciation;
- in order to fulfil the requirements of IAS 16 regarding the component approach, some assets have been analysed and classified into more proper asset classes;
- Italian GAAP compliant financial statements often use half of the annual depreciation rate for the first period of operation (in accordance with Italian tax regulations). This is not allowed by IAS/IFRS standards, which allow for only a monthly based approximation;

- several companies capitalised the improvement costs to leased third party assets, because such costs are referred to property, plant and equipment, as allowed by International accounting standards;
- the review of assets useful life required by IAS 16 caused a modification of the useful life of several plants and equipments.

Adjustments caused by the application of the financial methodology requested by IAS 17 in theory should have had a significant effect on leased property evaluation. The actual impact though was quite modest, both on Equity and Net Income, as suggested in the hypothesis. Adjustments to financial statements items caused by the adoption of IAS 38 and IAS 36 are due to the following factors:
- some costs, which do not meet the IAS/IFRS requirements, have been capitalised according to the Italian GAAPs;
- according to the international accounting standards, the goodwill has been assessed through an impairment test and the amortisation allowed by previous accounting standards was removed;
- according to Italian GAAPs, financial charges incurred to raise long term loans were classified among intangible assets. They were amortised on the base of the amount paid and the residual time to the expiration of the loan. IAS 38 doesn’t allow to classify these costs into intangible assets;
- IAS/IFRS standards require that brands and other intangible assets with an indefinite useful life must not be amortised, but their value must be reassessed at least yearly.

5. Conclusion

The impacts deriving from the transition to IAS/IFRS of Italian companies on their Equity and Net Income have been analysed and the reasons for those impacts have been investigated through reading financial statements explanatory notes. Results coming from empirical evidences are in line with hypothesis stated in paragraph 3; hypothesis number 3 is only partially verified, because it is true that there is a decrease of Net Income due to an increase of the annual property, plant and equipment depreciation reassessed at fair value, but the global impact on Net Income is positive thanks to other factors such as the component approach required by IAS 16, which allows for the application of different depreciation rates to different assets, with positive effects on costs when the rate is lower. There is a high increase of ROE (Return on Equity = Net Income/Equity), due to a relevant increase of Net Income (15,4% on average) against a modest increase of Equity (6,5% on average). Authors intend to expand this work, as a future evolution, through an integrated approach of empirical research, involving a survey targeted to listed companies belonging to specific industry sectors (furniture and fashion), in order to evaluate main differences and impacts generated by the use of the following international accounting standards: IAS 38 and IAS 36, with regards to the treatment of intangible assets.

References

Barth, M., Landsman, W. & Lang, M. 2008, "International Accounting Standards and Accounting Quality", *Journal of Accounting Research*, vol. 46, no. 3, pp. 467-498.

Cairns, D. 2006, "The Use of Fair Value in IFRS", *Accounting in Europe*, vol. 3, pp. 5-22.

Cantino, V. & Devalle, A. 2005, *Impatto degli IAS/IFRS sui processi gestionali*, Ipsoa, Milano.

Comoli, M., Corno, F. & Viganò, A. 2006, *Il bilancio secondo gli IAS*, Giuffré, Milano.

Daske, H., Hail, L., Leuz, C. & Verdi, R. 2008, "Mandatory IFRS Reporting around the World: Early Evidence on the Economic Consequences", *Journal of Accounting Research*, vol. 46, no. 5, pp. 1085-1142.

Delvaille, P., Ebbers, G. & Saccon, C. 2005, "International Financial Reporting Convergence: Evidence from three Continental European Countries", *Accounting in Europe*, vol. 2, pp. 137-164.

Epstein, B.J. & Mirza, A.A. 2006, *IFRS 2006: interpretation and application of International financial reporting standards*, John Wiley & Sons Inc., Somerset, NJ, USA.

Frankel, R., Li, X., 2004 "Characteristics of a firm's information environment and the information asymmetry between insiders and outsiders", *Journal of Accounting and Economics*, vol. 37-2, pp. 229-259.

Haller, A., Eierle, B. 2004, "The Adaptation of German Accounting Rules to IFRS: A Legislative Balancing Act", *Accounting in Europe*, vol. 1, pp. 27-50.

Hitz, J.M. 2007, "The Decision Usefulness of Fair Value Accounting – A Theoretical Perspective", *European Accounting Review*, vol. 16, No. 2, pp. 323-362.

Hopwood, A. 1994, "Some reflections on the harmonisation of accounting within the EU", *European Accounting Review*, vol. 3, no. 2, pp. 241-254.

Jermakovicz, E. K. 2004, "Effects of Adoption of International Financial Reporting Standards in Belgium: The Evidence from BEL-20 Companies", *Accounting in Europe*, vol. 1, pp. 51-70.

Lefebvre, F. 2007, *Principi contabili internazionali*. *Memento pratico*, IPSOA, Milano.

Leuz, C. 2003, "IAS Versus US GAAP: Information Asymmetry-Based Evidence From Germany's New Market", *Journal of Accounting Research*, vol. 41, no. 3, pp. 445-472.

Nobes, C. & Parker, R. 2004, *Comparative International Accounting*, Prentice Hall, Eight edition, London, UK.

Ormrod, P. & Taylor, P. 2004, "The Impact of the Change to International Accounting Standards on Debt Covenants: A UK Perspective"; *Accounting in Europe*, vol. 1, pp. 71-94.

Richard, J. 2004, “ The Secret Past of Fair Value: Lessons from History Applied to the French Case”, *Accounting in Europe*, pp. 95-108.

Soderstrom, N. & Sun, K. J. 2007, “IFRS Adoption and Accounting Quality: A Review”, *European Accounting Review*, vol. 16, No. 4, pp. 675-702.

Sucher P. & Jindrichovska, I. 2004, “Implementing IFRS: A Case Study of the Czech Republic”, *Accounting in Europe*, vol. 1, pp. 109-142.

Tokar, M. 2005, “Convergence and the Implementation of a Single Set of Global Standards: The Real-life Challenge”, *Accounting in Europe*, vol. 2, pp. 47-68.

Vellam, I. 2004, “Implementation of International Accounting Standards in Poland: Can True Convergence be Achieved in Practice?”, *Accounting in Europe*, vol. 1, pp. 143-168.