IFRS Implementation Mechanism in Pakistan: Opportunities and Challenges

Dr. Syed Zulfiqar Ali Shah*, Nousheen Tariq Bhutta
Assistant Professor, Lecturer and PhD Scholar,
Faculty of Management Sciences, International Islamic University, Islamabad, Pakistan.
Email: zulfiqar.shah@gmail.com, imaantariq@gmail.com

Abstract

One of the important requirements for operating a successful business is to implement a good financial reporting. During the last century, Accounting Bodies and Accounting Professionals across the world had tried to put harmonized financial reporting system. Many other economies have converged to IFRS in recent years. Due to this reasons Pakistan decided to implement a robust IFRS. This study analyzes the opportunities while implementing the IFRS in Pakistan. It addresses the IFRS procedure as well as merits for adopting IFRS. It also highlights the challenges faced by Firms, Regulators and Accountants while implementing IFRS in Pakistan. This study suggests some recommendations through which problems can be removed to great extent.

Introduction

Nowadays, investors make decisions, based on investment opportunities available around the globe. There is a need for uniform reporting framework for dealing in capital market world-widely. It would be difficult for investors to make investment decisions while considering different reporting system. Thus, the need for global reporting framework is generated while integrating the capital markets globally [1].On the contrary, due to higher transaction costs it is also a complex task for companies to accumulate their cash flows globally by presenting their financials in multiple reporting principles. Uniformity of accounting standards is very crucible determinant in value relevancy area due to reporting quality, which would improve the uniform disclosures and benefit to investor for better decision making [2].

Basically, this study is qualitative in nature, mainly constructed on the basis of prior studies and secondary information published in journals, newspaper and magazines while writing this manuscript.

Objectives

The objectives of this study have been presented in ensuing points:

- To discuss the IFRS adoption process in Pakistan
- To highlight the advantages adopted for IFRS
- To present the challenges faced by stakeholders while adopting the IFRS.
- To emphasize the solutions through which challenges can be resolved

* Corresponding Author

The presentation of this study is as follows. Section II highlights the major problems in financial reporting. Section III discusses the importance of reporting standards. Section IV emphasizes the previous literature. Section V depicts the financial reporting structure in Pakistan. Section VI presents the advantages of adoption of IFRS followed by challenges faced by stakeholders and last section presents conclusion and recommendations.

Major Problems in Financial Reporting: Globalization Perspective

Country-specific rules

Financial reporting is a key procedure for disclosure of financial information through annual reports. Generally, annual reports are prepared according to country specific rules; moreover, it depends upon companies whether public limited or private limited. However, financial reporting is very crucible for public limited company attributable to large public interest. As public limited companies issued shares which are traded on floor of stock exchange. Public limited companies accumulate funds while selling these shares. But it is challenge for company to keep its high or stable share price for gaining the attention of potential investors. Through annual reports investors can estimate the expected share price. Real share price are determined on the bases of market fundamentals however, it is probable to estimate share price while using some valuation models and statistical techniques [3].

Importance of Reporting Standards

Financial standards generally have accounting principles and policies used globally. However, every country sets its own accounting principles known as Generally Accepted Accounting Policies (GAAP). Other prerequisite imposed by accounting bodies, company's law and stock exchange. Company must abide these rules for better reporting quality, also take auditor report that shows that company followed all rules for maintaining their accounts [3].

However, the problems for uniformity of reporting principles around the globe arose, later solved by the establishment of International Accounting Standards Committee (IASC) in 1973.The basic aim of IASC is harmonization of accounting practices for accepted world widely. In 2001 IASC changed to IASB (International Accounting Standards Board) after implementing new structure [3].

With the establishment of International Organization of Securities Commission (IOSC) another milestone achieved for integrating the capital markets. The functioning of this commission is to regulate the stock exchanges around the globe [3].

Literature Review

Companies which adopted IFRS are less probable for income smoothing in post IFRS adoption period [4]. They enforced strict implementation mechanism for adopting of IFRS in emerging economies. There is positive reaction to IFRS adoption procedure [5]. Furthermore, IFRS authorization significantly diminishes the cost of equity for mandatory prerequisites [6]. This reduction was seen in those countries having strong legal enforcement like adoption of IFRS adoption has increased integration among them [7]. On the contrary, IFRS adoption would lead to worse reporting quality in German companies [8]. Similarly, adoption of IFRS impacts the performance of firms listed at London Stock Exchange [9]. It highlights that fair value orientation violates the income statement figures like IFRS adoption changes the magnitude of key accounting ratio of Finland companies [10]. They observed that changes in

accounting ratios and income statement figures are attributable to adoption of Fair Value adoption rules

Some researcher argued the IFRS adoption like large accounting firms transfer their economic resources where the public interest usually ignored [11]. Moreover, comparability of IFRS and local accounting standards is affected if both applied at same time [12]. Similarly, firms adoption IFRS experience more timely loss recognition, less earnings management and relevance of accounting numbers; furthermore, they evidenced improve accounting quality in pre and post IFRS period [13]. Similarly, Turkey faced many challenges while adopting the IFRS like complicated structure of IFRS standards, potential knowledge shortfalls and other problems in their application [14]

Comparatively, firms in Switzerland, Australia and Luxembourg usually have better corporate governance and transparent accounting policies as compared to European firms that usually have aggressive accounting and poor governance standards [15]. Similarly, IFRS adoption would enhance the market liquidity, lessen transaction cost for investors and cost of capital and facilitate capital flows [16]. Furthermore, IFRS adoption increases the accounting quality indicators like higher accruals quality, lower magnitude of absolute discretionary accruals and improved accounting quality [17] and rise in share price due to IFRS adoption impact on earnings [18].

Financial Reporting Structure in Pakistan

Previous studies argued that different methods of accounting adopted in subcontinent like they used Hindu accounting method but later they adopted Persian method in this area. Similarly, Bengali traders was used the double entry system. After the emergence of Pakistan in 1952 Pakistan Institute of Accountants (PIA).In 1959, accountancy department was established for dealing the accounting profession [20]. Later on Council of Accountancy was formed under auditor 'certificate rules. [3]

There are many accounting bodies established by Government of Pakistan, which regulate the accounting standards has been presented in ensuing points

- ICAP(Institute of Chartered Accountant Pakistan)
- SECP (Securities and Exchange Commission of Pakistan
- Karachi Stock Exchange, Lahore Stock Exchange and Islamabad Stock Exchange
- State Bank of Pakistan
- Company Ordinance 1984
- Code of Corporate Governance

ICAP is the only body that regulates the accounting within country. It issued 31 Accounting Technical Releases out of 19 were withdrawn. In 1974 Pakistan became a member of International Accounting Standards. After the adoption of accounting standards by superpower in 2005, EU issued notice for adoption of IFRS. There are 38 IFRS issued notified by SECP. [3]

Advantages for Adoption of IFRS

IFRS is an important tool for uniformity of accounting principles around the globe. Some advantages have been presented in ensuing paragraphs [21]

- **Better Access of Global Market**

Pakistan economy is growing due to which firms acquired around the world. It raised funds at cheaper rate available in Japan, America and European capital markets. To integrate these markets Pakistan have to maintain their accounts on the basis of IFRS.

Both functions i.e. accessing the capital market and funds available at cheaper rate can be possible while adopting the IFRS

- **Easier Global Comparability**

While accessing the capital markets, IFRS made it easier for the comparability across the economies. Stakeholders like investors and leaders might the financial statements for raising funds from overseas markets

- **Easy Cross Border Listing**

Pakistan firms are listed around the globe. Through maintain their financial statements; it is possible to access the cross border capital markets

- **Better Quality of Financial Reporting**

While adoption of IFRS financial statement prepared in better quality due to uniform application of accounting principles and rules.IFRS introduced a fair value concept that would beneficial for Pakistani companies for true valuation of their assets in their accounting disclosures.IFRS rules are easy to adopt, consistent and reliable attributable to better quality

- **Elimination of Multiple Reporting**

Many Pakistani firms registered in overseas countries therefore they prepared their statement according to the country .However, companies listed in Pakistan prepared their accounts according to Pakistan Accounting Rules. Adoption of IFRS rules the problem of multiple reporting was eliminated

Challenges in the Adoption of IFRS

Although there are some benefits while adopting IFRS however, it is complex task. Some challenges for IFRS adoption have been presented in ensuing paragraphs [21]

- **Awareness of International Reporting Practices**

IFRS have a complete set of accounting standards. To create awareness of all rules of IFRS to stakeholders like investors, bank, companies and stock exchange is really a complex task

- **Training**

Accountants, Government officials, Chief Executive Officers, Chief Information officers are accountable for adoption of IFRS rules; however to train these stakeholders are complex task due to lacking of accounting professionals and training facilities in Pakistan

- **Amendments to Existing Laws**

There are some laws specific to country but IFRS did not recognize these rules. Thus, accountants follow only IFRS with no amendments. However, few amendments have made for ensuring the smooth reporting of IFRS

- **Taxation**

IFRS adoption would impact the tax liabilities in financial statement. Necessary changes in tax laws have to be made otherwise it will duplicate the administrative work of companies

- **Use of fair measurement value**

IFRS uses fair value concept while evaluating the different assets in financial statement. As Pakistan uses historical cost method while preparing their financial statements, it would be a complex task for bringing it to fair value accountancy.

- **Financial Reporting System**

IFRS provide a complete set of accounting standards while preparing their financial statements. The amended reporting system should take care of new prerequisites of IFRS. There is a challenging for launching an effective control to avoid the business destruction at the time of transition

Conclusion

There is a need of effective control and enforcement mechanisms for ensuring a high quality of financial reporting. Moreover, Top management, directors, accountants, regulators and law market must play a vital role in implementation of IFRS by ensuring the financial statement prepared in compliance with IFRS and changing existing laws for adopting of IFRS.

Recommendations

There are few recommendations through which problems can be eliminated have been presented in ensuing points:

- Necessary amendments have to make in existing laws and in line with IFRS
- To establish a monitoring unit for better functioning of IFRS rules
- To train the government officials training programs have been started

References

1. Zarziski, M. (1996). "Spontaneous harmonization effects of culture and market forces on accounting disclosure practices", *Accounting Horizons*, Vol.10, pp. 18-37
2. Purvis, S., Gerson, H.,Diamond, M.(1991). "The IASC and its comparability project: Prerequisites for success", *Accounting Horizon*,Vol. 5,pp.25-44
3. Azeem, Muhammed and Kousar, Rehana. (2011). "International Accounting Standards and value relevance of Book value and earnings : panel study from Pakistan, *International Journal of Contemporary Business Studies*, Vol.2 ,No. 9, pp. 18-35
4. Zhou, Haiyan, Xiong, Yan, Ganguli, Gouranga. (2009)."Does The Adoption of International Financial Reporting Standards Restrain Earnings Management?:Evidence From An Emerging Market", *Academy of Accounting and Financial Studies Journal*, Vol. 13 (Special Issue) pp 43-56.
5. Armstrong, S, Christopher, Barth, E, Mary, Jagolinzer, D, Alan, Riedl, J, Edward. (2010). "Market Reaction to the adoption of IFRS in Europe", *The Accounting Review*, Vol. 85, No. 1, pp 31-61.
6. Siqi, Li.(2010). "Does Mandatory Adoption of International Financial Reporting Standards in the European Union Reduce the cost of Equity Capital", *The Accounting Review*,Vol. 85, No. 2, pp 607-636.
7. Cai, Francis and Wong Hannah, (2010). "The Effect of IFRS Adoption On Global Market Integration", *International Business and Economics Research Journal*, Vol. 9, No. 10, pp. 25-34.
8. Paananen, Mari and Lin, Henghsiu.(2009). "The Development of Accounting Quality of IAS and IFRS over Time: The Case of Germany", *Journal of International Accounting Research*, Vol. 8, No. 1, pp. 31-55.

9. Iatridis, George. (2010). "IFRS Adoption and Financial Statement Effects: The UK Case", *International Research Journal of Finance and Economics*, Vol. 38, pp.165-172
10. Lantto, Anna-Maija and Sahlströ m, Petri. (2009). "Impact of International Financial Reporting Standard adoption on key financial ratios", *Accounting and Finance*, Vol. 49, pp. 341-361
11. Chand, Pramod and White, Michael. (2007). "A critique of the influence of globalization and convergence of accounting standards in Fiji", *Critical Perspective on Accounting*, Vol. 18 , No. 5, pg 605.
12. Callao, Susana, Jarne, I, José, Laínez, A, José. (2007). "Adoption of IFRS in Spain: Effect on the Comparability and Relevance of Financial Reporting", *Journal of International Accounting Auditing & Taxation*, Vol. 16, No. 2, pp. 148.
13. Barth, E, Mary, Landsman, R, Wayne, Lang, H, Mark. (2008). "International Accounting Standards and Accounting Quality". Journal of Accounting Research, Vol. 46, No. 3, pg 467
14. Ali, Alp and Ustundag, Salim (2009). "Financial reporting transformation: the experience of Turkey", *Critical Perspective on Accounting*, Vol. 20, No. 5, pp. 680.
15. Steffee, S.(2009)."IFRS Discrepancies Vary by Country, Company", *The Internal Auditor*, Vol. 66, No. 4, pp. 13
16. Epstein, J, Barry. (2009). "The Economic Effects of IFRS Adoption", *The CPA Journal*, Vol. 79, No. 3, pp. 26-31.
17. Chen, Huifa, Tang, Qingliang, Jiang, Yihong, Lin, Zhijun (2010). "The Role of International Financial Reporting Standards in Accounting Quality: Evidence from the European Union", *Journal of International Financial Management & Acco*unting, Vol. 21, No. 3, pp. 220
18. Devalle, Alain, Onali, Enrico, Magarini, Riccardo .(2010). "Assessing the Value Relevance of Accounting Data after the Introduction of IFRS in Europe", *Journal of International Financial Management & Accounting*, Vol. 21, No. 2, pp. 8
19. Gladwin, F. (1796). "A compendious system of Bengal Revenue", 2nd edition, Calcutta,179
20. Himalton, A. (1798). "Art II. A history of inventions and discoveries",*Monthly Review*, part 6.
21. Jain, Pawan. (2011). "IFRS Implementation in India: Opportunities and Challenges". *World Journal of Social Sciences*, Vol. 1. No. 1.pp.125-136