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Adoption of IFRS around the World and the Lack of Clear Audit Reports on the Issue

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Adoption of IFRS around the World and the Lack of Clear Audit Reports on the Issue

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ABSTRACT

It is widely believed that International Financial Reporting Standards (IFRS) have been adopted in many countries, at least for the consolidated reporting of listed companies. However, in nearly all cases, what the rules require is some national or supranational version of IFRS. This vexed the Securities and Exchange Commission (SEC) while it was deciding whether to accept IFRS from foreign registrants. We examine what companies and auditors report concerning compliance with IFRS, focussing on the first full year of IFRS reporting by companies in the stock market indices of four major European countries and Australia. We find that, even when companies were complying with IFRS, they were generally not saying so, which seems to miss the point of the 35-year project on international harmonization. In a small number of cases, auditors provided dual reports: on full IFRS in addition to the mandated reference to national GAAP where the latter corresponds with full IFRS. These cases were found only in Germany and the UK, and mainly related to companies that filed with the SEC as foreign private issuers. We propose explanations for the general lack of dual reports and for the exceptions. We call for widespread adoption of dual reporting where a plain report on IFRS is not yet possible.
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INTRODUCTION

In 1976, Sir Henry Benson\(^1\) said that he foresaw the “dominating importance” of international accounting standards “by about the year 2000” (Benson, 1976). Perhaps his listeners thought that this was a forgivable, but gross, exaggeration that was to be expected from the founding chairman of the International Accounting Standards Committee (IASC). However, the European Union’s (EU’s) Regulation (EU, 2002), concerning the compulsory use of IFRS from 2005, moved us a major step towards the goal. With the announcements of 2007 from the SEC accepting international standards (IFRS) for foreign registrants and perhaps for all registrants, Benson’s dream is coming true.

As part of assessing whether IFRS should be accepted without reconciliation to US GAAP, the SEC expected to be able to review several hundred sets of IFRS financial statements from 2005 onwards. However, as Commissioner Campos of the SEC complained,\(^2\) only about 40 filings straightforwardly affirmed compliance with IFRS were received. Many said they complied with “IFRSs as adopted by the EU”; others said they complied with national rules, which, they said, corresponded with IFRS. Even in those cases where compliance with full IFRS\(^3\) was almost certainly being achieved (e.g. in Australia), the audit report did not say so in 2005/6.

The central purpose of IFRS is that users all around the world can better compare company financial statements, so that the cost of capital falls because information risks are reduced. Decades of effort have been made towards this end. It

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1. Later Lord Benson. Henry Benson was the great nephew of the Cooper brothers, as in PricewaterhouseCoopers.
3. By this, we mean IFRS as issued by the IASB.
will not be achieved merely because statements are internationally comparable but only when users understand and believe that they are comparable. It is startling that many companies have been complying with full IFRS but not feeling it necessary to say so, and therefore not reaping the full rewards. The Canadian securities regulators and the International Organization of Securities Commissions (IOSCO) have both commented\(^4\) on the expected incremental benefits to investors of clarity on this subject.

We have two main objectives in this paper. First, we survey major capital markets in order to identify where IFRS is required or where, instead, some local version of IFRS is required. We find that direct application of IFRS is required in only one major capital market. Given the rarity of direct application of IFRS, it becomes important for users to be alerted to the accounting rules being used. This leads us to our second objective. We examine audit reports with respect to IFRS for all the companies in the main stock indices of the world’s five largest capital markets that require IFRS. We find little reporting directly on IFRS.

Given the “commentary” nature of this paper, we do not provide a full literature review. We refer throughout to literature (both regulatory and academic) as needed. However, we note here that there is a mass of literature on related issues such as IFRS adoption for unlisted companies or unconsolidated statements (included in the coverage of Larson and Street, 2004), transforming IFRS into domestic law (e.g. Haller and Eierle, 2004), or non-compliance with IFRS (e.g. Street, Gray and Bryant, 1999).

\(^4\) OSC (2008), Section 3; IOSCO (2008) refers to “risk of investors making investment decisions without a full understanding”.
The paper proceeds as follows. First, we investigate the legal and political backgrounds to our issues. We then survey the degree to which IFRS has been adopted or adapted in major capital markets. Next, we distinguish between adoption of IFRS and convergence with it, and examine major countries in that light. We then look at the rules relating to reporting on IFRS by management and auditors. Then we report on audit practice in five major countries, and try to explain it. Finally, we offer some conclusions and policy recommendations.

THE INFLUENCE OF POLITICS

Much of the progress on harmonization since the 1970s has been affected by politics. The re-unification of Germany in 1990 was a key political factor contributing\(^5\) to the use of “foreign” accounting rules (US GAAP and IFRS) by large German companies from 1993 onwards (Nobes and Parker, 2004, pp.86-92; Camfferman and Zeff, 2007, ch.10). This openness to international standards by Germany and other EU countries enabled the EU Regulation that requires IFRS for the consolidated statements of listed companies.

Politics also dominated the negotiations on setting up the IASC’s successor, the International Accounting Standards Board (IASB) which began work in 2001 (Camfferman and Zeff, 2007, ch.13; Kirsch, 2006, ch.10). Put simply, there was a battle between the EU and the SEC over the structure of the IASB, with a victory for the SEC. However, the EU’s Regulation made it the largest “customer” for IFRS which led the EU to seek more influence over the IASB (e.g. European Parliament, 2007). Its perceived lack of influence probably played a role in leading the EU to create the “endorsement mechanism,” as envisioned from the earliest announcements relating to EU use of IFRS in June 2000, whereby new or amended IFRS must be

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\(^5\) Post re-unification capital shortages and expansion opportunities were one of the reasons for the need to access international capital markets.
approved by a legal (and, therefore, political) mechanism (Whittington, 2005). This always adds a delay between an IFRS being approved by the IASB and it being endorsed by the EU. Sometimes the delay can last a year. In a few cases, standards or interpretations (or parts of them) have not been endorsed, the most conspicuous example relating to the hedge accounting rules in IAS 39 (Whittington, 2005; Zeff, 2006).

Another cause of delay (in the EU and elsewhere) is that IFRS must be translated from the official English version. These versions have legal authority in their respective countries. Although this process is a necessary part of spreading IFRS across the world, it is bound to lead to translation errors and ambiguities (e.g. Nobes, 2006a).

Further political issues in the USA have been relevant. The Enron/Andersen debacle of 2001/2 undermined the US position internationally at a critical moment in the development of the IASB. The Sarbanes-Oxley Act, coming after Enron/Andersen, has made US exchanges so unpopular for foreign registrants that London is now the preferred destination for new issues. As part of redressing that, the long-run campaign of the New York Stock Exchange to get IFRS accepted for foreign SEC-registrants was given impetus.

These political developments are the background both to the convergence program agreed between the IASB and the FASB in 2002, and to the SEC’s rule and concept release of 2007 concerning the acceptance of IFRS. The rule concerns the
acceptance without reconciliation of financial statements from foreign registrants that are in accordance with “IFRS as issued by the IASB” (SEC, 2007, Section A.III.2). The concept release concerns the possibility of accepting IFRS from domestic registrants.

The issue binding the above points together is whether it is the private sector or the public sector that controls the content of accounting rules. This debate has a long history (e.g. Benston, 1976; Zeff, 1995). Even in the UK, with its tradition of private regulation, there has always been a legal context into which accounting standards are set. In many jurisdictions, the state takes a closer interest in financial reporting, especially that by listed companies. So, for example, the authority of accounting standards in the US rests entirely on the SEC. In continental Europe, private sector standards are an invention of less than ten years ago in some countries (e.g. France and Germany). The EU’s institutions continue a long continental tradition of reluctance to cede control to the private sector.

This has made for a difficult relationship between the EU and the IASB and its predecessor (e.g. Camfferman and Zeff, 2007, pp.418-422). Recently, in addition to the European Commission, the EU Parliament has felt the need to engage in the endorsement process and also demanded greater public accountability from the IASB (European Parliament, 2007).

The issue can be summarized by contrasting the acceptance by regulators of the process of standard setting as opposed to assessing individual standards. This was a major issue in the 1990s when the IASC was seeking to persuade IOSCO to endorse the process of setting international standards (Camfferman and Zeff, 2007, ch. 10).
In the US, the SEC gives its support\textsuperscript{11} to the FASB rather than endorsing standard-by-standard. Similarly, in Canada and the UK, accounting standards are absorbed in various ways into a legal context without individual endorsement (Parker, 1991).

It would appear that the SEC is considering the acceptance of IFRS in the same way that it accepts the standards of the FASB. That is, it is considering acceptance of the process. By contrast, the EU has not done that and, with the recent involvement of Parliament, has moved further away from it.

**ADOPTION OR CONVERGENCE?**

It is important to distinguish between adoption of IFRS and convergence with IFRS. Adoption (whether of process or of content) means that IFRS are used instead of domestic financial reporting rules. This might apply in certain countries for all companies or for some of them. It might apply compulsorily by law or \textit{de facto}. An example of the former is that, in South Africa, domestic standards no longer apply to listed companies.\textsuperscript{12} Instead there is a requirement\textsuperscript{13} to comply with IFRS and therefore for directors and auditors to report on that basis (\textit{de jure} adoption). An example of \textit{de facto} adoption is the use of IFRS by many Swiss listed companies\textsuperscript{14} for their consolidated statements. The issue of whether financial statements really have complied with IFRS is important but beyond our scope.

In contrast to adoption, convergence with IFRS is a \textit{process}, whereby domestic standards and IFRS are gradually brought into line. That is, part of the convergence could be achieved by changes to IFRS. Indeed, various different

\textsuperscript{11}The SEC no doubt influences the FASB’s considerations, as do others, and the SEC’s staff makes known its own interpretations on various issues, e.g. Staff Accounting Bulletins. However, the SEC allows the FASB to issue standards in its own right.

\textsuperscript{12}Unlisted companies use national standards based very closely on IFRS.

\textsuperscript{13}The listing requirements (para. 8.62) of the Johannesburg Stock Exchange require financial statements from 2005 onwards to comply with national law and with IFRS.

\textsuperscript{14}The Swiss Exchange’s Directive on Requirements for Financial Reporting (as revised on November 1, 2006) allows several GAAPs, including IFRS and US GAAP.
countries might be able to contribute good answers to technical problems. However, extensive multilateral convergence is impossible, because converging with one country would mean diverging from another. Because of the economic importance of the US capital markets and because of the importance of securing the acceptability of IFRS to them, convergence in the case of the US has meant moving both IFRS and US GAAP towards each other. However, convergence with the Accounting Standards Board of Japan (ASBJ, 2006), for example, may effectively mean changes to Japanese standards.

In 2007, a new series of accounting standards came into force in China for listed companies (Deloitte, 2006). These remove many of the previous differences from IFRS; so this was a further example of one-sided convergence.

The remarkable point that we now investigate is that nearly all the famous examples of alleged adoption of IFRS do not strictly satisfy our definition of de jure adoption. As noted in the Introduction, this can be an important issue, especially for foreign users of financial statements. To our knowledge, the only consequential capital market that requires the use of IFRS as issued by the IASB is South Africa.

**THE ADOPTION THAT NEVER WAS**

As explained above, although the EU has brought virtually all of the content of IFRS into force for various purposes, it is not exactly IFRS as issued by the IASB that is required. For example, in France, what is used for consolidated reporting by listed companies is the French language version of the IFRS as endorsed in the EU by a particular date. A quite separate point is that, in many countries outside of North America, companies are required to publish unconsolidated statements of each legal entity, so that there are hundreds of such sets of financial statements produced by large groups, whether the top company is listed or not, and by entities that are not part
of a group. Such reporting is not allowed to use IFRS in France, although it is in the UK. This complexity is noted elsewhere (e.g. Haller and Eierle, 2004; Nobes, 2006b, pp.272-275) but is outside the scope of this paper.

Another high-profile version of “adoption” is that of Australia, where the law still requires Australian standards to be followed by reporting entities. The Australian Accounting Standards Board (AASB) takes IFRS and turned them into Australian standards. However, the AASB initially made numerous amendments to IFRS, to delete options, to add disclosure requirements and to include requirements for public sector entities. For example, IAS 31 contains an option to use proportionate consolidation, whereas AASB 131 did not. Nevertheless, it could therefore be claimed that compliance with Australian standards would also achieve compliance with IFRS. This approach was abandoned in 2007, and Australian standards are now based exactly on IFRS, except for amendments relating to public sector entities.

This was proposed by the Accounting Standards Board as the position for Canada when IFRS is brought into force in 2011 (OSC, 2008, Appendix). That is, IFRS would not exactly be “adopted” but incorporated into the Handbook of the Canadian Institute of Chartered Accountants, which is imposed on companies by the corporations and securities laws. However, such a process involves the need, as in Australia, constantly to turn IFRS into national standards and it means that time lags occur, as noted earlier. It also reduces the clarity, for foreigners, of whether or not IFRS is being complied with. Partly for this reason, the securities regulators in Canada have begun consulting on a more direct approach to IFRS adoption.

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15 Listed companies and some others.
16 The IASB proposed to delete the option in an exposure draft of 2007.
17 By AASB 2007-4.
In some other jurisdictions that claim to put IFRS into national regulations, e.g. Singapore, there is not only a potential for lags but also a series of differences.\textsuperscript{19} Similarly, in China, where the new standards of 2007 came close to IFRS, there are some differences and more might arise as the IASB changes its standards. Of course, in these and other countries, certain companies choose to publish an additional set of financial statements that comply with IFRS for various purposes, including foreign listings.

\textit{DE FACTO ADOPTION}

Even where there is no direct adoption \textit{de jure} of IFRS (i.e. in nearly all jurisdictions), it is in some cases possible or inevitable for a company to comply with IFRS. It is (and was) apparently inevitable in Australia, assuming compliance with the rules and no delays in turning new IFRS into Australian standards. It is also achieved in the EU, assuming that a company does not wish to take advantage of the more lax hedge accounting rules in the EU version of IAS 39. A survey (ICAEW, 2007, p.78) suggests that this issue affects only non-UK banks. The possibility of EU compliance also assumes that there are no relevant implementation lags. For example, for EU companies with September 30, 2007 year ends, this would have meant complying with IAS 14 rather than IFRS 8 for segment reporting. Only IAS 14 was EU-endorsed at the date, and it was still optional IFRS in 2007. However, unendorsed IFRS can be followed in the EU if it does not conflict with endorsed IFRS.

As mentioned earlier, where law is permissive, such as in Switzerland, \textit{de facto} adoption of IFRS is also possible.

\textsuperscript{19} For example, in the case of Singapore, there are differences in effective dates for IAS 40, IFRS 2, and IFRS 7; and IFRIC 2 (effective 2005) has not been adopted as we write in April 2008. Malaysia and the Philippines also have a series of differences from IFRS. We are grateful to Paul Pacter for this information.
WHAT SHOULD THE REPORTS SAY?

So far, we have established that IFRS (as issued by the IASB) is only directly required in very few jurisdictions, but that it might be complied with in many. We now ask what the management and auditors should state in these many jurisdictions.

Where the requirement is for a national adaptation of IFRS or for national standards based on IFRS, the management and auditors have to refer, *inter alia*, to whatever the legal requirement is. In the case of EU audit reports, the exact wording was discussed by the *Fédération des Experts Comptables Européens* (FEE),\(^\text{20}\) which originally recommended “… in accordance with IFRSs as adopted for use in the EU.” This was turned into a recommendation in the UK and Ireland by the Auditing Practices Board (2005). However, after discussion at the Accounting Regulatory Committee\(^\text{21}\) of the European Commission, the “adopted for use in the EU” was replaced by “adopted by the EU,” in order to suggest that such reports should be acceptable outside the EU (e.g. in Washington). This formulation (hereafter called “EU-IFRS”) can be found in the final version from FEE (2005), which also contained translations into 20 European languages, and in APB (2006). The change of mind led to some variety in audit reports, as explained in the next section.

In Australia and various Asian jurisdictions, management and auditors must refer to compliance with national law and standards, even if they are based closely or exactly on IFRS. So, given the widespread *de facto* compliance with IFRS, can the management and auditors refer additionally to IFRS, and do they do so? We know of no reason why management and auditors cannot add to their statements by referring also to IFRS in the many cases where this *de facto* compliance is achieved, although in some countries there are disadvantages, as explained below. For ease of reference,

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\(^{20}\) FEE is a professional body representing European auditors.

\(^{21}\) See the “Draft Summary Record” of the meeting of ARC on November 30, 2005 at http://ec.europa.eu/internal_market/accounting/docs/arc.
we call this “dual IFRS reporting.” We restrict this term to references to both full IFRS and another version of IFRS in the statutory financial statements. However, it can come in two forms: two separate opinions, or references both to IFRS and to a version of IFRS in one opinion (perhaps in the same sentence). We do not consider it to be dual reporting when companies or auditors refer to IFRS and to a legal framework, for example, “in accordance with IFRS, and in the manner required by the Companies Act” in the case of South Africa. Another issue (see below) is whether there is another statement or report somewhere else, e.g. in a Form 20-F deposited with the SEC.

Under IAS 1 *Presentation of Financial Statements* (para. 16),\(^{22}\) management cannot claim compliance with IFRS unless it complies with all requirements. More subtly, a proposed amendment to IAS 1 of September 2007 adds a requirement concerning the case where a company “refers” to IFRS but does not fully comply. The amended IAS 1 would require such a company to describe the differences between its reporting and IFRS. Since, in this case, the company is not complying with IFRS, it is hard to see why it should necessarily comply with this new requirement.

In conclusion, there is no impediment to dual IFRS reporting by management if compliance with full IFRS is achieved. Under International Standards on Auditing,\(^{23}\) dual reporting by auditors is allowed where financial statements comply simultaneously with two frameworks. The SEC (2007, Section III.A.2) confirms that it also sees no impediments.

Dual reporting is not a new idea. For example, some US managements asserted compliance with US GAAP and with “International Accounting Standards”

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\(^{22}\) As revised in 2007.

\(^{23}\) International Auditing Practice Statement 1014 of March 2003.
in the 1980s and early 1990s (Camfferman and Zeff, 2007, pp.156-57, 249). In some cases, e.g. Salomon Inc., the auditor also dual reported. This was the case for Microsoft in 1996 and 1997. Especially from 1995, international standards became less permissive, and simultaneous compliance was increasingly difficult to achieve.

**WHAT DO THE REPORTS SAY?**

In the countries where a version of IFRS is required, dual IFRS reporting by auditors has been rare. We have surveyed the audit reports of all the companies in the main stock indices in Australia, France, Germany, Spain, and the UK for 2005/6 (255 companies in all). These were the largest stock markets for which IFRS was required at that date. Our data relate to reports of 2005/6, which was generally the first year of compulsory IFRS reporting, and was also the most recent year for which a full set of reports was available. In some cases, we comment also on 2006/7 reports. Because a few companies use foreign accounting (eg US GAAP), the numbers of companies surveyed is slightly smaller than the numbers in the indices. The largest such reduction relates to Germany where seven of the DAX 30 used US GAAP, which was still allowed by the EU Regulation, under various conditions, for 2005 and 2006.

For all the 255 companies, we examined the audit reports to see whether the opinion related to “local” IFRS only or to full IFRS as well. Of the five countries that we examined in detail, only Germany and the UK produced examples of dual IFRS reporting by auditors. In the latter, 17 out of the 99 companies dual reported. In

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24 Several options were removed from international standards in 1993, with effect from 1995.
25 We examined the English language reports in all cases where these were available. However, we looked at the original language reports when necessary to resolve doubts.
26 Respectively, the ASX 50, CAC 40, DAX 30, IBEX 35, FTSE 100 as in June 2007.
27 By market capitalization, according to www.world-exchanges.org/publications/EQU1107.
28 That is, IFRS with various provisos as explained above.
29 That is, we looked at the earliest reports for accounting years beginning on or after January 1, 2005.
30 For example, companies with November year ends did not produce their second IFRS reports until 2008.
31 We used the same companies as for 2005/6 in each case.
nearly all cases, the management reported in the same way as the auditors, i.e. not referring to full IFRS except where the auditors did. However, in the case of BG, for example, the management dual reported but the auditors referred only to EU-IFRS.

In Germany, five companies\(^{32}\) out of the 23 IFRS reporters (22\%) had dual IFRS audit reports. Where there was a dual audit report, the reporting by the management in accounting policy notes was varied: for example, Hypo Real Estate’s management referred to the two bases, Henkel’s to IFRS only.

In France and Spain, the audit reports uniformly referred only to EU-IFRS, both in the annual reports and in the Forms 20-F of the companies listed on US exchanges.\(^{33}\)

A published survey of IFRS practice in Europe (ICAEW, 2007, Ch. 8) sheds further light on EU practices. However, it studies 200 listed companies of all sizes across the whole of the EU for 2005/6. So, our sample size for our four EU countries is larger and more homogeneous in terms of size. It is therefore difficult to compare results. The ICAEW finds examples of references to IFRS only, to EU-IFRS only, and to dual IFRS reporting. However, it concentrates on management rather than auditors, and does not note that the auditors sometimes dual report when the management do not, or vice versa. The ICAEW finds some dual reporting by management in countries other than the UK and Germany. In percentage terms, this is the highest in the Netherlands (ICAEW, 2007, p.76).

We noted earlier that the approved wording in the EU is “IFRSs as adopted by the EU.” However, in the UK, all of the Deloitte reports and two PwC reports\(^{34}\) refer to “IFRS as adopted for use in the European Union,” which was the rejected draft

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\(^{32}\) Henkel, Hypo Real Estate, Linde, Lufthansa, and ThyssenKrupp.

\(^{33}\) For example, Alcatel Lucent, AXA, and Total from France; and Banco Santander, Endesa, and Telefónica from Spain.

\(^{34}\) Kingfisher and Schroders.
wording. A KPMG report\textsuperscript{35} refers to “adopted IFRS” without saying who has adopted it. Nearly all this is corrected for the 2006/7 reports, except for a few\textsuperscript{36} Deloitte reports.

In Australia, for 2005/6 reports (mostly years ending June 30, 2006), the auditors uniformly reported on “Accounting Standards in Australia.” By contrast, directors generally referred to “Australian Accounting Standards which include Australian equivalents to International Financial Reporting Standards.” Of course, the companies would have affirmed compliance with IFRS in the footnote required by IAS 1. These findings are also the case in the Forms 20-F of those few\textsuperscript{37} Australian companies that were SEC-registered. Indeed, the auditors of SEC-registered companies of all the countries except Germany (see below) generally did not dual report in Form 20-F unless they had done so in the annual report.

**SOME EXPLANATORY FACTORS**

As noted earlier, the widespread failure to assert compliance with IFRS when compliance has probably been achieved seems to miss an important part of the point of 35 years’ worth of effort on international harmonization. What explains this, what explains the few exceptions, and is the position changing?

We suggest that the explanation for the lack of reference to full IFRS in 2005/6 is prosaic: companies and auditors increasingly do merely what they are required to do by regulation. Reporting and auditing are now largely seen as part of “compliance,”\textsuperscript{38} rather than being seen as a useful commercial or professional activity. The rules are now more detailed (2600 pages of IFRS) and the enforcement

\textsuperscript{35} Scottish and Southern Energy.

\textsuperscript{36} For example, the reports on Vodafone and Shire refer again to “use in.” Not all audit reports on this second year were available at the time of writing.

\textsuperscript{37} The only Australian-index companies on the New York Stock Exchange (on December 14, 2007) that used Australian standards were Alumina and Westpac. BHP Billiton used EU-IFRS, and James Hardie used US GAAP.

\textsuperscript{38} With which we include avoidance of litigation.
more strict (e.g. CESR, 2007) so that there is little incentive to think or act beyond the rules.

The examples of auditors’ dual reporting are, in a sense, easy to explain. The 17 UK dual IFRS reporters are mostly (i.e. except for three) “foreign private issuers” (FPIs) in the United States. Table 1 shows the figures. It is necessary here to distinguish between two types of foreign private issuers in the context of the SEC: (i) those with only Level I American Depositary Receipts, and (ii) those that are listed. The former can trade their securities over-the-counter only and have minimal reporting requirements. The latter must register with the SEC, including (until the changes of 2007) filing US GAAP reports or reconciling to US GAAP on Form 20-F.

The use of dual IFRS reporting by FPIs is an example of how greater clarity for foreign investors could be a motivation for wanting an audit opinion that refers to full IFRS. In two cases, this explanation is particularly obvious, because the second opinion, on full IFRS, is headed “US opinion” even in the UK annual report. The UK’s Auditing Practices Board specifically notes the possibility of a dual report, and expresses a preference for two clearly separate opinions (APB, 2006, para. 8). This is generally the approach of UK auditors, whether or not the IFRS opinion is headed “US opinion.” Discussions with the Big-4 audit firms in the UK confirm that a dual report would generally have been easy to provide. This is confirmed by more formal evidence to the SEC (2007, III, A, 2).

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39 Royal Bank of Scotland and Vodafone. In the case of Royal Bank of Scotland, there are three opinions: EU-IFRS, IFRS, and US opinion on IFRS.
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As Table 1 shows, 12 out of the 17 UK dual IFRS audit reports (71%) were written by Deloitte, which is disproportionately large for its share of FTSE 100 companies (17%) or of FPIs.\(^{41}\) None of the dual reports were by KPMG, although the firm was not opposed in principle to giving them.\(^{42}\) We believe that the predominance of Deloitte can be explained by the deliberate policies of the firms. Only Deloitte expressed\(^{43}\) a clear view in favor of dual reporting.

However, we cannot explain\(^{44}\) why the three\(^{45}\) companies of the 17 that are not FPIs had dual audit reports. Two different audit firms were involved.

\(^{41}\) For example, 22 of the FTSE 100 companies were listed on the New York Stock Exchange (on December 17, 2007). Of these, only 4 were audited by Deloitte; 10 by PwC, 6 by KPMG, and 2 by Ernst & Young.

\(^{42}\) Correspondence with Mary Tokar (IFRS partner, KPMG) on August 24, 2007.

\(^{43}\) Martyn Jones (UK Audit Technical Partner) reports that they had been “pushing it strongly … from the beginning” (correspondence of January 15, 2008).

\(^{44}\) We have written to the finance directors of the companies. We have received two replies. One does not explain the decision to seek a dual report except that it shows an awareness that IFRS and EU-IFRS were potentially different. The other reply suggests that the company’s investors were aware of uncertainty in 2005 about endorsement but are less interested now, such that dual reporting has been dropped. The company also confirmed that the dual report had created no problems for its auditors.

\(^{45}\) Capita, Daily Mail, and Hammerson.
Furthermore, there are many other UK companies that are FPIs or even fully SEC-registered which did not dual report.\textsuperscript{46}

As an example of the confusion in this area, the journal of the Institute of Chartered Accountants in England and Wales reports that only 11 of the FTSE 100 companies reported on full IFRS and that this shows how many companies would be affected by the SEC’s proposal to accept only full IFRS (Accountancy, 2007). In addition to having a smaller count from us,\textsuperscript{47} this is wrong because most of the remaining 89 companies are not SEC-registered and so would not be affected. Furthermore, nearly all the companies are probably already complying with full IFRS and merely need to ask their auditors to affirm that.

In the case of Germany, it was noted above that five DAX companies provided dual IFRS audit reports. More detail is given in Table 2. As may be seen, there were 24 FPIs in the DAX. Of these, seven were using US GAAP, as then permitted by the German adaptation of the EU Regulation. Three others were dual reporters (Henkel, Hypo Real Estate, and Lufthansa). The remaining 14 FPIs (e.g. Adidas, Allianz, and Commerzbank) neither used US GAAP nor had a dual audit report. Surprisingly, in addition to the above three FPI dual reporters, another two (Linde and ThyssenKrupp) which were not FPIs did dual report. Of the five dual IFRS reports, four were written by KPMG and one by PricewaterhouseCoopers, quite a different result from the UK position in Table 1.

The partial explanation for the majority usage of EU-IFRS in Germany even for FPIs is that most of the FPIs (including all the dual reporters) were Level I only and not required to use US GAAP or to reconcile to it. The only DAX companies

\textsuperscript{46} For example, the SEC lists 40 FTSE companies as registered at December 31, 2005 but only 7 of them had dual audit reports.

\textsuperscript{47} We find 14 dual reports for 2006/7.
with full SEC registrations that neither used US GAAP nor dual reported were Allianz,\textsuperscript{48} BASF, Bayer, and Deutsche Telekom. The first three of these\textsuperscript{49} had EU-IFRS reports in their annual reports but IFRS reports in Form 20-F. Deutsche Telekom had EU-IFRS reports in both places.

In Germany and Austria, there is a particular legal reason for restricting an audit assignment in the annual report to EU-IFRS: the legally required audit opinion (reference to EU-IFRS) activates a cap on auditor liability. In Austria, for example, the \textit{Unternehmensgesetzbuch} limits the liability of auditors when operating within its legal framework, i.e. in the context of EU-endorsed IFRS. An audit report relating to anything else (e.g. full IFRS) would not enjoy a liability cap, except by separate negotiation.\textsuperscript{50} This is also the position for Germany.\textsuperscript{51} It means that a report on full IFRS would be riskier for auditors and therefore costlier for companies. A further complication is that the SEC requires auditors to use US generally accepted auditing

\begin{table}
\caption{DAX companies: to which GAAP do auditors refer (2005)?}
\label{table:gaap}
\begin{tabular}{|l|c|c|c|}
\hline
\textbf{Audit reference} & \textbf{SEC-registered} & \textbf{Other FPI} & \textbf{Not FPI} & \textbf{Total} \\
\hline
US GAAP & 7 & - & - & 7 \\
Dual IFRS & - & 3 & 2 & 5 \\
EU-IFRS & 4 & 10 & 4 & 18 \\
Total & 11 & 13 & 6 & 30 \\
\hline
\end{tabular}
\end{table}

\textsuperscript{48} Allianz is unusual in another way: it is an S.E. (a \textit{Societas Europaea}, a European public company); so in principle it is European, not German.
\textsuperscript{49} BASF had an EU-IFRS report in its German language annual report but an IFRS report in its English language document.
\textsuperscript{50} We are grateful to Gerhard Prachner (PricewaterhouseCoopers, Vienna) for this information.
\textsuperscript{51} We are grateful to Alfred Wagenhofer for this information (correspondence of December 5, 2007).
standards rather than International Standards on Auditing as used in the EU, so a separate opinion for SEC purposes is anyway necessary.

Another potential\textsuperscript{52} explanation for avoiding a dual IFRS report in the EU is that EU-IFRS could, in the future, depart further from IFRS such that simultaneous compliance might become more difficult. To avoid the embarrassment of having later to drop the reference to full IFRS, it would be better never to make it

**IS THE POSITION CHANGING?**

The remaining question from above is whether the position is changing. We found a slight decrease in the number of dual IFRS audit reports for 2006/7 compared to 2005/6.\textsuperscript{53} The position has changed in another way for foreign registrants of the SEC for 2007 reports onwards. At least for their SEC filings, their auditors will have to report on full IFRS if they wish to avoid reconciliation. Given that these auditors will have specifically to address the issue of full IFRS conformity in the audit reports designed for the SEC, it would then presumably be costless (except in Austria and Germany, as explained above) for them to opine on full IFRS in their domestic audit reports. This will presumably increase the number of domestic opinions on full IFRS, i.e. it will increase dual reporting, given the continued legal need for opinions on national versions of IFRS.

Elsewhere, in June 2007, the Australian Auditing and Assurance Standards Board revised auditing standard ASA 700 to require an additional reference to IFRS, i.e. dual reporting. In New Zealand, the Professional Standards Board of the Institute of Chartered Accountants had done the same one month earlier with AGS-1012\textsuperscript{54}

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\textsuperscript{52} Our suggestion here received confirmation from Liesel Knorr of the German Accounting Standards Board; correspondence of January 2, 2008.

\textsuperscript{53} The UK numbers fell from 17 to 14; the numbers per auditor falling to 11 (Deloitte), 1 (Ernst & Young) and 2 (PwC). The German numbers fell from 5 to 4 (Linde had only an EU-IFRS opinion).

\textsuperscript{54} Audit Implications of the Transition to New Zealand Equivalents to International Financial Reporting Standards, 2007.
(Fisher and Perry, 2007). We applaud these changes because they will make it clear to foreign users whether IFRS is being followed or not. They seem to be the world’s first requirements for dual IFRS reporting.

In Canada, it is intended (OSC, 2008) that IFRS will be the primary basis of reporting, although it remains unclear whether dual reporting will be necessary because of a continued need to comply with national laws and regulations.

MORE POLITICS

The SEC’s decision to accept IFRS without reconciliation from foreign registrants was welcomed in some EU quarters, but it met some opposition from EU institutions (House, 2007). This is despite the fact that the IASB, EU companies, and EU auditors had been calling for it for years. The explanation is that the SEC requires compliance with “IFRS as issued by the IASB” (SEC, 2007, Section III.A.2), that is, full IFRS. This is politically unattractive to EU politicians and bureaucrats who support endorsed IFRS. It might also be relevant that, if the SEC also comes to allow IFRS for US registrants, the EU’s claim to be the best customer for the IASB’s standards will be undermined, as will its attempts at political pressure. Furthermore, the SEC might become keener to influence the IASB’s deliberations.

CONCLUSIONS AND POLICY IMPLICATIONS

Few jurisdictions have directly adopted IFRS, partly because of the widespread and long-standing reluctance of the state to allow a private-sector body to control accounting. South Africa has accepted the process of international standard setting by the IASB. The SEC and the Canadian regulators are considering doing so. However, this is not the position in the EU, nor is it likely to become so.

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55 For example, speech by EU Commissioner McCreevy at the European Parliament (Speech/07/836), December 18, 2007.
56 For companies already using the IAS 39 carve out, there is permission to continue to do so (SEC, 2007, p.36) for 2008 and 2009, with a reconciliation to full IFRS.
Where, despite the lack of direct adoption of IFRS, it is nevertheless in practice fully complied with, it was not normal for auditors to be asked to affirm this in 2005 or 2006. The exceptions were some German and UK companies that were generally foreign private issuers in the United States. However, some FPIs from those countries did not dual report and some dual reporters were not FPIs.

For 2007 onward, Australia and New Zealand have moved to a requirement for dual audit reports. The SEC’s requirement for full IFRS from foreign registrants that wish to avoid reconciliations might increase the frequency of dual reporting elsewhere.

We do not comment here on the wisdom of the SEC’s decision to accept IFRS for foreign registrants. That would require a consideration of the current differences between IFRS and US GAAP, whether those differences are value relevant, and so on. However, we believe that the SEC should hold to its requirement that, if IFRS is to be allowed, it must be full IFRS, which incidentally implies the English language version. We take this view because the EU endorsement process and adjustments to IFRS in other parts of the world allow political interference in standard setting that is unlikely generally to improve IFRS, and because the lags involved add nothing useful.

Ideally, we believe that regulators should assess the process of standard setting by the IASB rather than attempting to assess each individual standard. Then, managers and auditors could report on full IFRS. Where it is not possible, for local reasons, to report simply on full IFRS, we believe that companies and auditors in the EU and elsewhere should consider the issuance of a dual report that includes opining on full IFRS, as now required in Australia and New Zealand. In most cases, it would be costless but would increase the clarity of reporting, which regulators suggest would entail an incremental benefit especially for companies with international investors.
For those few companies unable to claim IFRS compliance, useful information would be forthcoming that is now hidden. If there are specific local reasons why dual reporting has disadvantages, then we would encourage regulators to remove them.

IOSCO (2008) has urged listed companies to state that their financial statements comply with IFRS as issued by the IASB, if that is the case, and otherwise to explain the differences. At present, the International Auditing and Assurance Standards Board (IAASB) appears to be unable to encourage or require dual audit reporting because it is “framework neutral.” Nevertheless, we believe that IFAC, FEE, and other audit-related bodies should consider encouraging or requiring dual reporting so as to make it widely known that they are, or are not, adhering to full IFRS.

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57 For example, as in the case of the liability cap in Austria and Germany,
58 This point was made to us by James M. Sylph, IFAC’s executive director of professional standards, in correspondence of November 19, 2007.
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