

Table of Contents

Introduction.....	2
Effects of IFRS on Investment.....	3
Theoretical Implications.....	9
Market Integration Analysis	10
Conclusion	12
Reference.....	13

Introduction

International Financial Reporting Standard (IFRS) is the latest system of accounting that has been developed by the International Accounting Standards Board (IASB). IASB is based out in London. It is probably the world's most powerful body in the arena of designing accounting procedures and regulations. Currently, the IASB enjoys the membership of nine countries.

The financial liberalisation and influx of foreign investment awakened the need for a uniform accounting system. There has been a constant effort of making IFRS the standard process of accounting across companies all over the world. This will make financial statements of different companies and their subsidiaries more standardized and comparable.

The implementation of IFRS practices in the states of European Union (EU) will need substantial efforts from the companies. There will be a significant change in the language of preparing financial statements. Companies will require re-scheduling the publication of their annual reports and other interim publications. IFRS requires such reports to be published earlier than was required by US GAAP (International financial reporting standards, n.d.). All companies that are listed in the European Union will have to mandatorily follow IFRS guidelines in designing their financial statements from January 1, 2005. It is believed that IFRS will be instrumental in enhancing the transparency and cross-country comparability of the financial reports. Companies can be evaluated in a more complete manner and national accounting discrepancies can be got rid of completely (Spathis C. and Georgakopoulou E., 2007).

Certain economists had expressed their faith in the implementation of IFRS regulations. They increasingly felt that shifting to the new accounting standards would improve the flow of investments into the Euro zone. However, organisations will need to put in extra efforts to face the combined challenge of changing into an entire set of new regulations ushered in by simultaneous adoption of Basel II norms, IFRS and Financial Services Action Plan. The IFRS advocates the use of Fair Value principle in valuation of investments, and emphasises on mandatory disclosures (Jermakowicz E.K., Tomaszewski S. G., November 23, 2005).

Effects of IFRS on Investment

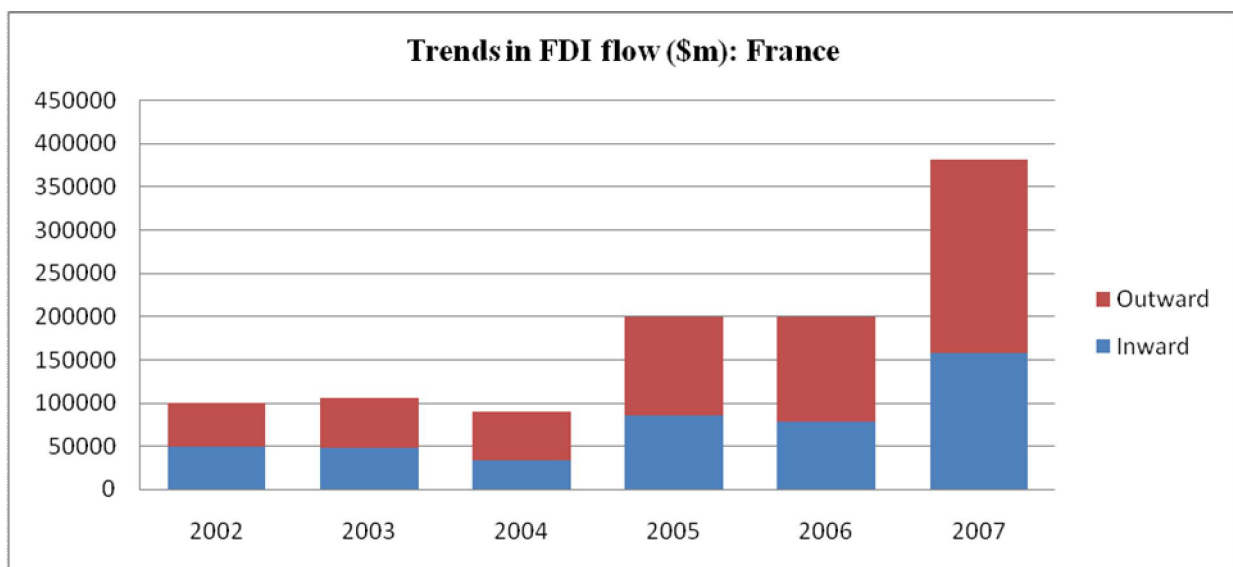
Since IFRS is intended to bring in uniformity in the language of accounting, it is expected to serve the investors in a positive manner. Investors will be at ease to value firms which follow identical accounting measures; the risk assessment can be done more accurately on account of decreasing disparities in the flow of information (Armstrong C. S., et al, September 2008).

An empirical assessment of the effects of the shift to IFRS framework in the European economy is designed to analyse whether IFRS has been effective in enhancing the flow of investment. The report can be made comprehensive by examining the investment scenario in each of the major countries of the EU. Due to constraint on availability of data, the total figures of Foreign Direct Investment (inflow and outflow) for the nations will be considered.

The analysis encompasses five major countries of the European Union; France, Spain, United Kingdom, Switzerland and Germany. The mode of research used to check the validity of the

proposal is simple. Investment data for some of the major economies has been collected for the period of 2002-2007. Implementation of IFRS system of accounting was done across EU on 1st January 2005. An analysis of data pre and post 2005 perhaps would be an ideal way to comment on the effect of IFRS on investment flows in European Union.

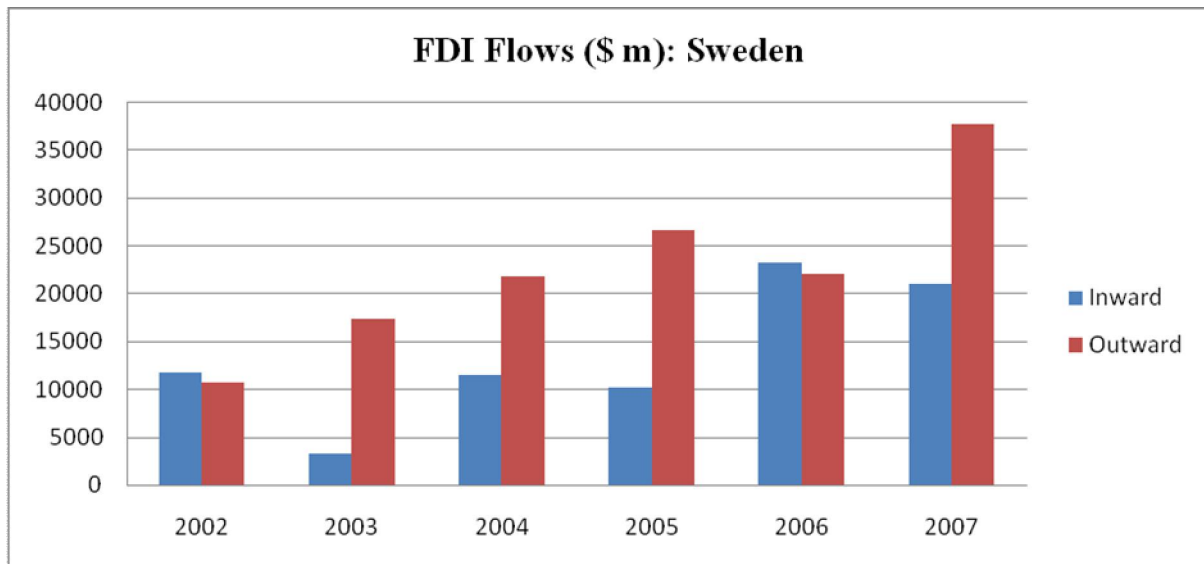
The data of FDI flows collected from UNCTAD and World Investment Report has been graphically represented as follows:



Source: UNCTAD

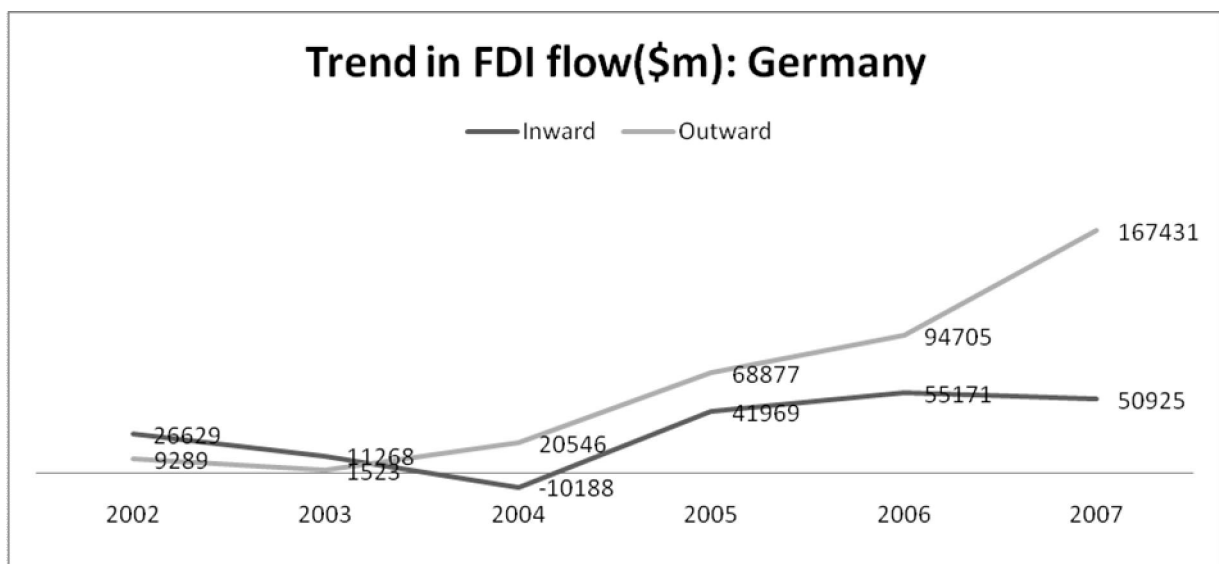
The above graph shows a sudden spurt in FDI after 2005. The increase appears all the more magnified due to a decrease in 2004. Post 2005, there has been an increase in both inflow and outflow of the investment. It has to be noted that the investment figures are flow of funds to and from the rest of the world. Interestingly, the 2005 level of investment is almost the double that of 2002 and 2003. In 2007, the levels further doubled in comparison to 2003.

The Central Bank of France feels that the introduction of IFRS (coupled with the Basel II norms) is most likely to increase the risk of credit default for the banks. There has been no particular and common model that can assess the potential risk of default of an investment. Banks do use their internal models but those act more as monitoring agents, rather than controlling the occurrence of a default. In modern times, a major avenue of investing has been the credit derivatives, mostly in the form of credit default swaps (CDS) and Collateralised Debt Obligations (CDO). The proportion of investment of some of the leading banks of France has seen almost a three time rise in investments in these credit derivatives in the last seven years. Officials fear that the IFRS system of accounting is prone to make risk assessment more complex. The IFRS method follows 'fair value accounting' which is on the lines of market value of evaluation. Traditionally, banks used the accrual system of accounting in the banking books while the market value method was used for accounting in the trading books. Conversion to IFRS will erase the dividing line between trading books and banking books and cause disequilibrium in the balance that is needed to be maintained in the different books of accounting (Prato O., May 2006).



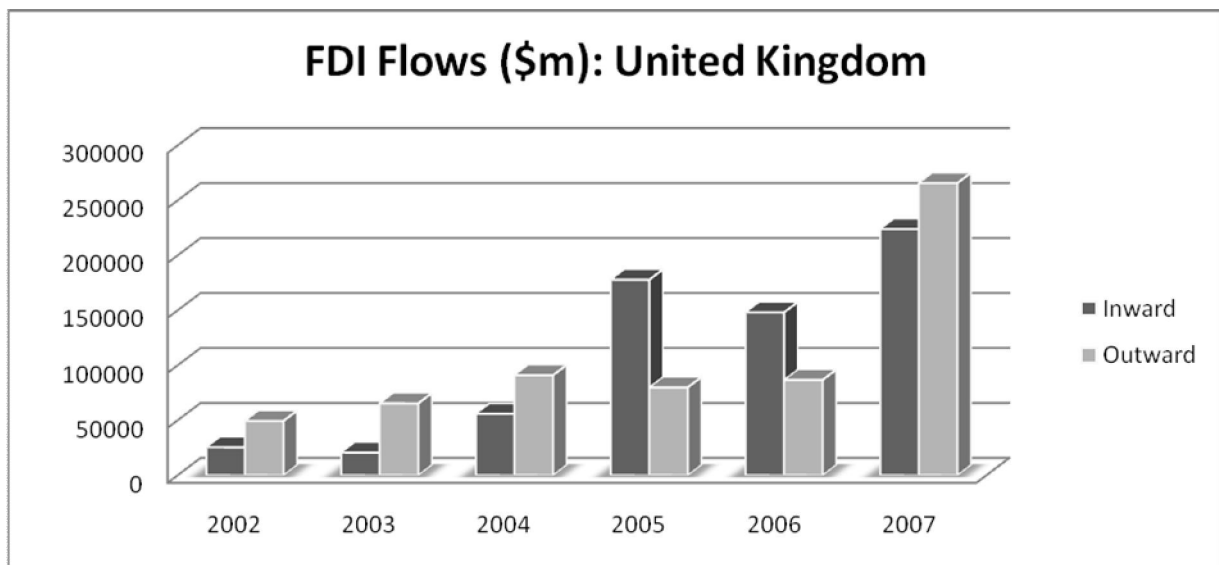
Source: UNCTAD

The foreign direct investment for Sweden has been following a regular trend for the considered time period. The outflows have remained always greater than the inflow, measured in US\$ million. Outward flows of foreign direct investment have been constantly on the rise, except for a trend reversal in 2006. Inward flows of capital have been erratic for the country. However, the overall flow of investment from and to Sweden has experienced an increase after 2005.



Source: UNCTAD

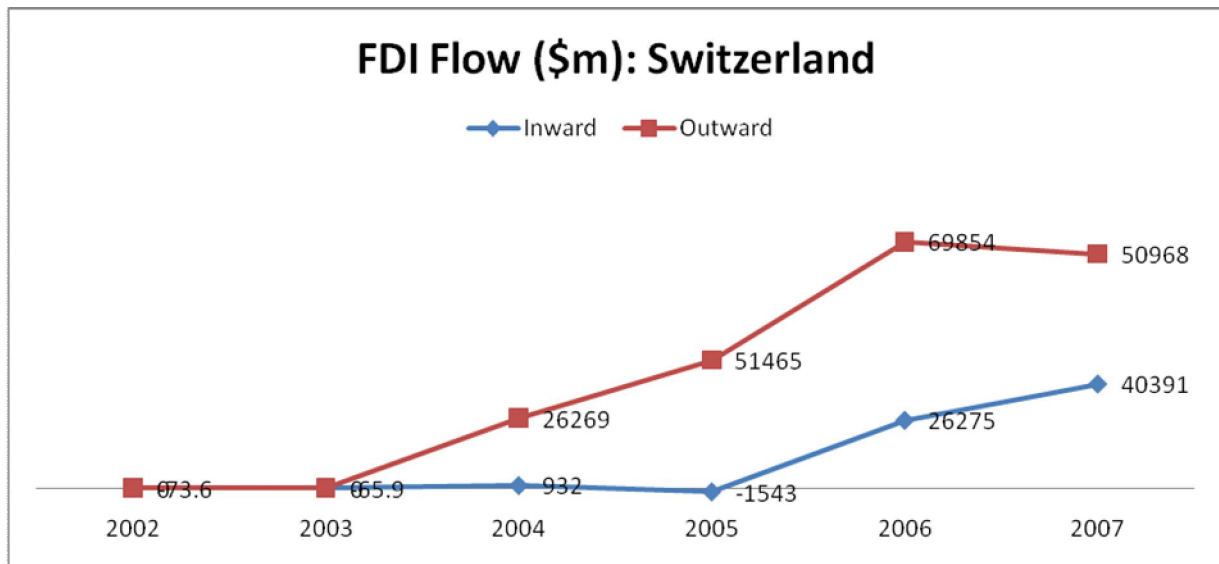
Germany is one of the major economies of the European Union and plays a pivotal role in shaping the socio-economic-political frameworks of the Union. The above graph displays two distinct trends of investment inflows and outflows. Both inward and outward investments have witnessed a decline in the period of 2002 to 2004. The figures have picked up from 2005 onwards and increased significantly. It is interesting to note that the gap between inflows and outflows have widened from 2005 as well, with outward flows going northwards and inflows decreasing.



Source: UNCTAD

The FDI trends of United Kingdom represent an almost increasing pattern all throughout the period of study. However, a critical assessment of the trend reveals that the growth of investment flows has been on the whole greater in and after 2005 than the previous levels. UK

has remained a favourable destination for direct investment. Again, British companies have played a major role in investing directly elsewhere in the world. The 2002 and 2003 levels have been visibly reduced as an after effect of the terrorist attacks on America.



Source: UNCTAD

The economy of Switzerland has been mainly a tourism based economy. The trends of investment flows in and out of the country have been a sort of extreme exhibition. In the years following 2002 there were no outward investments, and only a nominal inward investment flow. However, the scenario has changed considerably as of late. As may be seen in all the countries that have been analysed here, there has been an increasing gap between the amounts of inward and outward investment all throughout the period of consideration.

Theoretical Implications

The effect of change in the system of financial accounting will affect the investment flows to a country in two different ways. The main among these factors is the ability to identify and evaluate prospective projects in a better manner. The most important factor however appears to be low level of discrepancies in the information that is accessed by investors to design their investment strategies. Naturally, investors will prefer to stock their funds in those geographical regions where there is lesser risk of suffering from the lack of information. In addition to this, as a general accounting philosophy, a sound accounting system is one which provides for the maximum possible disclosures for investors at regular time intervals. The IFRS system takes care of all of this and hence is perfectly poised to be an efficient accounting system (Ramos L. M., 2008).

A critical component in determining the direction of the flow of foreign investment has been the efficiency and costs associated with accessing relevant information. In a scenario where each country follows different patterns and systems of accounting, it becomes difficult for investors to decide the relative positions of companies. Under such circumstances, proper evaluation (which is so very necessary for investing) becomes costly. The economies of EU adopted the IFRS system in a phased manner, thereby providing investors with the relief from cumbersome calculations. Different accounting practices also present the problem of evaluating the trade inflow figures correctly. A uniform language of analysis will result in fewer errors in evaluating

risks. This translates to the fact the companies will be able to judge more clearly their ability to honour financial contracts.

Market Integration Analysis

The following figure demonstrates the market integration of FDI in the European Union. Market Integration is defined as the average of the inflow and outflow of foreign direct investment, expressed as a percentage of the GDP. The figure below depicts the change in market integration figures in the European economy and some of the key economies for the time interval of 2000 to 2007. This is a comprehensive tool for evaluating whether the move to implement IFRS norms has paid off in terms of improvement of the flows of cross border investment in the European economy.

	2001	2002	2003	2004	2005	2006	2007
EU (27 countries)				0.9	1.7	2.2	3.4
EU (25 countries)	2.4	1.3	1.3	1	1.7	2.3	3.5
EU (15 countries)	2.6	1.4	1.4	1.1	2	2.5	3.7
Euro area (13 countries)							4.6
Euro area (12 countries)	4	2.5	1.9	1.7	3.2	4.1	

Source: Eurostat Data

The market integration figures are of particular interest due to their comprehensive nature. It represents the investment relations with the countries of the rest of the world. Each country's average investment amount is represented as a percentage of its GDP to make the representation free from effects of the size of the economy.

The figures for EU 15 countries and EU 25 countries clearly demonstrate an increasing trend from 2005. Though incomplete for a part, the data for 27 countries of the European economy has

demonstrated an increase in each of the subsequent years since 2004. These facts are decent testimonial to the effect of IFRS standards enhancing the flow of investments across the countries in relation to the international economies.

In order to encapsulate the market integration results in a better manner, similar data has been captured for some of the European countries as well. This will make the analysis more comprehensive.

Table: Market Integration Data for EU countries (avg. inflow & outflow FDI fig. as a % of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007
United Kingdom	11.9	3.8	2.3	2.1	3.3	5.6	5	8.2
Switzerland	12.8	5.3	2.6	4.9	3.7	6.7	13.7	11.6
Norway	4.7	0.7	1.2	1.8	1.5	3.8	3.8	2.2
Italy	1.2	1.6	1.3	0.8	1	1.7	2.2	3.1
Turkey	0.3	1	0.3	0.4	0.5	1.2	2	1.9
Hungary	2.3	4	2.5	2.2	2.8	4.5	17.2	32.5
Ireland	16.1	6.6	15.3	9	2	-4.3	2.2	9.8
Finland	13.5	4.8	5.7	0.3	0.5	2.3	2.1	3.7
France	8.2	5.5	3.4	2.7	2.2	4.7	4.4	7.4
Germany	6.7	1.7	1.8	0.8	0.2	2	2.6	3.3
Greece	1.3	0.8			0.7	0.4	1.8	1.2

Source: Eurostat

The table above charts the data for eleven European countries that have resorted to IFRS system of accounting. The data for all countries represents a similar trend; the figures of 2001 are drastically lower than the 2000 figures. This happened as an effect of the 9/11 terrorist attacks on US which hit foreign trade and investment all across the world. The US has been a major investor in the European economies all throughout. Subsequently, a negative impact on the US economy got reflected in the market integration figures of the European states as well.

Considering the time series data from 2001 to 2004, almost all the representative countries analysed here have suffered a fall in their investment flows barring Hungary, Turkey, Italy, and Norway. Post 2005, all the countries have recorded an increase in the market integration figures. Hungary and Ireland became the most favourable location of foreign direct investment as denoted by the high percentage increase in the figures.

Conclusion

The analysis done in this paper points out that the investment figures of the countries of the European Union have seen an increase after 2005. In certain cases, the rise in the figures has been high enough. Implementation of IFRS has enhanced investor confidence, reduced the cost of transaction and made information flows more symmetric. It can be fairly concluded, without loss of generality that investment flows across the European economy has improved as a result of IFRS implementation.

Reference

Armstrong C. S., et al, September 2008, Market Reaction to the Adoption of IFRS in Europe, Harvard Business School, [Online], Available: <http://www.hbs.edu/research/pdf/09-032.pdf>, May 7 2009

International financial reporting standards, No Date, LSE Executive Education, About the course, [Online], Available: <http://www.lse.ac.uk/collections/execEd/corporateSectorExecutiveEducation/internationalFinancialReportingStandards.htm>, May 7 2009

Jermakowicz E.K., Tomaszewski S. G., November 23 2005, *The Brave New World Of IFRS*, Financial Executives International, [Online], Available: <http://www.iasplus.com/resource/0511feibravenewworld.pdf>, May 7 2009

Prato O., May 2006, *Better Capturing Risks in the Trading Books*, Banque de France, Financial Stability Review, No. 8, [Online], Available: http://www.banque-france.fr/gb/publications/telnomot/rsf/2006/etudes_0506.pdf, May 7 2009

Dissertationtoday.com

Ramos L. M., 2008, *The Effect of IFRS Adoption on Trade and Foreign Direct Investments*, International Trade and Finance Association Working Papers, Paper 19, [Online], Available: <http://services.bepress.com/cgi/viewcontent.cgi?article=1124&context=itfa>, May 8 2009

Spathis, C. and Georgakopoulou, E., 2007, *The Adoption Of IFRS In South Eastern Europe: The Case Of Greece*, Int. J. Financial Services Management, Vol. 2, Nos. 1/2, [Online], Available: http://www.eefs.eu/conf/Prague/Papers/902_Georgakopoulou_Spathis.pdf, May 7 2009

UNCTAD, Foreign Direct Investment Database, United Nations Conference on Trade and Development, [Online], Available: <http://www.unctad.org/Templates/Page.asp?intItemID=1923>, May 7 2009

Market Integration Data for EU countries, Eurostat, [Online], Available: <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=0&language=en&pcode=tsier130>, May 7 2009

Dissertationtoday.com

Dissertationtoday.com