

THE IMPACT OF IAS/IFRS ON ACCOUNTING PRACTICES: EVIDENCES FROM ITALIAN LISTED COMPANIES

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Abstract: The European Commission has required the adoption of IAS/IFRS in order to harmonize financial reporting standards for European listed companies as of 1 January 2005. Converting to IAS/IFRS has represented much more than a change in accounting rules, and firms' main concern has been to understand the extent to which accounting differences between national GAAP and IAS/IFRS could affect their reported performance. The purpose of the paper is to address this concern by providing empirical evidence of the nature and the size of the differences between Italian GAAP and IAS/IFRS. The total and individual differences between Italian accounting principles and IAS/IFRS are identified in the reconciliations of net income and shareholders' equity of Italian listed companies in order to show the major impacts of the conversion to IAS/IFRS. The findings indicate a more relevant total impact of such a transition on net income than shareholders' equity. The individual adjustments show a more significant discrepancy between the two set of standards in the accounting treatment of business combination, provisions, financial instruments and intangible assets with reference to both net income and shareholders' equity; while the individual accounting differences in income taxes, and property, plant, and equipment show a significant difference only on shareholders' equity.

Keywords: IAS/IFRS; Accounting practices; Measurement

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1. Introduction

The IAS/IFRS (International Accounting Standards/International Financial Reporting Standards) consist of a set of international accounting principles, the adoption of which aims at establishing clear rules within the European Union to draw up comparable and transparent annual reports and financial statements. Their adoption represents an essential element to obtain an integrated, competitive and attractive European capital market, which has impelled the European Commission to introduce this set of uniform accounting standards for listed EU companies.

The European Community Regulation 1606/2002 required companies listed in regulated European markets to adopt international accounting and financial reporting standards for preparing their consolidated financial statements as from January 1, 2005. In Italy, the law 306/2003, issued by Italian legislators, delegated the Government to adopt one or more legislative decrees implementing the requirements of the EU Regulation within one year of the law coming into force. The Italian Government approved the legislative decree 58/2005 to implement the options allowed EU Regulation 1606/2002, which made it optional for quoted companies to adopt IAS/IFRS for their 2005 financial year but mandatory as from the 2006 financial year.

Beginning from the year 2005, Italian listed companies, banks and financial companies prepare their interim and annual consolidated financial statements in accordance with IAS/IFRS. Given the Recommendations of CESR (Committee of European Securities Regulators) published on 2003 and containing guidelines for companies listed within the EU regarding the transition to IFRS, the information required by IFRS 1 – *First time adoption of International Financial Reporting Standards* regards the impact that the conversion has on the consolidated financial position, the consolidated statements of operations and cash flows presented for the fiscal year immediately preceding the adoption. The consolidated balance sheet and consolidated statement of operations in accordance with IAS/IFRS have been derived from the consolidated statements prepared in accordance with the provisions of Italian law, by making the appropriate IAS/IFRS adjustments and reclassifications to reflect the changes in the presentation, recognition and valuation required by IAS/IFRS (Delvaille et al., 2005). In Italy, the application of IAS/IFRS has been extended to the individual accounts of listed companies, banks and financial companies from 2006, and their adoption is also permitted for non-listed companies in both individual and consolidated financial statements (Verna, 2003; Sottoriva, 2005).

The transition to IAS/IFRS has meant fundamental changes for many Italian and European companies. IAS/IFRS conversion has not been viewed simply as an accounting exercise, but as a change in national GAAP (generally accepted accounting principles) and in whole basis of financial reporting. IAS/IFRS information has affected the perception of firm's business performance, and firms have been enabled to produce IAS/IFRS financial statements that allow them to adopt a global financial reporting language as well as to be evaluated in a global marketplace (PricewaterhouseCoopers, 2004). Communicating in one language to stakeholders enhances confidence in the business and improves finance-raising capabilities. IAS/IFRS allows companies to benchmark themselves against their peers, and allows investors to compare firm performance with competitors globally.

This new performance measurement system has been expected to produce some differences in accounting rules between the set of Italian GAAP and IAS/IFRS, and firms' main concern has been to understand the extent to which accounting differences could change their performance. The *Organismo Italiano di Contabilità* – OIC (Italian Accounting Body) indicated that the main accounting differences emerging from the application of IAS/IFRS compared to Italian accounting principles affect many areas, including fair value reporting, depreciation and amortization, leasing, segment reporting, revenue recognition, impairment tests, deferred taxes, and post-retirement employee benefits (OIC, 2005).

Given firms' concern and development of a new accounting framework and the indications of OIC, the focus of this paper is to provide empirical evidence of the nature and the size of the differences between Italian GAAP and IAS/IFRS, by analysing the total and individual adjustments to IAS/IFRS in the reconciliations of net income and shareholders' equity of Italian listed companies. The level of discrepancy between Italian GAAP and IAS/IFRS is measured by proposing a new measure of accounting comparability, *i.e.* the proportionality index, a measure that is different from the Gray's conservatism index adopted for measuring the level of conservatism of financial results in some countries as compared to US GAAP (Gray, 1980; Weetman and Gray 1990, 1991; Weetman et al. 1993; Adams et al. 1993; Cooke 1993; Hellman 1993; and Norton 1995), as well as level of comparability of quantitative differences between some European countries (Weetman et al. 1998; Adams et al. 1999; Street et al. 2000). This in order to address in more detail the increasing interest to show which is the effect of the adoption of IAS/IFRS in accounting practice of European listed companies and to demonstrate which are the consequences on their reported performance; as well as to provide evidence of the quantitative effect of the principal impacts emerging from

the application of IAS/IFRS compared to Italian accounting principles.

The paper is organized as follows. Section 2 presents a literature review of the studies on the adoption of IAS/IFRS. Section 3 describes the sample of companies and methodology applied for measuring the total and individual accounting differences between Italian GAAP and IAS/IFRS. Section 4 discusses the results emerging from the empirical analysis. Section 5 offers some concluding remarks.

2. Prior research

The studies on the adoption of IAS/IFRS by European companies investigate the implications of the introduction of this set of international accounting standards by adopting two main research approaches: a first group of studies focuses on the transition and implementation of IAS/IFRS and in particular it highlights their effects for firms (Jermakowicz, 2004; Street and Larson, 2004; Sucher and Jindrichovska, 2004; Vellam, 2004) and for local and international regulators (Weißenberger et al., 2004; Haller and Eierle, 2004; Shipper, 2005; Whittington, 2005); a second category investigates the financial reporting under IAS/IFRS with reference to the compliance to IAS/IFRS (Emenyonu and Gray, 1996; Dumontier and Raffounier, 1998; El-Gazzar et al., 1999; Murphy, 1999; Street and Bryant, 2000; Ashbaugh, 2001; Glaum and Street 2003; Tarca, 2004; Cuijpers and Buijink, 2005) and the quality of information under IAS/IFRS (Ashbaugh and Pincus, 2001; Hung and Subramanyam, 2004; Barth et al., 2005; Van Tendeloo and Vanstraelen, 2005).

A first group of studies demonstrates that the problems in implementing IAS/IFRS within European member states are widely linked to the preparation of accounting information for taxation purposes by continental European companies which do not correspond to the investors/users financial reporting orientation of IAS/IFRS (Nobes, 1983; IASB 2003). Street and Larson (2004) conduct a survey within EU member states to test the plans and barriers to convergence to IAS/IFRS before their mandatory adoption by listed companies in 2005. The survey highlights that most of EU listed companies do not plan to converge national GAAP to IAS/IFRS, and after the required adoption they might keep this two accounting systems for individual accounts. The main impediments are based on the difficulties rising in the application of some IAS/IFRS and the tax-system of countries sampled as well as the lack of guidelines of national bodies in the application of such standards. Sucher and Jindrichovska (2004) confirm the problems of implementing IAS/IFRS in Czech Republic by analysing the

key issues that arise by moving to IAS/IFRS reporting. Their research paper underlines that even though the Czech accounting system is moving closer to IAS/IFRS in some areas such as the valuation at fair value, the need of national system to keep separate the tax and financial reporting to ensure that the different objectives of the two reporting systems are met explains why the Czech system differs in certain aspects from IAS/IFRS. Given the strong influence of tax rules on financial reporting, Vellam (2004) discusses whether the convergence between national GAAP and IAS/IFRS can be achieved in practice, by describing the differences between Polish financial reporting and the IASB conceptual framework. The preference of Polish accounting system for a tax orientation and the lack of an effective enforcement of international accounting standards are perceived as the main reasons of a full compliance of IAS/IFRS requirements. In Belgium, Jermakowicz (2004) underlines the benefits of complying with IAS/IFRS by all listed and non-listed companies by identifying and describing the main differences between IAS/IFRS and Belgian GAAP. The contribution of this paper as compared to the previous is to analyse the implementation problems with reference to the link between financial accounting and tax accounting by measuring the main impacts on the conversion to IFRS. The survey shows that the major differences between the two set of standards are linked to the tax nature of Belgian accounting rules and the inadequate implementation guidance that creates a risk of a different interpretation of IAS/IFRS. Jermakowicz underlines that the latter key issue could explain why the implementation of a new accounting regime is not known and understood by local and European companies.

Such implementation difficulties persist also for those European countries which have practised an international accounting implementation before the conversion to IAS/IFRS. Moreover since 1998 German companies can publish their accounts in accordance with international accounting principles (IAS/IFRS or US GAAP) and the objectives achieved for choosing one of the two international reporting systems, Weißenberger et al. (2004) show that German companies not applying such standards are not clearly motivated to move to a particular international regime. The motives that have driven the change to an international regime such as the improved supply of information to investors and the improved standing on capital markets do not play any role in the process of transition to IAS/IFRS, because companies perceive such reporting and business objectives may not be easy to achieve. Haller and Eierle (2004) support such conclusions by finding evidence that the implementation of IFRS rules requires a thorough change of the German accounting system, and that such a reform requests a step-by-step revision of existing rules. The experience based on the previous

adoption of international accounting rules does not make the process of transition to IAS/IFRS fast and easy, but slow and conservative. The previous change to an international accounting regime has not introduced considerable changes for the German accounting system, but it has played only a role at improving the companies' financial reporting and business performance.

The regulatory change introduced by the adoption of IAS/IFRS in Europe has not only shifted the national accounting regulation and has revisited questions related to the importance of IAS/IFRS in determining financial reporting outcomes, but it has also created some implications for the overall international convergence of financial reporting. Shipper (2005) analyses the implications of the introduction of IAS/IFRS for international convergence between IASB and FASB, and concludes that the mandatory adoption of IAS/IFRS by European companies represents also an effort for removing the several differences between these accounting principles in order to make the two set of standards as closer as possible as well as for producing comparable financial information. In particular, Whittington (2005) identifies two relevant critical areas where the changes introduced by IASB would reduce the boundaries between IAS/IFRS and US GAAP in order to achieve convergence, which refer to the development of fair value measures, such as the application of hedge accounting, and the treatment of business combination as acquisition which precludes the application of pooling of interest accounting. The increased use of such accounting treatments would settle the convergence between IASB and FASB in a shared financial reporting project.

A second group of studies analyses the implications of the application of IAS/IFRS by looking at both the potential effects of this accounting choice and why companies voluntarily decide to move to a set of international accounting standards, and the characteristics of adopting companies as well as the consequences of the adoption on their performance.

Emenyonu and Gray (1996), Dumontier and Raffounier (1998), El-Gazzar et al. (1999), Murphy (1999) examine to what extent the accounting measures and associated disclosure of European companies applying IAS have become more harmonized internationally, and the motivations and characteristics of companies complying with international accounting principles. They find evidence that the decision to apply IAS is significantly associated with financing policy and performance, foreign operations and multiple international listings. Street and Bryant (2000), Ashbaugh (2001) find support for these findings by identifying differences between non US-companies preparing reporting financial information in accordance with IAS or US GAAP with and without US listing and filings. In particular, their results show that companies traded in US financial markets disclose IAS or US GAAP financial information

because they can provide more standardized information than information prepared under national GAAP. On the other hand, Glaum and Street (2003), Tarca, (2004), Cuijpers and Buijink (2005) show that the benefits of IAS adoption are more relevant in those countries national regulators and standard setters require companies to achieve more comparable financial information by applying IAS or US GAAP.

Ashbaugh and Pincus (2001) investigate whether the differences between domestic and international accounting standards can influence the financial analysts' forecasts of earnings. The research shows that the association of the differences between domestic accounting standards and IAS with analysts' forecasts of earnings is positive and significant, and the convergence in accounting policies by applying IAS can reduce the financial analysts' errors and increase the quality of earnings. Hung and Subramanyam (2004), Barth et al. (2005) Van Tendeloo and Vanstraelen (2005) argue that high quality accounting standards could be a condition for high quality information to show that companies complying with IAS can improve the value relevance of their financial statement information. These studies do not obtain significant results fully supporting that companies adopting IAS clearly evidence higher accounting quality after the compliance than before. They suggests that IAS adoption is associated with an improvement in accounting quality, that it is not still effective.

3. Research methodology

Driven by the findings of the studies investigating the effects of IAS/IFRS transition for firms (Jermakowicz, 2004; Street and Larson, 2004; Sucher and Jindrichovska, 2004; Vellam, 2004) and for local and international regulators (Weißberger et al., 2004; Haller and Eierle, 2004; Shipper, 2005; Whittington, 2005), the purpose of this paper is to provide empirical evidence of the nature and the size of the differences between Italian GAAP and IAS/IFRS, by analysing the total and individual adjustments to IAS/IFRS in the reconciliations of net income and shareholders' equity of Italian listed companies. This is addressed by proposing a new measure of accounting comparability, *i.e.* the proportionality index, vs. the Gray's conservatism index, in order to analyse the quantitative effect of the principal impacts emerging from the application of IAS/IFRS compared to Italian accounting principles.

Gray (1980) first introduces the index of conservatism in comparing profits of several countries as a quantitative measure of differences between accounting practices. Weetman and Gray (1990, 1991), Weetman et al. (1993), Adams et al. (1993), Cooke (1993), Hellman

(1993) and Norton (1995) apply the index in similar manners. The main focus of these studies was to explore the material quantitative differences in profits reported under US GAAP compared to profits reported in accordance with European GAAP for supporting the hypothesis that US standards were less conservative than European standards. Then the index has been proposed as a measure of comparability of accounting treatments without a judgment of conservatism (Weetman et al., 1998; Adams et al., 1999; Street et al., 2000; Zambon 2002). The index of comparability has been adopted as a measurement of the quantitative impact of accounting differences more than a level of harmonization as H, I, and C indicators of national and international harmonization introduced by van der Tas, which quantify the incidence of accounting differences rather than their impact on profit or equity (van der Tas, 1988; Emenyonu and Gray, 1992; Archer et al., 1995; Herrmann and Thomas, 1995).

In these previous studies the benchmark to make comparison is US GAAP, in order to measure the extent to which disclosed profit or shareholders' equity in other countries are more/less conservative than or more/less comparable with US GAAP on the basis of the differences in accounting principles. The studies analyse the Form 20-F reconciliations prepared in accordance with the SEC's requirements by European companies listed on NYSE and NASDAQ in order to analyze the nature and the impact of accounting differences between US GAAP and non-US companies preparing financial information in accordance with domestic accounting standards or complying with IAS.

The benchmark used in this study is IAS/IFRS for evaluating the accounting impacts of the transition from Italian GAAP to IAS/IFRS. Where Italian net income or equity is compared to that reported under IAS/IFRS, the total comparability index (TCI) is expressed as in Table 1. The net income or equity reported under IAS/IFRS is chosen as the denominator in order to assess the impact of IAS/IFRS on Italian financial statements and to provide a comparison across countries. The neutral value is 1. An index greater than 1 means that the Italian net income (loss) or equity is higher (lower) than that reported under IAS/IFRS. An index lower than 1 means that the Italian net income (loss) or equity is lower (higher) than that reported under IAS/IFRS.

The partial comparability index (PCI) provides a measure of the impact of each accounting differences in explaining the total distance between the Italian net income or equity and that reported under IAS/IFRS (Table 1). The neutral value is 1 for consistency. An index greater than 1 means that the partial adjustment is negative. An index lower than 1 means that the partial adjustment is positive. The relationship between the total and partial indexes of

Table 1 – Proportionality indexes vs. Gray’s comparability indexes

Total comparability indexes	
$TCI_{\text{net income}} = 1 - \frac{\text{net income}_{\text{IAS/IFRS}} - \text{net income}_{\text{IT}}}{ \text{net income}_{\text{IAS/IFRS}} }$	$TCI_{\text{equity}} = 1 - \frac{\text{equity}_{\text{IAS/IFRS}} - \text{equity}_{\text{IT}}}{ \text{equity}_{\text{IAS/IFRS}} }$
Partial comparability indexes	
$PCI_{\text{net income}} = 1 - \frac{\text{partial adjustment}}{ \text{net income}_{\text{IAS/IFRS}} }$	$PCI_{\text{equity}} = 1 - \frac{\text{partial adjustment}}{ \text{equity}_{\text{IAS/IFRS}} }$
Relationship between total and partial index of comparability	
$TCI = \sum_{i=1}^n \left(1 - \frac{\text{partial adjustment}_i}{ \text{net income or equity}_{\text{IAS/IFRS}} } \right) - (n - 1)$	
Total proportionality indexes	
$TPI_{\text{net income}} = \frac{\text{net income}_{\text{IT}} - \text{net income}_{\text{IAS/IFRS}}}{ \text{net income}_{\text{IAS/IFRS}} }$	$TPI_{\text{equity}} = \frac{\text{equity}_{\text{IT}} - \text{equity}_{\text{IAS/IFRS}}}{ \text{equity}_{\text{IAS/IFRS}} }$
Partial proportionality indexes	
$PPI_{\text{net income}} = \frac{\text{partial adjustment}}{ \text{net income}_{\text{IAS/IFRS}} }$	$PPI_{\text{equity}} = \frac{\text{partial adjustment}}{ \text{equity}_{\text{IAS/IFRS}} }$
Relationship between total and partial index of proportionality	
$TPI = \sum_{i=1}^n \left(\frac{\text{partial adjustment}_i}{ \text{net income or equity}_{\text{IAS/IFRS}} } \right)$	

comparability is expressed by the sum of total partial adjustments minus (n-1).

Following Gray’s methodology, which quantifies how the differences impact on accounting results, this study proposes the index of proportionality as an alternative assessment of the significance of Italian-IAS/IFRS differences. The indexes of total (TPI) and partial proportionality (PPI) as well as the relationship between the indexes are reported in Table 1.

According to the assumption that the IAS/IFRS net income (equity) is a synthesis of the differences between the Italian accounting system and IAS/IFRS in the process of conversion to IAS/IFRS, the paper assumes that the IAS/IFRS net income (equity) is the result of the accounting adjustments applied to IT net income (equity). In this perspective, the total proportionality ratio measures the extent to which the transition to IAS/IFRS affects Italian accounting results.

The main difference between the Gray's index and the total index of proportionality is that the extent does not refer to a principle of conservatism, but it evidences how to express the difference between the national value and that under IAS/IFRS in the process of conversion to this international set of accounting rules. If the extent is null, the ratio is 0.0, that means there are no differences between the Italian value and that under the IAS/IFRS. A value of the index higher (lower) than 0.0 shows the Italian accounting result is higher (lower) than those reported under IAS/IFRS, *i.e.* the process of conversion to IAS/IFRS produces a negative (positive) impact on national accounts (cf. example).

On the basis of the previous assumption, the partial proportionality ratio measures the positive or negative extent of each individual accounting adjustment by converting the Italian values to IAS/IFRS. The neutral value is 0.0, whether the individual accounting adjustment is not collected. An index lower (higher) than 0.0 means that the partial adjustment has a negative (positive) impact on IAS/IFRS net income or equity in the process of transition to IAS/IFRS (cf. example).

The relationship between the total and partial indexes of proportionality shows that the total index of proportionality is equal to the sum of the relative accounting impacts on Italian net income or equity.

By calculating the partial index of proportionality, it seems that such an index presents a more relevant measure of the impact of each relative accounting difference, as it shows directly the positive or negative impact of the accounting adjustment. As well as the total index of proportionality is expressed in a manner vs. Gray's index that could result more comprehensive to firms. The application of such indexes is thus more consistent with the aim of the study, that intends to address firms' concern on the extent to which accounting differences could change their reported performance in the transition to IAS/IFRS.

The total index of proportionality is calculated also for ROE, that represents a synthesis of the two main accounting results. This extension thus provides more insights on the magnitude of the IT-IAS/IFRS accounting differences in terms of firm's financial performance (Hellman,

1993; Zambon, 2002).

To illustrate the effects of indexes, the empirical study presents the following example:

Calculation of total indexes:

IT net income = 150

IAS/IFRS net income = 100

$$TCI = 1 - \left(\frac{100 - 150}{100} \right) = 1.50$$

$$TPI = \frac{100 - 150}{100} = -0.50$$

Calculation of partial indexes:

IT net income = 150

IAS 38 – Intangible assets (60)

IAS 19 – Employee benefits 10

IAS/IFRS net income = 100

$$PCI_{IAS\ 38} = 1 - \left(\frac{-60}{100} \right) = 1.60$$

$$PCI_{IAS\ 19} = 1 - \left(\frac{10}{100} \right) = 0.90$$

$$PPI_{IAS\ 38} = \frac{-60}{100} = -0.60$$

$$PPI_{IAS\ 19} = \frac{10}{100} = 0.10$$

According to previous empirical studies, the value of total/partial indexes of proportionality are classified on bands of 5%-10% of IT-IAS/IFRS accounting difference. The outlying values are removed for calculating the mean values, as they give a more representative picture of such differences. Outliers have been assumed to occur when the total/partial proportional indexes are above or below a 300% difference.

In order to test the significance of total/partial differences, the non-parametric two-tailed

Wilcoxon signed rank test and the parametric two tailed t-test are applied respectively to medians and means without outlying values. The calculation of medians support the distribution of indexes, when the transition to IAS/IFRS accounting standards can produce a lower or higher impact on net income or equity. The study requires to run both statistical non-parametric and parametric techniques in order to reinforce the significance on means whether the values of indexes are closer to the outliers' bands.

4. Sample

The sample of companies selected include all industrial and services companies listed on *Borsa Italiana* (Italian Stock Exchange) as at 31 October 2006, which have completed the transition of consolidated financial accounts to IAS/IFRS (Appendix).

In order to analyse the nature and the size of total and individual adjustments to IAS/IFRS, the reconciliation statements between Italian GAAP and IAS/IFRS has been evaluated. IFRS 1 indicates that "An entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows". Then it underlines that a "... company's first IFRS financial statements should include a reconciliation of shareholders' equity and net income...". Following the requirements of IFRS 1, in Italy the CONSOB (*Commissione Nazionale per le Società e la Borsa* – Italian Securities and Exchange Commission) does not specify the contents of such reconciliations, but it recommends that they provide useful and complete information for the understanding of the potential impact of the new set of accounting rules on company financial performance, investors, issuers and markets. After the transition date, the reconciliations can be disclosed in the first quarterly or half-year report, or as an appendix in the annual report. Most of Italian listed companies choose the first option, and include the disclosure of the transition to IAS/IFRS in their 2005 half-year statement as an annex (Teodori, 2006). An example of such reconciliation is reported in Table 2.

The reconciliation statements of 178 companies are examined at the date of transition to IAS/IFRS (Table 3). Despite the recommendations of the CONSOB, 10 of the sampled companies do not provide IAS/IFRS reconciliation statement of both net income and shareholders' equity, and 4 do not produce the IAS/IFRS reconciliation statement of net income. For these two sub-samples the individual adjustments to IAS/IFRS have not been analysed, but the study considered only the total impact in terms of net income and

Table 2 – Reconciliation statement disclosed in Benetton Group’s 2005 half-year report

<i>(thousands of Euro)</i>	<i>Shareholders’ equity as at 01.01.2004</i>	<i>Shareholders’ equity as at 31.12.2004</i>	<i>Net income year 2004</i>
Total amounts (Parent Company portion and minority interests portion) under Italian GAAP	1,186,660	1,237,159	122,582
less - minority interests portion	(12,799)	(6,840)	492
Parent Company portion under Italian GAAP	1,173,861	1,230,319	123,074
Adjustments to financial statements for IFRS:			
a) reversal of monetary revaluations (IAS 16)	(3,085)	(2,896)	189
b) reversal of start-up and expansion costs (IAS 38)	(7,361)	(3,496)	3,865
c) reversal of goodwill amortization (IFRS 3)	-	721	721
d) straight-line lease instalments (IAS 17)	(4,357)	(1,098)	3,308
e) recognition of deferred tax assets (IAS 12)	-	7,146	7,146
f) different tax rate for calculation of “profit in stock” (IAS 12)	73	1,334	1,261
g) discounting of employee benefits to present value (IAS 19)	3,825	4,207	373
h) cost of stock options (IFRS 2)	-	-	(722)
i) derivatives for interest rate risks (IAS 39)	(9,653)	(4,963)	4,690
l) derivatives for exchange rate risks (IAS 39)	(264)	139	(264)
m) securities available for sale (IAS 39)	262	301	(43)
n) impairment loss adjustments for non-current assets (IAS 36)	-	(35,683)	(35,951)
o) provisions for risks and future charges (IAS 37)	4,494	-	(4,563)
p) exchange differences on equity investment disposals (IAS 21)	-	-	69
Tax effect on reconciling items	4,215	10,019	5,684
Minority interests in reconciling items	(194)	(41)	(41)
Parent Company portion under IFRS	1,163,180	1,206,009	108,796

Table 3 – Sample selection criteria

Listed companies on <i>Borsa Italiana</i> as at 31 October 2006	
- industrial sectors	111
- services sectors	83
Total	194
Less:	
- early IAS/IFRS adopters	2
- IPOs	6
- companies exempted from producing consolidated financial statements	8
Final example	178
Companies providing both net income and shareholders’ equity reconciliations	164
Companies not providing both net income and shareholders’ equity reconciliations	10
Companies not providing net income reconciliations	4

Table 4 – Frequency of all individual adjustments to IAS/IFRS

Net income		Shareholders' equity	
	N		N
IAS 38 – Intangible assets	148	IAS 38 – Intangible assets	152
IAS 19 – Employee benefits	144	IAS 19 – Employee benefits	150
IAS 12 – Income taxes	132	IAS 12 – Income taxes	132
IFRS 3 – Business combinations	104	IAS 16 – Property, plant and equipment	112
IAS 16 – Property, plant and equipment	103	IFRS 3 – Business combinations	110
IAS 37 – Provisions, contingent liabilities and contingent assets	63	IAS 39 – Financial instruments: recognition and measurement	72
IAS 39 – Financial instruments: recognition and measurement	62	IAS 37 – Provisions, contingent liabilities and contingent assets	62
IAS 2 – Inventories	44	IAS 32 – Financial instruments: disclosure and presentation	55
IAS 17 – Leases	41	IAS 17 – Leases	43
IAS 28 – Investments in associates	31	IAS 2 – Inventories	42
IAS 18 – Revenue	29	IAS 28 – Investments in associates	31
IFRS 2 – Share-based payments	27	IAS 36 – Impairment of assets	27
IAS 32 – Financial instruments: disclosure and presentation	27	IAS 18 – Revenue	25
IAS 36 – Impairment of assets	24	IAS 27 – Consolidated and separate financial statements	25
IAS 27 – Consolidated and separate financial statements	21	IAS 11 – Construction contracts	12
IAS 11 – Construction contracts	10	IAS 8 – Accounting policies, changes in accounting estimates and errors	10
IAS 8 – Accounting policies, changes in accounting estimates and errors	9	IAS 21 – The effects of changes in foreign exchange rates	6
IAS 20 – Accounting for governments grants and disclosure of government assistance	6	IFRS 2 – Share-based payments	4
IAS 21 – The effects of changes in foreign exchange rates	5	IAS 20 – Accounting for governments grants and disclosure of government assistance	4
IAS 1 – Events after the balance sheet date	3	IAS 40 – Investment property	4
IAS 23 – Borrowing costs	2	IAS 1 – Events after the balance sheet date	3
IAS 29 – Financial reporting in hyperinflationary economies	2	IAS 23 – Borrowing costs	2
IAS 40 – Investment property	2	IAS 29 – Financial reporting in hyperinflationary economies	2
IAS 31 – Interests in joint ventures	1	IAS 31 – Interests in joint ventures	1
IAS 41 – Agriculture	1	IAS 41 – Agriculture	1

shareholders' equity to IAS/IFRS.

The analysis also excludes early IAS/IFRS adopters (2) and IPOs (6), because they do not provide a reconciliation statement of net income and shareholders' equity; and companies exempted from producing consolidated financial statements (8).

Table 4 shows the frequency of all individual adjustments to net income and shareholders' equity to convert to IAS/IFRS for the sample companies which disclose a specific adjustment, except for those companies not providing a reconciliation statement. The most significant individual adjustments with respect to net income and shareholders' equity are examined in detail for highlighting the differences between the Italian accounting system and IAS/IFRS.

4. Results

4.1. Total proportional index

Table 5 shows the total impact of the adoption of IAS/IFRS on net income, equity and ROE. Italian net income is on average 12.47% lower than IAS/IFRS reported net income, and 41.57% of companies have an index lower than 0.90. From the t-test and the Wilcoxon test, the medians and means are significantly different. Italian equity is on average 4.78% lower than IAS/IFRS reported equity, as demonstrated by the highest percentage of companies with an index around the neutral value of 0.0 (Table 6). The findings show that Italian equity is much closer to 0.0 than Italian net income, but it is still different from 0.0. The study of Cortesi et al. (2007) finds the same positive increase of IAS/IFRS vs. Italian net income and equity by analysing the introduction of international accounting standards in the preparation of financial statements by a group of Italian family business companies listed on *Borsa Italiana*. The impact is on average 1.50% for equity and 9.80% for net income.

The application of the t-test and the Wilcoxon test shows that both mean and median differences are significant at 1%. By the calculation of ROE as synthesis of the two main accounting results, Italian ROE is on average 9.47% lower than IAS/IFRS index, and the highest percentage of companies evidence a ratio lower than 0.90. The t-test and Wilcoxon test verify again the difference in means and medians at 5%.

Table 5 – Wilcoxon and t statistics for total indexes of proportionality

Variable	N	Median	Wilcoxon statistic	
Net income	172	-0.0683**	5138	
Equity	178	-0.0141**	5232	
ROE	171	-0.0583*	5717	
Variable	N	Mean	StDev	t statistic
Net income	172	-0.1247**	0.6048	-2.70
Equity	178	-0.0478**	0.2424	-2.63
ROE	171	-0.0947*	0.6599	-1.89

Note: * Total index is significantly different from the neutral value 0.0 at 5%.

** Total index is significantly different from the neutral value 0.0 at 1%.

Table 6 – Distribution of total indexes of proportionality

		Net income		Equity		ROE	
		N	%	N	%	N	%
IT ≤ -10% vs. IAS/IFRS	≤ -0.10	74	41.57	39	21.91	74	41.57
-5% ≤ IT ≤ -10% vs. IAS/IFRS	-0.999 - -0.05	19	10.67	23	12.92	18	10.11
IT ±5% vs. IAS/IFRS	-0.0499 – 0.0	20	11.24	47	26.40	14	7.87
	0.0 - 0.0499	9	5.06	42	23.60	7	3.93
5% ≤ IT ≤ 10% vs. IAS/IFRS	0.05 - 0.0999	6	3.37	13	7.30	9	5.06
IT ≥ 10% vs. IAS/IFRS	≥ 0.10	50	28.09	14	7.87	56	31.46
Total		178	100	178	100	178	100
Min		-48.877		-2.329		-49.748	
Max		226.838		0.674		263.208	

4.2. Partial proportional index

The most important partial adjustments are discussed briefly and their impact on net income and equity are presented in Tables 7 and 8, respectively.

IAS 38 – Intangible assets

Under Italian GAAP the costs of applied research and development may alternatively be capitalised or charged to operations when incurred. IAS 38 requires that research costs be expensed, whereas development costs that meet the criteria for capitalisation must be capitalised and then amortised from the start of production over the economic life of the

related products.

In accordance with Italian accounting principles, costs for extraordinary company transactions, costs for the start-up or expansion of production activities and costs for the establishment of a company or for issuance of capital stock can be capitalized. IAS/IFRS require these costs to be charged against profit and loss account, except for establishment and issuance of capital stock of the parent company that are recognised as a decrease in shareholders' equity net of the relevant fiscal effect. Costs for software development can be capitalized under certain circumstances. IAS/IFRS pose more stringent conditions for their capitalization.

Other purchased and internally-generated intangible assets are recognised as assets in accordance with IAS 38, where it is probable that the use of the asset will generate future economic benefits and costs of the asset can be determined reliably. Such assets are measured at purchase or manufacturing cost and amortised on a straight-line basis over their estimated useful lives, if these assets have definite useful lives. Intangible assets with indefinite useful lives (e.g. goodwill) are not amortised, but are tested for impairment annually, or more frequently whenever there is an indication that the asset may be impaired.

The net book values of intangible assets capitalized in accordance with Italian accounting system, and for which IAS/IFRS require expensing are therefore written off and offset in shareholders' equity on the date of transition.

The combination of these new accounting rules produces a negative effect on IAS/IFRS equity that is 0.20% lower than IT equity, and a positive effect on IAS/IFRS net income that results 1.89% higher than IT net income (Table 7). The negative effect on IAS/IFRS equity is the result of the accounting reversal of intangible assets for which IAS 38 requires recognition in the income statement when they are incurred; while the positive effect on IAS/IFRS net income is due to the combination of the lower amortization charges and the elimination of costs that do not include amortization, which have produced a pretax benefit. The IAS/IFRS net income benefits also of the reversal of the amortization of goodwill recorded during the year under Italian GAAP, that is no longer amortized but subject to the impairment test.

Only the application of Wilcoxon test to median values of partial indexes shows significant differences. This follows as the 43.92% (85.53%) of sampled companies is grouped within $\pm 5\%$ net income (equity) band (Table 8).

IAS 19 – Employee benefits

Italian GAAP require the liability for TFR (Reserve for employee termination indemnity) and other post-retirement benefits to be recorded at nominal value and calculated as required by the Civil Code. Under IAS/IFRS, the liability for benefits to be paid on the termination of employment is based on actuarial assumptions, and recorded on an accruals basis consistent with the work performed to obtain such benefits and discounted; the extent of the liability is determined by independent actuaries. The gains and losses determined by the actuarial calculations are recognised as revenues or costs in the statement of operations, only when their cumulative net value exceeds 10% of the obligations under the pension plan or the fair value of the plan's assets at that date (i.e. corridor method).

The adjustments made for the measurement and recognition of the new actuarial liability for benefits associated to the obligation of firms toward their employee has determined a IAS/IFRS equity 0.62% lower than IT equity. The actuarial calculation of gains and losses shows a IAS/IFRS net income 2.52% higher than IT net income due to lower costs. Despite such differences, both the t-test and the Wilcoxon test show no statistical significance on means and medians (Tables 7), and the majority of companies are classified with a IT net income (equity) to be $\pm 5\%$ of IAS/IFRS net income (equity) (Table 8).

IAS 12 – Income taxes

Under Italian GAAP, deferred tax assets and liabilities must be calculated including all the temporary differences between the book value of an asset and the value attributed to it for tax purposes. Nevertheless, no amount must be posted if it is unlikely that the relative liability will ever have to be paid, or if it is not reasonably certain that there will be sufficient taxable income to absorb the relative deferred tax assets in the future. The adoption of IAS 12 does not provide for any special exceptions to the accrual of deferred tax liabilities, but it has requirements similar to those of Italian GAAP for deferred tax assets.

The effect of IAS 12 in the reconciliation statement of net income and shareholders' equity includes the combined effect of the net impact of deferred taxes on IAS/IFRS adjustments (such as inventories, doubtful accounts, depreciation, business combination, goodwill, revaluation of assets) and on other differences between Italian accounting principles and IAS/IFRS concerning the recognition of deferred tax assets and liabilities. The application of IAS 12 determines a negative effect showing a IAS/IFRS net income 0.19% lower than IT net income, and IAS/IFRS equity 2.92% lower than IT equity (Table 7). The t-test and the

Table 7 – Wilcoxon and t statistics for partial indexes of proportionality

Panel A: Partial indexes of proportionality of net income				
Partial adjustment	N	Median	Wilcoxon statistic	
IAS 38 – Intangible assets	145	0.0132**	7004	
IAS 19 – Employee benefits	143	0.0008	5215	
IAS 12 – Income taxes	129	-0.0073	3507	
IFRS 3 – Business combinations	101	0.0368**	3501	
IAS 16 – Property, plant and equipment	98	0.0019	2569	
IAS 37 – Provisions, contingent liabilities and contingent assets	62	-0.0062*	483	
IAS 39 – Financial instruments: recognition and measurement	62	-0.0058*	658	
IAS 2 – Inventories	43	0.0022	529	
IAS 17 – Leases	40	-0.0004	381	
IAS 32 – Financial instruments: disclosure and presentation	27	-0.0093**	80	
Partial adjustment	N	Mean	StDev	t statistic
IAS 38 – Intangible assets	145	0.0189	0.4079	0.56
IAS 19 – Employee benefits	143	0.0252	0.2739	1.10
IAS 12 – Income taxes	129	-0.0019	0.3636	-0.06
IFRS 3 – Business combinations	101	0.1248*	0.4926	2.55
IAS 16 – Property, plant and equipment	98	0.0327	0.2915	1.11
IAS 37 – Provisions, contingent liabilities and contingent assets	62	-0.0267**	0.1010	-2.08
IAS 39 – Financial instruments: recognition and measurement	62	-0.0560*	0.2294	-1.92
IAS 2 – Inventories	43	0.0577	0.2278	1.66
IAS 17 – Leases	40	-0.0004	0.2074	-0.01
IAS 32 – Financial instruments: disclosure and presentation	27	-0.0810	0.2568	-1.64
Panel B: Partial indexes of proportionality of equity				
Partial adjustment	N	Median	Wilcoxon statistic	
IAS 38 – Intangible assets	151	-0.0031**	3446	
IAS 19 – Employee benefits	150	0.0005	6015	
IAS 12 – Income taxes	132	-0.0056**	2953	
IAS 16 – Property, plant and equipment	112	0.0082**	5431	
IFRS 3 – Business combinations	110	0.0122**	4986	
IAS 39 – Financial instruments: recognition and measurement	72	-0.0008	1213	
IAS 37 – Provisions, contingent liabilities and contingent assets	62	0.0026**	1483	
IAS 32 – Financial instruments: disclosure and presentation	55	-0.0102**	51	
IAS 17 – Leases	43	0.0036**	724	
IAS 2 – Inventories	42	0.0010	586	
Partial adjustment	N	Mean	StDev	t statistic
IAS 38 – Intangible assets	151	-0.0020	0.1088	-0.22
IAS 19 – Employee benefits	150	-0.0062	0.0584	-1.29
IAS 12 – Income taxes	132	-0.0292*	0.1540	-2.18
IAS 16 – Property, plant and equipment	112	0.0483**	0.1451	3.52
IFRS 3 – Business combinations	110	0.0292**	0.0790	3.88
IAS 39 – Financial instruments: recognition and measurement	72	0.0049	0.0395	1.05
IAS 37 – Provisions, contingent liabilities and contingent assets	62	0.0021	0.0557	0.29
IAS 32 – Financial instruments: disclosure and presentation	55	-0.0207**	0.0244	-6.32
IAS 17 – Leases	43	0.0165*	0.0549	1.98
IAS 2 – Inventories	42	0.0125	0.0764	1.06

Note: * Total index is significantly different from the neutral value 0.0 at 5%.

** Total index is significantly different from the neutral value 0.0 at 1%.

Wilcoxon test indicate significant differences on both average and median values of equity partial indexes. Most of companies are classified within $\pm 5\%$ band, but 54 companies on 102 show an equity partial index between -0.0499 and 0.0 (Table 8).

IFRS 3 – Business combinations

The Italian accounting system requires that goodwill deriving from business combinations and consolidation differences posted on the consolidated financial statements are subject to systematic amortization for no more than twenty years after the purchase date. According to IFRS 3, the goodwill deriving from business combinations and consolidation differences is no longer amortized (insofar as they refer to assets with an indefinite useful life), but it is subjected to a test of recoverability of residual values carried out in compliance with IAS 36 – *Impairment of assets*. The unamortised values of goodwill and consolidation differences at the transition date are thus attributed to the identified cash generating units, whose forecast cash flows – determined in accordance with the rules defined by IAS 36 –, confirm the recoverability of the values posted on the financial statements.

The impact of the application of IFRS 3 shows an important and positive effect on IAS/IFRS net income, that results on average 12.48% higher than IT net income; and on IAS/IFRS equity, that is 2.92% higher than IT equity (Table 7). The positive effect is due to the elimination of amortization of goodwill. Both the t-test and the Wilcoxon test demonstrate significant differences, as 43 companies on 104 evidence a partial index with an IT net income 10% or more greater than IAS/IFRS net income, and 70 on 110 companies show an equity partial index between 0.0 and 0.0499 (Table 8).

IAS 16 – Property, plant and equipment

Under Italian GAAP and IAS/IFRS, assets included in property, plant and equipment are generally recorded at cost, corresponding to the purchase price plus the direct attributable cost of bringing the assets to their working condition, and depreciated over their useful life.

Under Italian GAAP, most of sampled companies revalue certain property, plant and equipment to amounts in excess of historical cost, as permitted or required by specific laws of the countries in which the assets were located. These revaluations are credited to shareholders' equity and the revalued assets are depreciated over their remaining useful lives. Furthermore, under Italian GAAP, the land directly related to buildings included in property, plant and equipment is depreciated together with the related building depreciation. The revaluations and

land depreciation are not permitted under IAS/IFRS.

The individual effect of IAS 16 on net income and shareholders' equity is the combination of the elimination of monetary revaluations of tangible assets and their relative depreciation, as well as the elimination of depreciation of land. Such elimination determine an increase of IAS/IFRS net income by 3.27% vs. IT net income, and of IAS/IFRS equity 4.83% vs. IT equity (Table 7). This last positive impact is statistically significant as tested by the t-test and the Wilcoxon test. The majority of equity partial indexes (69 on 112) are clustered with values between 0.0 and 0.0499, and 70 on 103 net income partial indexes are within the $\pm 5\%$ band (Table 8).

IAS 37 – Provisions, contingent liabilities and contingent assets

Under Italian GAAP the provisions for contingencies concern costs and charges of a determined nature, whose existence is certain or probable, but whose amounts or occurrence are not determinable at the period-end. The provisions for contingencies are stated on an undiscounted basis.

Under IFRS a provision is made only if there is a current obligation considered probable as a consequence of events occurred before period-end deriving from legal or contractual obligations or from behaviours or announcements of the company that determine valid expectations in third parties (implicit obligations), provided that the amount of the liability can be reasonably determined. When the financial effect of time is significant and the date of the expense to clear the relevant obligation can be reasonably determined, the estimated cost is discounted on the basis of the risk-free rate of interest and adjusted for the Company's credit cost.

As a consequence of the adoption of this accounting principle, the absence of a current obligation determines a reversal of the provisions and a negative effect on IAS/IFRS equity, that is 0.21% higher than IT equity (Table 7). This different accounting treatment causes a reduction of net income as a consequence of the reversal of the releases to the statement of operations of provisions recorded in 2004 under Italian GAAP, and IAS/IFRS net income 2.67% lower than IT net income. These effects are statistically significant by applying both the t-test and the Wilcoxon test, but only for medians of equity partial indexes. Most of companies are concentrated within the IT net income (equity) to be $\pm 5\%$ of IAS/IFRS net income (equity) (Table 8).

Table 7 – Distribution of partial indexes of proportionality

Panel A: Partial indexes of proportionality of net income																
	IT ≤ -10% vs. IAS/IFRS		-5% ≤ IT ≤ -10% vs. IAS/IFRS		IT ±5% vs. IAS/IFRS				5% ≤ IT ≤ 10% vs. IAS/IFRS		IT ≥ 10% vs. IAS/IFRS				Min	Max
	≤ -0.10		-0.099 - -0.05		-0.0499 – 0.0		0.0 - -0.0499		0.05 - 0.0999		≥ 0.10		Total			
	N	%	N	%	N	%	N	%	N	%	N	%	N	%		
IAS 38 – Intangible assets	22	14.86	7	4.73	23	15.54	42	28.38	16	10.81	38	25.68	148	100	-20.4595	2.6790
IAS 19 – Employee benefits	12	8.33	8	5.56	43	29.86	64	44.44	8	5.56	9	6.25	144	100	-9.6216	2.1481
IAS 12 – Income taxes	22	16.67	14	10.61	41	31.06	29	21.97	5	3.79	21	15.91	132	100	-2.9877	48.6486
IFRS 3 – Business combinations	19	18.27	6	5.77	10	9.62	21	20.19	5	4.81	43	41.35	104	100	-22.9459	43.6173
IAS 16 – Property, plant and equipment	12	11.65	6	5.83	28	27.18	42	40.78	5	4.85	10	9.71	103	100	-27.0058	3.7232
IAS 37 – Provisions, contingent liabilities and contingent assets	9	14.29	5	7.94	31	49.21	14	22.22	0	0.00	4	6.35	63	100	-3.9189	0.2711
IAS 39 – Financial instruments: recognition and measurement	12	19.35	6	9.68	18	29.03	20	32.26	3	4.84	3	4.84	62	100	-1.4180	0.4054
IAS 2 – Inventories	3	6.82	2	4.55	14	31.82	16	36.36	2	4.55	7	15.91	44	100	-0.4173	10.5806
IAS 17 – Leases	5	12.20	4	9.76	13	31.71	15	36.59	2	4.88	2	4.88	41	100	-7.0000	0.7607
IAS 32 – Financial instruments: disclosure and presentation	4	14.81	2	7.41	15	55.56	3	11.11	1	3.70	2	7.41	27	100	-1.2092	0.1281
Panel B: Partial indexes of proportionality of equity																
	IT ≤ -10% vs. IAS/IFRS		-5% ≤ IT ≤ -10% vs. IAS/IFRS		IT ±5% vs. IAS/IFRS				5% ≤ IT ≤ 10% vs. IAS/IFRS		IT ≥ 10% vs. IAS/IFRS				Min	Max
	≤ -0.10		-0.099 - -0.05		-0.0499 – 0.0		0.0 - -0.0499		0.05 - 0.0999		≥ 0.10		Total			
	N	%	N	%	N	%	N	%	N	%	N	%	N	%		
IAS 38 – Intangible assets	6	3.95	6	3.95	102	67.11	28	18.42	2	1.32	8	5.26	152	100	-0.6321	5.8193
IAS 19 – Employee benefits	2	1.33	2	1.33	59	39.33	85	56.67	2	1.33	0	0.00	150	100	-0.6530	0.0658
IAS 12 – Income taxes	10	7.58	12	9.09	54	40.91	48	36.36	5	3.79	3	2.27	132	100	-1.6327	0.2303
IAS 16 – Property, plant and equipment	1	0.89	1	0.89	13	11.61	69	61.61	10	8.93	18	16.07	112	100	-0.7435	0.7377
IFRS 3 – Business combinations	2	1.82	4	3.64	15	13.64	70	63.64	9	8.18	10	9.09	110	100	-0.1821	0.4690
IAS 39 – Financial instruments: recognition and measurement	0	0.00	2	2.78	42	58.33	22	30.56	5	6.94	1	1.39	72	100	-0.0895	0.2377
IAS 37 – Provisions, contingent liabilities and contingent assets	1	1.61	2	3.23	10	16.13	45	72.58	3	4.84	1	1.61	62	100	-0.3694	0.1489
IAS 32 – Financial instruments: disclosure and presentation	1	1.82	6	10.91	45	81.82	3	5.45	0	0.00	0	0.00	55	100	-0.1029	0.0130
IAS 17 – Leases	0	0.00	1	2.33	11	25.58	26	60.47	4	9.30	1	2.33	43	100	-0.1759	0.4062
IAS 2 – Inventories	1	2.38	0	0.00	11	26.19	27	64.29	0	0.00	3	7.14	42	100	-0.0939	0.3226

IAS 39 – Financial instruments: recognition and measurement

The main differences between Italian GAAP and IAS/IFRS may be summarized with reference to instruments defined as “hedging” and “non-hedging” derivative instruments.

Under Italian GAAP, the hedging derivative instrument is valued symmetrically with the underlying hedged item. Therefore, where the hedged item is not been adjusted to fair value in the financial statements, the hedging instrument is also not adjusted. Similarly, where the hedged item is not yet recorded in the financial statements (hedging of future flows), the valuation of the hedging instrument at fair value is deferred. Under IAS/IFRS in the case of a fair value hedge, the gains or losses from re-measuring the hedging instrument at fair value shall be recognised in the income statement, and the gains or losses on the hedged item attributable to the hedge risk shall adjust the carrying amount of the hedged item and be recognised in the income statement. Consequently, no impact arises on net income (except for the ineffective portion of the hedge, if any) and on net equity, while adjustments impact the carrying values of hedging instruments and hedged items. On the other hand, in the case of a cash flow hedge (hedging of future flows), the portion of gains or losses on the hedging instrument that is determined to be an effective hedge shall be recognised directly in equity through the statement of changes in equity; the ineffective portion of the gains or losses shall be recognised in the income statement. Consequently, with reference to the effective portion, only a difference in net equity arises between Italian GAAP and IAS/IFRS.

Under Italian GAAP, the non-hedging derivative instrument (except for foreign currency derivative instrument) is valued at market value and the differential, if negative compared to the contractual value, is recorded in the income statement in accordance with the concept of conservatism. Under IAS 39 also positive differences must be recorded. With reference to foreign currency derivative instruments, the accounting treatment adopted under Italian GAAP is in compliance with IAS 39.

The effect of IAS 39 in the reconciliation of net income and equity is mostly referred to the accounting treatment of hedging derivative instruments. The difference between IT accounting standards and IAS/IFRS is due to the recognition of the fair value of the derivative (fair value hedge and cash flow hedge) asset or liability in the balance sheet at its fair value; and in particular to the recognition of a cash flow hedge reserve in equity for the effective part (gain or loss) of the hedge as well as the recognition of the ineffective part (gain or loss) of the cash flow hedge in the income statement. The final result of these new accounting treatments is a IAS/IFRS net income 5.60% lower than IT net income, and IAS/IFRS equity 0.49% higher

than IT equity (Table 7). Both the t-test and the Wilcoxon test do not show any significant difference, except for the median values of net income partial indexes. The majority of Italian companies are classified within the IT net income (equity) to be $\pm 5\%$ of IAS/IFRS net income (equity) (Table 8).

IAS 2 – Inventories

According to the Italian set of accounting rules, most of companies determine the cost of inventories according to the LIFO (Last In, First Out) method. IAS 2 does not permit the valuation of inventories with the LIFO method, and requires alternative valuation according to FIFO (First In, First Out) or the weighted average method.

The analysis of reconciliation statements shows that most of companies apply the weighted average method and the application of this accounting treatment has determined an increase of the value of their inventories. The measurement at weighted average method evidences a IAS/IFRS net income 5.77% higher than IT net income, and a IAS/IFRS equity 1.25% higher than IT equity (Table 7). Both the t-test and the Wilcoxon test do not evidence any statistical difference. The majority of sampled companies are classified within the $\pm 5\%$ band (Table 8).

IAS 17 – Leases

Under Italian GAAP, finance leases are recognised in the income statement under an accrual basis, as the lease payment is accounted as an expense over the lease term. According to IAS/IFRS, they are recognised as tangible assets with the registering of a financial obligation of equal value. The debt is progressively reduced on the basis of a repayment plan of the lease included in the rents, while the value of the asset is systematically depreciated in accordance with its economic life.

The adoption of IAS 17 generates a negative impact on IAS/IFRS net income, that is 0.04% lower than IT net income, as a consequence of a negative difference between the reversal of leases payments and the increase in depreciation (Table 7). The recognition of finance leases in the balance sheet has a positive impact on IAS/IFRS equity, that becomes 1.65% higher than IT equity. These impacts are not statistically significant by applying the t-test and the Wilcoxon test, except for the median values of equity partial index. In 26 cases out of 43, the equity adjustment is grouped between 0.0 and 0.0499, and in 28 on 41 the net income adjustment is in the $\pm 5\%$ band (Table 8).

These results are confirmed by the study of Andrei (2006). The research analyses the IT-

IAS/IFRS reconciliation statements of all Italian companies listed on *Borsa Italiana* at 31 March 2003, and evidences a highest frequency of negative (positive) impact of IAS 17 on IAS/IFRS net income (equity).

IAS 32 – Financial instruments: disclosure and presentation

According to Italian accounting principles, companies represent treasury shares as assets in the balance sheet and record the relative value adjustments in the income statement, as well as the gains and losses deriving from the resale of their own shares. According to IAS 32, treasury shares must be recorded as a decrease in shareholders' equity and all movements relative to own shares must be recorded in the shareholders' equity rather than in the income statement.

The application of IAS 32 generates a negative effect on both IAS/IFRS net income and equity which are respectively 8.10% and 2.07% lower than IT net income and equity. The negative effect is due to the reversal of the gains from the resale of their own shares, while the negative impact on shareholders' equity is the result of the combination of the write-off of the treasury share and the reversal of the movements in gains and losses in the income statement. The negative impact is statistically different from the neutral value 0.0 by applying the t-test and the Wilcoxon test, except for the average values of net income partial indexes (Table 7). In 45 cases out of 55, the adjustment shows and equity partial index between -0.0499 and 0.0, and in 18 on 27 the net income partial indexes are grouped in the $\pm 5\%$ band (Table 8).

5. Conclusions

Beginning from the year 2005, the European Commission has required the adoption of IAS/IFRS to European listed companies. The transition to IAS/IFRS has meant a change in the whole approach to reporting for many companies, and the firms' main concern has been the extent to which accounting differences between their primary GAAP and IAS/IFRS could affect their performance measure (Street and Larson, 2004).

In Italy, despite the legislative indication and the CONSOB's position in favour of the application of IAS/IFRS, there were not significant adoption of such a set of standards before the mandatory transition requested by the European Commission. Indeed only a few listed companies have referred to a transition IAS/IFRS project in 2003 (Delville et al. 2004). This could confirm the findings of the reviewed studies showing that most of EU listed companies

did not plan to converge from national GAAP to IAS/IFRS before the required adoption, and they were not clearly motivated to move to this international accounting regime.

A survey of PricewaterhouseCoopers (2004) over 300 European firms shows their preference of and their full perception of the benefits of converting to IAS/IFRS, even though some implementation problems and impact on firms' performance have been seen as a barrier to the enforcement of IAS/IFRS. Other barriers include disagreement with certain IAS/IFRS and the complicated nature of certain IAS/IFRS.

In order to address the firms' concern about the changes introduced by the new performance measurement system, the purpose of the paper was to examine the effects of IAS/IFRS mandate adoption on the accounting practices of Italian listed companies.

The results confirm the impact of some individual adjustments pointed out by the *Organismo Italiano Italiano di Contabilità* on both net income and shareholders' equity. The total adjustment from Italian GAAP to IAS/IFRS to net income is significant with an adjustment of 14.10%. The relative adjustments that show a significant positive impact on Italian net income are referred to business combinations and intangible assets, while the accounting treatments of provisions and financial instruments evidence a significant negative effect. These effects are less relevant on shareholders' equity that decreases on average of 4.78% by converting to IAS/IFRS. This difference is explained by the significant partial adjustments relating to the negative effect of intangible assets, income taxes, financial instruments, and the positive impact of business combinations, property, plant, and equipment, provisions and leases. The calculation of the index of proportionality for ROE confirms the extent of the total adjustments to net income and shareholders' equity, as a synthesis of the two main accounting results. The ROE under Italian GAAP is significantly 12.50% lower than that calculated under IAS/IFRS.

The empirical study of Street et al. (1999) on a sample of large companies, including some from Italy, that claimed to comply to IAS is consistent with some findings of this paper. The main areas of noncompliance with IAS were research and development costs, property, plant, and equipment and business combinations. In particular, some sampled firms still capitalized some development costs, revaluated property, plant, and equipment, and charged goodwill to reserves. The individual impact of such adjustments to net income and shareholders equity measured by the partial index of proportionality provides a quantitative measure of the noncompliance areas, as well as confirms the importance of these accounting differences in highlighting the differences between Italian accounting standards and IAS/IFRS.

In summary, the study shows that the transition to IAS/IFRS has produced a quite relevant impact on Italian accounting practices, that depends *de facto* on the tax driven nature of the Italian accounting system and some disagreement with some IAS/IFRS areas relating to fair valuations, capital allocation, leasing, segment reporting, revenue recognition, impairment reviews, deferred taxation, and employee benefits. But these findings also enforce firms belief that to converge to IAS/IFRS has meant to make a deep revision and improvement of the Italian accounting system, and to adopt a global financial reporting model that will enable firms to play in a global marketplace.

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Appendix – Companies listed on *Borsa Italiana* at 31 October 2006

Companies	Sectors
1. A.S. Roma	Services/Media
2. Acea	Services/Utilities
3. Acegas-Aps	Services/Utilities
4. Acotel Group	Services/Information Technology
5. Acque Potabili	Services/Utilities
6. Acsm	Services/Utilities
7. Actelios	Services/Utilities
8. Aem	Services/Utilities
9. AEM Torino	Services/Utilities
10. Aeroporto di Firenze	Services/Transport-Tourism
11. Alitalia	Services/Transport-Tourism
12. Amplifon	Industrials/Electronic and electrical equipment
13. Ansaldo Sts	Industrials/Electronic and electrical equipment
14. Antichi Pellettieri	Industrials/Household goods-Textiles
15. Arkimedica	Industrials/Other services
16. ARTE'	Services/Media
17. Asm	Services/Utilities
18. Astaldi	Industrials/Constructions and building materials
19. Autogrill	Services/Transport-Tourism
20. Autostrada Torino-Milano	Services/Transport-Tourism
21. Autostrade	Services/Transport-Tourism
22. BasicNet	Industrials/Household goods-Textiles
23. Beghelli	Industrials/Electronic and electrical equipment
24. Benetton	Industrials/Household goods-Textiles
25. Biesse	Industrials/Engineering-Machinery
26. Bioera	Industrials/Engineering-Machinery
27. Boero Bartolomeo	Industrials/Constructions and building materials
28. Bolzoni	Industrials/Engineering-Machinery
29. Bonifiche Ferraresi	Industrials/Foods
30. Brembo	Industrials/Automobiles
31. Bulgari	Industrials/Household goods-Textiles
32. Buongiorno Vitaminic	Services/Information Technology
33. Buzzi Unicem	Industrials/Constructions and building materials
34. CAD IT	Services/Information Technology
35. Cairo Communications	Services/Telecommunications
36. Caleffi	Industrials/Household goods-Textiles
37. Caltagirone Editore	Services/Media
38. Camfin	Services/General retailers
39. Campari	Industrials/Foods
40. Carraro	Industrials/Automobiles
41. Cdb Web Tech	Services/Information Technology
42. Cdc	Services/Information Technology
43. Cembre	Industrials/Electronic and electrical equipment
44. Cementir	Industrials/Constructions and building materials
45. Centrale del Latte di Torino	Industrials/Foods
46. Ceramiche Ricchetti.	Industrials/Chemicals
47. Chl	Services/Information Technology
48. Class Editori	Services/Media
49. Cremonini	Industrials/Foods
50. Crespi	Industrials/Chemicals
51. CSP	Industrials/Household goods-Textiles
52. Dada	Services/Information Technology
53. Danieli	Industrials/Engineering-Machinery
54. Data Service	Services/Information Technology
55. Datalogic	Services/Information Technology
56. Datamat	Services/Information Technology
57. De'Longhi	Industrials/Engineering-Machinery

58. Digital Bros	Services/Information Technology
59. Dmail Group	Services/Information Technology
60. DMT	Services/Media
61. Ducati	Industrials/Automobiles
62. Edison	Services/Utilities
63. EEMS	Services/Information Technology
64. El.En.	Services/Information Technology
65. Emak	Industrials/Electronic and electrical equipment
66. Enel	Services/Utilities
67. Enertad	Services/Utilities
68. Engineering	Services/Information Technology
69. Eni	Industrials/Steel-Other metals-Oil-Gas
70. Erg	Industrials/Steel-Other metals-Oil-Gas
71. Esprinet	Services/Information Technology
72. Euphon	Services/Information Technology
73. Eurofly	Services/Transport-Tourism
74. Eurotech	Industrials/Other industrials
75. Eutelia	Services/Telecommunications
76. Exprivia	Services/Software
77. Fastweb	Services/Telecommunications
78. Fiat	Industrials/Automobiles
79. Fidia	Industrials/Engineering-Machinery
80. Fiera Milano	Services/Other services
81. Filatura di Pollone	Industrials/Household goods-Textiles
82. Finmeccanica	Industrials/Electronic and electrical equipment
83. FNM Ferrovie Nord Milano	Services/Transport-Tourism
84. FullSix	Services/Media
85. Gefran	Industrials/Electronic and electrical equipment
86. Geox	Industrials/Household goods-Textiles
87. Gewiss	Industrials/Electronic and electrical equipment
88. Gruppo Editoriale L'Espresso	Services/Media
89. Gruppo Hera	Services/Utilities
90. GranitiFiandre	Industrials/Chemicals
91. Greenvision ambiente	Industrials/Constructions and building materials
92. Gruppo Coin	Services/General retailers
93. Guala Closures	Industrials/Foods
94. I Grandi Viaggi	Services/Transport-Tourism
95. I Viaggi del Ventaglio	Services/Transport-Tourism
96. I.M.A.	Industrials/Engineering-Machinery
97. INet	Services/Information Technology
98. Impregilo	Industrials/Constructions and building materials
99. Indesit Company	Industrials/Electronic and electrical equipment
100. Innotech	Services/Information Technology
101. Intek	Industrials/Electronic and electrical equipment
102. Interpump Group	Industrials/Electronic and electrical equipment
103. Investimenti e Sviluppo	Industrials/Household goods-Textiles
104. Irce	Industrials/Electronic and electrical equipment
105. Isagro	Industrials/Chemicals
106. IT Holding	Industrials/Household goods-Textiles
107. Itway	Services/Information Technology
108. Italcementi	Industrials/Constructions and building materials
109. Jolly Hotel	Services/Transport-Tourism
110. Juventus Football Club	Services/Media
111. Kaitech	Services/Information Technology
112. Kerself	Industrials/Engineering-Machinery
113. La Doria	Industrials/Foods
114. Lavorwash	Industrials/Electronic and electrical equipment
115. Linificio	Industrials/Household goods-Textiles
116. Lottomatica	Services/Other services
117. Luxottica Group	Industrials/Household goods-Textiles

118. Maffei Spa	Industrials/Steel-Other metals-Oil-Gas
119. Marazzi Group	Industrials/Chemicals
120. Marcolin	Industrials/Household goods-Textiles
121. Mariella Burani.	Industrials/Household goods-Textiles
122. Marr	Industrials/Foods
123. Marzotto	Industrials/Household goods-Textiles
124. Mediaset	Services/Media
125. Mediterranea Acque	Services/Utilities
126. Mirato	Industrials/Chemicals
127. Mondadori Editore	Services/Media
128. Mondo Tv	Services/Media
129. Montefibre	Industrials/Chemicals
130. Monti Ascensori	Industrials/Engineering-Machinery
131. Navigazioni Montanari	Services/Transport-Tourism
132. Negri Bossi	Industrials/Engineering-Machinery
133. Nice	Industrials/Electronic and electrical equipment
134. Noemalife	Services/Software
135. Olidata	Industrials/Electronic and electrical equipment
136. Pagnossin	Industrials/Chemicals
137. Panariagroup Industrie Ceramiche	Industrials/Chemicals
138. Parmalat	Industrials/Foods
139. Permasteelisa	Industrials/Constructions and building materials
140. Piaggio & C.	Industrials/Automobiles
141. Pierrel	Industrials/Chemicals
142. Pininfarina Spa	Industrials/Automobiles
143. Pirelli & C.	Industrials/Chemicals
144. Poligrafica San Faustino	Services/Media
145. Poligrafici Editoriale	Services/Media
146. Polynt	Industrials/Chemicals
147. Premuda	Services/Transport-Tourism
148. Prima Industrie	Industrials/Engineering-Machinery
149. Ratti	Industrials/Household goods-Textiles
150. RCS MediaGroup	Services/Media
151. Recordati	Industrials/Chemicals
152. Reno De Medici	Industrials/Papers
153. Reply	Services/Media
154. Retelit	Services/Telecommunications
155. RGI	Services/Software
156. Richard-Ginori 1735	Industrials/Chemicals
157. Roncadin	Industrials/Foods
158. S.S. Lazio	Services/Media
159. Sabaf	Industrials/Electronic and electrical equipment
160. Sadi Spa	Industrials/Constructions and building materials
161. Saes Getters	Industrials/Electronic and electrical equipment
162. Safilo	Industrials/Household goods-Textiles
163. Saipem	Industrials/Engineering-Machinery
164. Saras	Industrials/Steel-Other metals-Oil-Gas
165. Save	Services/Transport-Tourism
166. Schiapparelli 1824	Industrials/Chemicals
167. SEAT Pagine Gialle	Services/Media
168. SIAS	Services/Transport-Tourism
169. Sicc	Industrials/Electronic and electrical equipment
170. Sirti	Industrials/Electronic and electrical equipment
171. Smurfit Sisa	Industrials/Other industrials
172. Snam Rete Gas	Services/Utilities
173. Snia	Industrials/Chemicals
174. Socotherm	Industrials/Other industrials
175. Sogefi	Industrials/Automobiles
176. Sol	Industrials/Chemicals
177. Sorin	Industrials/Other industrials

178. Stefanel	Industrials/Household goods-Textiles
179. Targetti Sankey	Industrials/Electronic and electrical equipment
180. TAS	Services/Information Technology
181. Telecom Italia	Services/Utilities
182. Telecom Italia Media	Services/Media
183. Terna	Services/Utilities
184. Tiscali	Services/Information Technology
185. TOD'S	Industrials/Household goods-Textiles
186. Trevi - Finanziaria Industriale	Industrials/Engineering-Machinery
187. Trevisan Cometal	Industrials/Engineering-Machinery
188. TXT e-solutions	Services/Information Technology
189. Valentino	Industrials/Household goods-Textiles
190. Valsoia	Industrials/Foods
191. Vemer Siber	Industrials/Electronic and electrical equipment
192. Vianini Industria	Industrials/Constructions and building materials
193. Vianini Lavori	Industrials/Constructions and building materials
194. Zucchi	Industrials/Household goods-Textiles
