Journal of International Business and Law

Volume 8 | Issue 1 Article 7

2009

The International Accounting Debate: Options in Standardization

Keith Bader

THE INTERNATIONAL ACCOUNTING DEBATE: OPTIONS IN STANDARDIZATION

*Keith Bader**

INTRODUCTION

In the next few years, the accounting industry in the United States will experience numerous changes in generally accepted practices. The traditional wisdom of following U.S. Generally Accepted Accounting Principles (GAAP) is now being questioned; both financial statement users and preparers are calling for a standardized, more widely-accepted approach to financial reporting in order to "reduce diversity and harmonize accounting standards and practices internationally."[1] The increased use of such standards, collectively known as International Financial Reporting Standards (IFRS), by companies based in countries around the world is evidence of this phenomenon.

Additional evidence suggesting a trend towards establishing one set of reporting standards exists in the "Roadmap to Convergence," developed by the Securities and Exchange Commission (SEC). Under this initiative, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are working together to "bring about a common set of accounting standards that will enhance the quality, comparability and consistency of global financial reporting, enabling the world's capital markets to operate more effectively."[2] Their proposed date for reaching full adoption of one set of reporting standards is the year 2014.[3] Further evidence of this trend can be found in the U.S. SEC's relaxing of the

---

* MBA Candidate in Accounting, 2009, Frank G. Zarb School of Business, Hofstra University. I would like to thank Dr. James Neelankavil and the entire staff of the Journal of International Business & Law for all their help in getting this article published. Additionally, I would like to thank Dr. Richard Jones for his guidance and support in this endeavor. Finally, I would like to thank my parents for always encouraging me to do my best.

[1] Doupnik, Timothy and Hector Perera, International Accounting. (New York: McGraw-Hill Irwin, 2007), p75.

[2] Taub, Stephen, "FASB, IASB Issue Convergence 'Roadmap'," CFO.com, 2/27/2006.

[3] Moberg, Liza McAndrew, "Speech by SEC Staff: Remarks before the 2008 AICPA National Conference on Current SEC and PCAOB Developments," 12/8/2008. Source: www.sec.gov/news/speech/2008.

reconciliation requirement between U.S. GAAP and IFRS in 2007. The removal of this requirement, which applied to all non-U.S. companies reporting under IFRS, "allow[ed] foreign private issuers to file their financial statements without reconciliation to U.S. GAAP."[4] These significant events indicate a shift toward one set of reporting standards. Because of initiatives such as the "Roadmap to Convergence," an understanding of the different alternatives available toward achieving a single set of high quality reporting standards is crucial.

The proliferation of cross-border entities and the globalization process as a whole have both played critical roles in encouraging this standardization process. However, in moving toward one set of reporting standards, the United States has three options. First, the U.S could pursue convergence of standards, whereby elements of both U.S. GAAP and IFRS are brought together. The second alternative is wholesale adoption of IFRS, which would require the U.S. to abandon its traditional GAAP standards and fully espouse IFRS. Finally, there is the option of keeping U.S. GAAP intact. Choosing which option to follow is a matter of great controversy. In the following sections, arguments for and against each alternative will be presented. However, before delving further into such an analysis, an examination of the history of this controversy is prudent.

I. HISTORY & ORGANIZATIONAL STRUCTURE / FRAMEWORK

The concept of establishing one set of global accounting standards is not new, as it dates back over forty years. "[T]he need for high quality 'global GAAP' was officially recognized in 1966, when professional accounting bodies first began working towards a set of globalized accounting standards."[5] Since then, as a byproduct of globalization, "world capital markets have become increasingly tied to one another, and so 'integrated and interdependent' that 'the stability of one market affects others.'"[6] Efforts to advance the process of globally standardizing accounting standards accelerated dramatically in the late 1990s when "a heightened recognition of the benefits of having 'one set of high-quality globally recognized financial reporting standards'" was achieved.[7]

---

[4] Weiss, Paul, "SEC Proposes to Eliminate Reconciliation Requirement for IFRS Financial Statements," www.businesswire.com, 7/19/2007.

[5] Irvine, Helen J. and Natalie Lucas, "The Rationale and Impact of the Adoption of International Financial Reporting Standards: The Case of the United Arab Emirates." *Faculty of Commerce – Papers, University of Wollongong*, (2006), p2.

[6] *Ibid.*

[7] *Ibid.*

The call for such global accounting standards was answered in 2001, when the IASB was formed as a result of the restructuring of its predecessor, the International Accounting Standards Committee (IASC), in accordance with the expectations of the International Organization of Securities Commissions (IOSCO).

The IASB is an independent, industry-driven standard-setting board, appointed and overseen by a geographically and professionally diverse group of Trustees of the IASC Foundation.[8] The twenty-two Trustees of the IASC Foundation are responsible for governance, oversight and funding.[9] The IASC Foundation appoints members of the IASB, the International Financial Reporting Interpretations Committee (IFRIC), and the Standards Advisory Council (SAC).[10] The SAC is a forum for the IASB to consult with a wide range of representatives from user groups, preparers, financial analysts, academics, auditors, regulators, and professional accounting bodies that are affected by the IASB's pronouncements.[11] Trustees are appointed for a renewable term of three years and must be chosen in the following way: six must be selected from the Asia/Oceania region, six from Europe, six from North America, and four from any other region.[12] Also, each is expected to have an understanding of international issues relevant to the development of global accounting standards.[13]

The IASB works with national accounting standard-setters to achieve convergence in accounting standards worldwide. Their mission is "to develop, in the public interest, a single set of high quality, understandable and international financial reporting standards (IFRSs) for general purpose financial statements."[14] The IASB's strategy is "to identify the best standard and build a body of accounting standards that constitute the highest common denominator of financial reporting."[15] By using an open process, the IASB develops principles-based international financial reporting standards (IFRSs) that focus on establishing general principles derived from the IASB Framework.[16]

Since its formation, the IASB has worked extensively with the FASB towards achieving their joint goal of convergence. Among other things,

---

[8] http://www.iasb.org.

[9] *Ibid.*

[10] *Ibid.*

[11] *Ibid.*

[12] *Ibid.*

[13] *Ibid.*

[14] *Ibid.*

[15] *Ibid.*

[16] *Ibid.*

convergence is a logical and necessary goal because it will help improve the comparability and understandability of financial statements of companies based in countries around the world. Additionally, convergence will result in higher-quality standards which will facilitate investor decisions. A further discussion follows in section II.

The early efforts of the IASB and the FASB led to the famous Norwalk Agreement (also known as the Memorandum of Understanding). This agreement was the result of a meeting held at the FASB's offices in Norwalk, Connecticut in September of 2002. At this meeting, the two groups "pledged to use their best efforts to (1) make their existing financial reporting standards fully compatible as soon as is practicable and (2) to coordinate their work program to ensure that once achieved, compatibility is maintained."[17] It is important to note that "compatible does not mean [word-for-word] identical [standards]"; rather, it "means the two sets of standards do not contain conflicts."[18] In 2006, and again in 2008, the IASB and the FASB reaffirmed their commitment to work closely toward achieving convergence.

But what exactly is convergence? From an historical perspective, the concept of convergence originated from "a program of harmonization of national GAAPs," which the IASC began in 1973.[19] Harmonization meant:

- [D]eveloping IASC standards that could serve as a model on which national standard setters could base their own standards[;]
- [N]arrowing but not necessarily eliminating the range of acceptable methods of accounting for particular types of transactions[;]
- [D]eveloping standards that set out broad principles but did not include the degree of detail that would almost surely put them in conflict with most of the existing standards[; and]
- [W]riting standards that were more descriptive of acceptable practices than prescriptive.[20]

This concept of harmonization evolved into one of convergence in 2001 when the IASC was restructured, resulting in the formation of the IASB.[21]

Convergence became the new goal and it called for a higher quality set of global accounting standards.[22] Under the purview of 'achieving

---

[17] Doupnik, Timothy and Hector Perera, International Accounting. (New York: McGraw-Hill Irwin 2007), p101.

[18] Pacter, Paul, "What Exactly Is Convergence?" International Journal of Accounting, Auditing, and Performance Evaluation, 2, Nos. 1/2 (2005).

[19] *Ibid.*

[20] *Ibid.*

[21] *Ibid.*

[22] *Ibid.*

convergence,' the organization sought "to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements, and other financial reporting to help participants in the world's capital markets and other users make economic decisions [,] and to promote the use and rigorous application of those standard [,] to bring about convergence of national accounting standards and International Accounting Standards to high quality solutions."[23] Although many efforts toward convergence have been made, some U.S. commentators, such as PCAOB member Charles Niemeier, have not embraced the idea of commingling the U.S.'s rules-based standards with more lax, principles-based standards.[24] Other opponents of convergence believe that "the world needs to adopt a single set of high-quality global accounting and financial reporting standards . . . [and] . . . that IFRS should serve as that set of standards."[25] Therefore, although some might favor a convergence effort, combining the standards of both U.S. GAAP and IFRS, others would prefer retaining the traditional U.S. model. However, there are some who also believe wholesale adoption of IFRS is the best alternative.

II. POSSIBLE OPTIONS IN STANDARDIZATION

A. Convergence

There are distinct advantages and disadvantages in the pursuit of an effort of convergence. In the broadest sense, the advantages of convergence include:

- Improved comparability of financial statements
- Reduced investor risk through facilitating diversification
- Desired standardization in the most reasonable way
- Increased reliability of financial statements
- Decreased complexity of standards, thereby making them easier to understand while simultaneously providing an adequate level of guidance

---

23 *Ibid.*

24 Kranacher, Mary-Jo, "An Interview with Charles D. Niemeier, Public Company Accounting Oversight Board Member; At the Frontlines in the Battle for Investor Protection," CPA Journal, 78 (2008), pp16-22.

25 Heffes, Ellen M., "Global Accounting Firm CEOs on Challenges Transitioning from GAAP to IFRS, and More," Financial Executive, 1 (2008).

One argument, posed by many proponents of accounting convergence is that "comparability of financial statements worldwide is necessary for the globalization of capital markets."[26] Further, comparable financial statements would facilitate the evaluation of potential investments in foreign securities. This will enable investors to "take advantage of the risk reduction possible through international diversification."[27] Additionally, some believe that convergence would "help raise the quality level of accounting practices internationally, thereby increasing the credibility of financial information."[28] Lastly, some propose that "a sensible way to achieve a single set of global accounting standards in a reasonable time span is to work towards convergence of IFRSs and US GAAP, in turn causing a 'trickle down effect' in those countries that continue to maintain their national GAAPs. And this is the approach the IASB has adopted."[29] These are the standard arguments in favor of a general harmonization of accounting standards.

More specific to convergence, some argue that such an effort should be pursued because by converging the two sets of standards (i.e. U.S. GAAP and IFRS), the new set of uniform, global standards will not be "as overwhelming as[, say,] US GAAP, while at the same time, providing a reasonable level of guidance [for financial statement users]."[30] Additional support for pursuing an effort of convergence came in 2002 with the passage of the Sarbanes-Oxley Act. "Section 108 of the Act permits the SEC to recognize [sic] standards established by a private-sector accounting standard-setter (i.e. FASB) provided that the standard-setter considers 'the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors."'[31] This significant piece of legislation "provided some impetus and support for the Norwalk agreement," which called for a convergence of standards.[32]

However, there are some potential drawbacks, or challenges, in attempting to converge two sets of inherently disparate standards. These challenges include:

- High magnitude of differences in reporting standards between countries

---

[26] Doupnik Timothy and Hector Perera, International Accounting (New York: McGraw-Hill Irwin 2007), p76.

[27] *Ibid.*

[28] *Ibid.*

[29] Pacter Paul, "What Exactly Is Convergence?" International Journal of Accounting, Auditing, and Performance Evaluation, 2, Nos. 1/2 (2005).

[30] *Ibid.*

[31] *Ibid.*

[32] *Ibid.*

- High cost of convergence
- Doubt over the need for convergence
- Strong belief by some that differences in reporting standards are necessary, as delineated in the concept of the "Global Dilemma" discussed below.
- Convergence will be fruitless without strong, competent enforcement

By some estimates, "the greatest obstacles to [convergence] are the magnitude of the differences that exist between countries and the fact that the cost of eliminating those differences would be enormous."[33] Overcoming such differences will be very difficult and, by some measures burdensome. Additionally, "not only is [convergence] difficult to achieve, but also the need for such standards is not universally accepted."[34] These are two central challenges that must be faced when pursuing an effort of convergence.

Another challenge of pursuing convergence, in light of the globalization process, is the idea of a "global dilemma," first posited by Professor Frederick Choi. The "global dilemma" refers to another potent argument against convergence, which says that "because of different environmental influences, differences in accounting [standards] across countries might be appropriate [and even] necessary."[35] Such differences could result from countries being at "different stages of economic development, or countries relying on different sources for financing."[36] Because some differences between reporting standards may be necessary, the idea of combining all accounting standards into one global set has not been accepted by all.

Additionally, not everyone is convinced of the need for a single set of standards. According to some, "full harmonization of international accounting standards is probably neither practical nor truly valuable. . .it is not clear whether significant benefits would be derived in fact." [37] Further, these critics of convergence argue that "a well-developed global capital market exists already [and] it has evolved without uniform accounting standards."[38] Lastly, some are concerned that convergence "will not work without enforcement."[39]

---

[33] Doupnik, Timothy and Hector Perera. International Accounting. New York: McGraw-Hill Irwin (2007), p76.

[34] *Ibid.*

[35] Choi, Frederick D. "A Cluster Approach to Harmonization," Management Accounting ,(1981), p29.

[36] *Ibid.*

[37] Goeltz, Richard K. "International Accounting Harmonization: The Impossible (and Unnecessary?) Dream," Accounting Horizons, (1991), pp85-86.

[38] *Ibid.*

[39] Pacter, Paul. "What Exactly Is Convergence?" International Journal of Accounting, Auditing,

They argue that "in an international environment with national capital markets in various stages of development and maturity, enforcement of [these] standards [will] be more challenging than in the U.S. environment." [40] As a result, because convergence will not work without strong enforcement, and such enforcement will be untenable at best, convergence of standards may not be the best alternative to pursue.

B. Wholesale Adoption of IFRS

As an alternative to converging U.S. GAAP standards with IFRS, some believe wholesale adoption of IFRS is the best course of action. Proponents of wholesale adoption of IFRS cite many reasons for this. The two most significant arguments are:

- All member nations of the European Union (EU) have fully adopted IFRS
- Wholesale adoption benefits both developed and developing countries alike

This first significant argument in favor of wholesale adoption of IFRS has become a very dominant one in recent years because "[i]n the European Union (EU), for listed companies, convergence has simply been bypassed in favor [sic] of [wholesale] adoption of IFRSs."[41] "In June 2002, the Council of the EU approved an Accounting Regulation requiring all European companies listed on a stock exchange in the EU to follow IASB standards in their consolidated financial statements starting in 2005."[42] Since then, the twenty-five member states of the EU and three members of the European Economic Area have all switched to IFRSs as the basis of their financial reporting; this means that 9,000 of the largest companies in these twenty-eight countries now report under IFRS.[43] Because the U.S. has relations with many of these countries, this is a potent argument in favor of wholesale adoption of IFRS. These twenty-eight countries are listed in Table 1 below.[44]

and Performance Evaluation, 2, Nos. 1/2 (2005).

[40] *Ibid.*

[41] *Id.* at 75.

[42] *Ibid.*

[43] *Ibid.*

[44] *Ibid.*

Table 1: 28 Countries which have fully adopted IFRS as of 2005

Austria	Belgium	Cyprus	Czech Republic	Denmark
Estonia	Finland	France	Germany	Greece
Hungary	Iceland	Ireland	Italy	Latvia
Liechtenstein	Lithuania	Luxembourg	Malta	Norway
Poland	Portugal	Slovakia	Slovenia	Spain
Sweden	The Netherlands	UK		

Currently there are over one hundred countries around the world that have fully adopted IFRS. Additionally, some countries continue in their efforts to pursue wholesale adoption. Figure 1 below, adapted from the IASB website, is a pictorial representation of those countries as of 2008.[45]

Figure 1: Prevalence of wholesale adoption of IFRS in countries around the world

A second argument in favor of wholesale adoption says that, for developing nations, "[t]he prospect of greater mobility of capital at a decreased cost, more efficient allocation of resources, improved quality of financial

[45] www.iasb.org.

reporting, a decline in earnings management, and [an] avoidance of the necessity of having to develop their own accounting standards, against a backdrop of the accountability demands of the World Bank and IMF [the International Monetary Fund], are all compelling incentives for the adoption of IFRS by countries wishing to participate in global capital markets."[46] Additionally, wholesale adoption of IFRS benefits the developed countries, because "[t]he adoption of IFRS will save multinational corporations the expense of preparing more than one set of accounts for different national jurisdictions."[47] Other benefits of wholesale adoption include "[the enhancement] of the professional status of accounting bodies" and "the [opportunity for] the big international accounting firms [to] benefit in their efforts to expand the global market for their services."[48]

Of course, as with convergence, there are some drawbacks to pursuing an effort of wholesale adoption of IFRS. First, "there are still significant difficulties for all countries in handing over power to an international body, particularly when global GAAP includes such differences in measurement and terminology."[49] This argument refers to the challenges of translating each country's local GAAP into a clear and concise reporting model that is well understood in different languages and contexts. Another related challenge faced by countries that already opted for wholesale adoption is "the taking of a foreign concept and translating it into another language where there is no exact equivalent terminology or regulatory infrastructure."[50] This statement again attests to the fact that, due to such structural differences, some of the challenges faced in wholesale adoption of IFRS in light of the globalization process will prove to be difficult, if not insurmountable.

Some critics of wholesale adoption believe that "in many developing and emerging countries, the accounting profession is not developed to the point where it can regulate accounting and financial reporting effectively as it must do in the implementation of IFRS."[51] Further, in the United States, certain of the rules in U.S. GAAP are tied to tax law and as a result, abandoning U.S. GAAP altogether will prove to be problematic. The same is true in other nations, where "the regulatory infrastructure [of these countries] may not

---

[46] Irvine, Helen J. and Natalie Lucas. "The Rationale and Impact of the Adoption of International Financial Reporting Standards: The Case of the United Arab Emirates." *Faculty of Commerce – Papers, University of Wollongong*, (2006), p2.

[47] *Id.*

[48] *Ibid.*

[49] *Ibid.*

[50] *Ibid.*

[51] *Ibid.*

provide the sound financial reporting base or corporate governance structures implicit in the adoption of IFRS, which may [in turn] necessitate coordination of legislative requirements to overcome inconsistencies between IFRS and national laws."[52]

Additional arguments against wholesale adoption of IFRS are more subjective in nature. For example, some believe that "IFRS-compliant annual reports are too complex and that users [have] to be financially literate to understand them."[53] Others contend that a complete overhaul of accounting standards would be very costly, as the process would require "professional expertise, education and training, legal backing, substantial equity financing in the form of both multinational corporations and local companies, and the possibility of adopting IFRS with amendments to suit [each country's] own specific culture and legislative infrastructure."[54] Such costs would not be outweighed by the benefits. In a recent study conducted by researchers at the Institute of Chartered Accountants of Scotland, it was discovered that, for financial statement users in the UK and Ireland, "financial statements produced under IFRS had not changed any of their investment decisions and they did not consider them to be any more decision-useful than UK/Irish GAAP financial statements."[55] In consideration of these arguments, wholesale adoption of IFRS may not be the best course of action either.

CONCLUSION

Although there are many arguments for and against convergence of U.S. GAAP and IFRS, and wholesale adoption of IFRS, the decision as to which course of action to take is a difficult one and has been the topic of much controversy in the accounting industry. Proponents of convergence argue that it is the better alternative to wholesale adoption of IFRS because it would aid in comparability of financial statements and facilitate investor decisions, thereby reducing risk. Additionally, convergence "would reduce financial reporting costs for companies that seek to list their shares on foreign stock exchanges" and such cross-listing of securities "would allow companies to gain access to

---

[52] *Ibid.*

[53] Dunne, Theresa, et. al. "The Implementation of IFRS in the UK, Italy, and Ireland: Executive Summary," *The Institute of Chartered Accountants of Scotland*, 2008.

[54] Irvine, Helen J. and Natalie Lucas. "The Rationale and Impact of the Adoption of International Financial Reporting Standards: The Case of the United Arab Emirates." *Faculty of Commerce – Papers, University of Wollongong*, 2006, p2.

[55] Dunne, Theresa, et. al. "The Implementation of IFRS in the UK, Italy, and Ireland: Executive Summary," *The Institute of Chartered Accountants of Scotland*, 2008.

less expensive capital in other countries and would make it easier for foreign investors to acquire the company's stock."[56] Opponents of convergence cite that it is difficult to achieve and that it will not work without enforcement.

Those in favor of wholesale adoption of IFRS claim that it will improve developing nations' access to capital and it will save multinational corporations the added expense of creating more than one set of financials. Opponents of wholesale adoption are largely not convinced of its utility to financial statement users and also point out that one set of global accounting standards may not be practical due to certain inconsistencies between IFRS and each country's local laws. Nonetheless, these opponents still acknowledge that there are clear benefits to the wholesale adoption of one set of reporting standards for both developed and developing countries around the world.

Presently, IFRS is widely accepted among countries outside of the U.S. Additionally, the SEC has already established a timetable for the wholesale adoption of IFRS. As a result, in consideration of these two factors, the arguments for and against each alternative, and the challenges identified in light of the globalization process, it seems reasonable to conclude that the accounting profession will embrace wholesale adoption of IFRS over the coming years.

[56] Doupnik, Timothy and Hector Perera. International Accounting. (New York: McGraw-Hill Irwin 2007), p76.