What is required: convergence or harmonization of accounting standards research p...

Business, Company

Post the Globalization era, the financial scandal of Enron and then the global economic and financial meltdown has raised the issue of convergence of the accounting standards. This is because both of the prevailing accounting standard, IFRS and GAAP, have different rules in their accounting standards, it has caused quite a complexity in the accounting world which is disclosed below:

- It causes difficulty and complexity in comparison on financial statements. For instance, if an investor is analyzing an Australian Company and an American company in the same industry, where the Australian company is using IFRS Standards while US company is based on GAAP Standards, the investor and analyst have to convert one of the financial statement to facilitate the comparison. This is because of difference in accounting standards.
- Different rules and standards under each standard also cause the problems of complexity and non-lucid presentation to the investors.
- Since there are differences in accounting standards, the ones who prepares the financial statements can exploit these differences by involving into window dressing or synthetic accounting. For Instance, users of GAAP accounting standards may use LIFO inventory method for the purpose of tax reporting as this leads to high cost of goods sold and thus lower profits leading to lower tax liability. However, he may adopt IFRS for financial reporting purpose and show high profits to the investors or analysts by switching to GAAP standards

Thus, in order to promote comparability among the financial statement and to make the accounting environment simple and easy to understand, many nations around the globe are now being forced to adopt convergence between the accounting standards. Even countries like United States have been facing the pressure now to end the gap between IFRS and GAAP. Such changes, if implemented will have global consequences on the world of accounting diversity and will surely affect the investors, stock market and accounting professionals. Important to note, that, the demand for convergence between IFRS and GAAP had been raised soon after IFRS standards were introduced. Prior to introduction of IFRS, most of the nations had their own national accounting standards and post the introduction of IFRS, the ideal decision proposed by accounting bodies were to move from here towards adopting an accounting standard which will lead to no difference in accounting standard of all the countries and thus it was proposed that nations will adopt only IFRS Reporting standards while preparing their financial statements and this will ensure fairness and easy comparability as all the companies around the globe will be using exactly the same rules for the purpose of recording and reporting of their key business transactions. We shall start with thinking about the fact, that, prior to the introduction of IFRS, most nations had their own national accounting standards. This whole process is a representation of convergence of US GAAP and IFRS.

But, in reality, the scenario is not that simple. Despite of need for the convergence of the accounting standards, the accounting standard setting bodies has been unsuccessful because of the following reasons:

Political Pressure: The continuous barrier in convergence of the accounting standards is the political pressure which the regulatory bodies face from business groups and others who will be affected by the changes in the reporting standards.

Non-alignment of interests: Different standard setting bodies and the regulatory authorities of different countries can and do disagree over the best treatment of the particular issue or item

Thus, in reality, rather than convergence, many countries are now moving towards harmonization rather than converging on accounting standards. The term harmonization differs completely from the convergence and refers to the process of blending and combining various practices into an orderly structure which produce synergistic results. On the other hand, convergence of accounting standards means complete amalgamation of the rpeaviling two accounting standards. Many academicians and accounting pundits has raised their support for harmonization citing it as a mean of facilitating the globalization of capital markets by enhancing the ability of an investor to make informed decisions regarding investment alternatives. The proponents of the harmonization of accounting standards, cites the following benefits of the process:

- Harmonization expedite the integration of global capital markets and make easier the cross-listing of securities because of the comparability of Financial statements.
- Harmonization facilitate international mergers and acquisitions.
- Harmonization reduce investor uncertainty and the cost of capital.
- Harmonization reduce financial reporting costs.
- Harmonization allow for easy adoption of high-quality standards by developing countries.

On the other hand, the critiques of the harmonization cites that that the process of harmonization will not be as beneficial as convergence as under the process of harmonization of accounting standard, nations rather than converging on accounting standards, simply and gradually change one standard at one time, until all the old and relevant accounting standards are left modified. Furthermore, even if all the nations follow the harmonization processes it will still produce differences as a result of legal rules that operate within each nation. Some of other reasons as why many nations are avoiding harmonization of accounting standards include:

Integration Problem:

Many western countries as USA, Canada and England have refrained from the harmonization of the accounting standards to IAS because of the complexity factor. For instance, all the public trade companies in USA follows GAAP standards. Thus, any change of accounting standards with IFRS will require the government to change the legal system itself. Citing an another example, companies following GAAP follows straight line depreciation method, while under IFRS, the companies are required to follow Modified Accelerated Cost Recovery System for depreciating assets. Thus, harmonization with IAS standards means that the federal government will be required to change the tax accounting systems.

Additional cost and time relating to training and retraining:

Another reason as why nations are avoiding harmonization is the associated training and retraining cost. Whenever a country decides to harmonize its accounting standards with the international standards, all the associated individuals as the accountants, auditors etc are required to be retrained to make them comfortable with the new harmonized standards. Similarly, at the ground level, the educational institutions will also be required to train their graduates as per new harmonized standards. All such activities will require additional costs, new examinations for professional licensing and new accounting software and reporting systems. To further complicate matters, the adoption of harmonized standards has to be phased in, so for a number of years, two different systems are in operation. Such a complex transition requires a lot of safety mechanisms to ensure it achieve uniform results and many nations would not be interested at this moment as they are still working over improvement of economic operations after the setback of financial crisis.

Cultural Differences

One of the major criticsm of harmonized accounting standards is that IASB does not take into consideration the cultural, political and social differences between the countries. Thus, their harmonization with accounting standards of developing countries is difficult as factors like language barriers, attitude towards accounting are likely to affect the harmonization process or their later application. For Instance, in Jordan, when the accounting standards were introduced they were in Arabic, but when it was required to translate some terminology in English, it posed much problem to the implementation because of translation difficulty.

This indicates that even when all the national accounting standard are aligned with matching IFRS standards, then for the purpose of business transactions covered by the IFRS Standards there will be a form of convergence, but still this kind of convergence i. e. which is achieved slowly and gradually with harmonization of accounting standards is flawed because many nations will still be retaining some of their old accounting standards. For instance, US still retain a large range of old accounting standards and most of the companies still follow GAAP standards while some of the listed companies have to comply with GAAP as well as are allowed to report some of the transactions are per IFRS Standards. This makes whole scenario quite confusing to the accounting market as US Company reports are complying with more than 300 accounting standards related to business transactions while on the other side Australian Companies are required to use only standards as prescribed by IFRS and nothing more than that.

Effects of harmonization of accounting standards in the European Union on other non-EU nations:

The discussion till now has made us sure that the phrase " International harmonization will end investor concerns about cross national difference in accounting practices." is not valid. Harmonization has been cited as a slow process of modifying existing accounting standards in alignment with IFRS standards and this may lead to inconsistency across the nations and in no way investors seem to be benefit from the process of harmonization. To study the effect of harmonization of accounting standards in one nation on the other, we may cite the example of European Union.

With efforts of European Union to harmonize their accounting standards as an attempt to reduce the accounting differences, have had an impact not only on European union members but also on Non-EU member countries. The accounting pundits propose that accounting harmonization had an impact on some of the non-EU member European countries like Turkey, Switzerland, Hungary and Poland and its is the EU accounting directives over harmonization that have influenced them the most. The major strength of the EU harmonization efforts is generally attributed to its enforcement power and the proposed directives. Thus, as EU and EU member states are obliged to transpose the provisions of the directives into national laws, even the non member countries have been influenced. For instance, Tay stated " alternative methods of financial reporting in the harmonization process will influence legislation of their countries.''

Switzerland which shares a close trade relationship with EU member countries and with 78% of its imports and 58% of its exports are with EU member states, influence of harmonization is that more and more companies will draw up their financial statements in accordance with the fourth and seven directives as proposed in harmonization drafts. Also, Poland is said to have a direct influence of EU directives of harmonization on the economic and political environment of the country.

Conclusion:

Rationale:

- The investors, corporate and the financial markets will be most benefit from the complete harmonization of the accounting standards, not only on local rather at global basis.
- A single to single change in the accounting standards under the harmonization process is very costly and such costs are ultimately

impounded in the cost of capital which the investor demands for cross-border investments. Thu, complete harmonization of the accounting standards will completely eliminate the additional cost and would not prove any hindrance in cross-border movement of the capital

- In the presence of singe to single change in accounting standards, the quality of auditing standards and resulting audits will differ substantially worldwide. Thus, in order to ensure high quality audits and to ensure that investors can rely on the audit results, it is essential that auditing standards be harmonized to the highest quality worldwide due to the critical importance of audits to the usefulness of financial statements
- Complete harmonization will also ensure no-manipulation in the financial transactions as only one method of recording an accounting transaction will not leave any permitted choice of recording transactions in the way that suits them the best and not the investors or other users of the financial statements

Many international accounting bodies are also urging the harmonizing of accounting standards to promote easy comparability of financial statements. Thus, both United Nations and Organization for Economic Co-operation and Development have made some important steps to harmonize the accounting standards. The OECD has recently approved a code of conduct for multinational enterprises for harmonization of national and international accounting bodies. Similarly, United Nations Commission on Translation Co-Operation made efforts to establish disclosure standards for Multinational Corporation operating in third world countries to promote harmonization of accounting standards. Thus, with the current discussion, it seems that the need of the hour is Complete Harmonization of the accounting standards.

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