

The international convergence of accounting standards flashcard



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Then, a comparative analysis of the two governing dies and their similarities and differences will be discussed. Although we have gone into great depth, the differences between the two sides are plentiful, as many issues have yet to be discussed on any level by professionals. We have touched on the thoughts of the SEC and certain players in the financial industry, as well as the next steps FAST and SAAB plan to take regarding the convergence project. The paper then analyzes what we feel to be numerous benefits for a number of stakeholders after the convergence has taken place.

There are also a few drawbacks and negatives loading back the convergence, but we feel these are miniscule compared to the advantageous impact it will have on so many worldwide. We conclude the paper with our thoughts on what steps companies should take moving forward, as well as our opinions on the convergence process. Our opinion and conclusion on the matter is the result of a high level of research and analysis of the topic, with consideration to how parties of all size and nature throughout the world may be affected. The idea of convergence first came about in the late asses after World War II.

The idea was introduced at that time in an effort to make capital flow across countries around the world easier and more flexible under one international law of accounting. At first the idea was to harmonize or converge the different accounting rules in different countries and make them better reflect one another. In 2001 the International Accounting Standards Board (SAAB) was officially formed to be the first international accounting committee to oversee the convergence to a one standard set of rules that all countries follow. 22 Jurisdictions now are required to use the International Financial

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Reporting Standards (FIRS) including the European Union, Latin American countries, Japan, and all other 620 Jurisdictions. Each year, more and more countries are converging to the international standards of accounting and most of the large economies in the world have converted. The United States has tried to make a similar move to cope with the international need for a unified set of rules in the accounting world.

The effort officially commenced in 2002, with the passing of the Norwalk Agreement. The agreement led the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to begin working on the convergence between the United States Generally Accepted Accounting Principles (GAAP) and FIRS and to make both standards more compatible. They continue to negotiate a number of issues in the convergence process, and it is uncertain when they will reach an agreement that satisfies all parties.

There are still many areas that the two sides are far from agreeing on. The convergence effort has been supported by Congress and the big accounting firms; however the small firms are opposing a convergence because it will require an expansive converting bill. It has been a long and slow moving process, but some key decisions have been made by the Securities and Exchange Commission (SEC) to further the convergence effort. An impact verdict was made in December 2012, when the SEC withdrew the requirement for Foreign Private Issuers to reconcile with US GAAP.

This aroused questions from many market participants because the SEC allows FIRS for Foreign Private Issuers, but not US Companies. A double

standard seemed to be in place. In November of 2008, the SEC paved a “roadman” for the future use of FIRS for other types of SEC filings. This Roadman indicated that the SEC would decide on the fate of FIRS in 2011. A major milestone in the movement towards FIRS was the SEC’s February 2010 statement in support of the convergence of international accounting standards.

The SEC issued a paper in May 2011 which described one possible FIRS adoption approach called “Contentment”. The Contentment combined the most common FIRS adoption approaches, Convergence and Endorsement. This approach set out to accomplish three things; preserve FAST as the US standard setter, preserve the SEC’s role as overseer of the FAST, and integrate FIRS into US GAP over a specified period of time. The SEC’s final report on the FIRS Work Plan for US Markets was delayed on December 5, 2011 after a speech by the SEC’s Chief Accountant, James L. Kroger.

In his speech, Kroger stated the reasoning behind the delay: Numerous conceptual, operational, and practical questions have been raised based upon proposals to date that I believe should be considered jointly by both Boards. I believe that, in the long run, history will judge this endeavor much more favorably if all the necessary steps were taken to provide for joint projects with integrated teams, joint deliberations and shared timeliness. Such an investment in the outcome will prove to be far more beneficial than any gains I believe are perceived by deliberating these issues individually. Kroger) In 2012 the two organizations announced that all short-term projects have been completed and they are now working on the long-term projects to make the convergence happen. As of 2013 the largest banks in America
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including Bank of America, J. P Morgan Chase and others had wrote a letter to the FAST and SAAB boards to support the convergence to the international standards in the U. S and resolve all differences that made the convergence take so long to be finalized .

The convergence is such an arduous process because of the number variations, some subtle and others much larger, between the two sets of accounting standards. There are many similarities and differences between the US GAP and FIRS. Each system has its advantages and disadvantages in financial statement presentations, business combinations, inventory, consolidating, joint venture accounting and equity method investment, etc. Which benefit companies. To understand the magnitude of the convergence effort, it is important to understand some of the major similarities and differences between US GAP and FIRS.

In terms of financial statement presentation, both US GAP and FIRS include a statement of financial position, an income statement, a statement of comprehensive income, a statement of cash flows, and notes to the financial statement as components of a complete set of financial statements. Except for the statement of cash flows, both US GAP and FIRS require that financial statements are prepared on the accrual basis of accounting. Under both US GAP and FIRS, comparative financial statements are required. However, under US GAP a single year may be presented under certain circumstances.

The SEC sets the rules for US public companies with regard to comparative financial statements. US GAP does not have general requirements to prepare the balance sheet and the income statement. However, public companies

must adhere to Regulation S-X. FIRS does not specify a standard for the layout, but it has a list of minimum lines of items. For balance sheet classification of deferred tax assets and liabilities, current or non-current classification is based on the nature of the assets and liabilities under US GAP.

On the other hands, FIRS classifies all amounts in the balance sheet as non-current. In the incomes statement, US GAP allows the counting for extraordinary items, items that are both unusual and infrequent in nature. The guidelines for accounting for business combinations in US GAP and FIRS represent the first major convergence project between the SAAB and the FAST. A business combination is a transaction or other event in which a reporting entity obtains control of one or more businesses. US GAP and FIRS use the acquisition method to accounting for business combinations.

When gaining control of another entity, the underlying transaction is measured at fair value. This creates the basis for which the assets, liabilities, and non-controlling interest are measured. In measurement of non-controlling interest, US GAP uses fair value measurement including goodwill. Conversely, FIRS excludes goodwill when measuring non- controlling interest. When acquiring operating leases through a business combination, US GAP requires the acquirer to recognize an intangible asset or liability whether the acquirer is the lessor or the lessee.

FIRS requires separate recognition of an intangible asset or liability if the acquirer is a lessee. However, if the acquirer is the lessor, the lease terms and conditions are taken into account when estimating the fair value of the

leased asset. US GAP and FIRS agree that the primary basis of accounting for inventory is cost. Whether it is assets held for sale or assets used for production, both systems have the same standards for measurement. In the costing methods for US GAP, LIFO is acceptable and it is not required that the cost formula for similar inventories be consistent.

However, FIRS prohibits LIFO and requires that the same cost formula is used for all inventories of a similar nature. US GAP and FIRS require existing current and future tax for accounts that recognize any activity using liabilities and assets that have or will affect the account. In GAP, most liabilities and assets fall under tax law. Under FIRS, the tax basis is the total amount deductible or "will be" tax. For the classification of deferred tax assets and liabilities in balance sheet, FIRS classifies all amounts as non-current in the balance sheet. Basics, 2012) US GAP classifies assets and liabilities based on their nature by either current or non-current. GAP reports deferred tax as a separate line in the balance sheet, while FIRS includes deferred tax beside liabilities and assets. Although international accounting professionals and the SAAB and FAST standard-setters possess conflicting views on many vital issues, almost all can agree that some sort of convergence or compromise should be in order. As we have previously discussed, there are more differences between FIRS and U.

S GAP than one can calculate, and this continues to transpire as new regulations pass with the arrival of further legal issues. It is our opinion that a convergence between FIRS and GAP would prove to be very favorable to stakeholders worldwide. Some argue for the adaptation of only one of the two governing bodies, which realistically is next to impossible due to the <https://assignbuster.com/the-international-convergence-of-accounting-standards-flashcard/>

depth of reconciled matters required. While there are a number of negative aspects that act as a roadblock to the convergence, the impending benefits and as well as amplified convenience of convergence would far outweigh the potential shortcomings.

Since the idea of International-U. S. Conjunction first came into discussion over a decade ago, there have been a number of breakthroughs in the Accounting profession. Not only through the Joint efforts of both parties, but also individually for each side after analyzing the practices of the other party. Improved accounting standards for each party is the first benefit of convergence to be discussed. A number of regulating bodies facing specific tasks have been created for both the United States as well as by the SAAB.

The FIRS body established the Accounting Standards Advisory Forum (USAF), which is a formal mechanism for national as well as regional accounting standard-setting bodies to provide technical advice and feedback to SAAB. Its' members include representatives from the FAST, the ELI, Japan, and China, amongst others. While both sides continue to seek converged solutions in a number of areas, the formal effort of Joint projects will conclude after solutions are found for a few ajar topics like revenue recognition, accounting for leases, financial instruments, and insurance projects.

Both sides are still expected, however, to continue to work together moving forward on vital issues as they see fit. Many view the successes of the convergence thus far to go well beyond just improved accounting standards. The achievements of standards convergence have left their footprints

worldwide, by greater acceptance of FIRS, and its' spread to new regions around the world. The SAAB has seen its' credibility improve, as well as the standard-setting resources available to the board greatly advance since its' early years.

In 2007, the SEC began permitting foreign registrants to fully incorporate FIRS when filing their financial statements, without needing to reconcile them to GAP, a huge victory and step forward for the SAAB. Additional nations abroad followed suit and now also permit the use of FIRS for financial statements as well as international capital raising. Another benefit of convergence has been the further devotion to essential topics such as revenue recognition, fixed asset reporting, and debt covenants. Although breakthroughs have yet to be reached regarding these areas, they are considered top priority by the new FAST Chairman, Russell Golden.

Certain practices such as the inventory method LIFO, which essentially allows companies to skew COGS and sales in their favor, are barred under FIRS. This method is still used today in the U. S. And is allowed under GAP, which many professionals believe will no longer be the case in the near future. Although new regulations have yet to be reached for many vital issues, the effort moves on, and progress continues to be made. Individuals from FIRS as well as GAP continue to work both jointly and solely, to ensure the advancement of accounting standards worldwide.

What may be the most productive return from GAP-FIRS nonviolence is transparency for beneficiaries throughout the world on all levels. Investors, top management and executive teams, global stock markets, as well as

accounting professionals and standard setters will all prosper via the velveteen of accounting and reporting standards. The utmost desire and objective of convergence is said to be quality; quality of financial reporting and auditing measures so that the statements presented to stakeholders are of the highest pedigree.

The quality has undoubtedly improved at some level since the convergence process began. Convergence gives management and executives the ability to prosper from a tankard, stream-line set of rules to be applied to all nations where they conduct business, allowing them to save capital and time. This could potentially allow funding to be raised more easily with lower interest rates, less risk, and lower cost of doing business in a variety of nations foreign to them. A parent company and all subsidiaries will report using the same accounting language, allowing easy comparison from entities across borders.

It will also allow entities to compare the financial statements of their foreign competitors directly to their own with more simplicity. Due to the expanding variance of accounting standards between nations, investors and stakeholders are often left in the dark when analyzing financial statements. Investors looking to provide capital to companies seeking funding deal with a number of inconsistencies in the reporting of organizations' financial positions. SAAB is hoping to eliminate conflict and confusion driven by inconsistency between nations.

Investors will first need to re-educate themselves on the newly recognized standards, but will then be able to more fluently analyze and evaluate

reports. The reports would further consist of more credible information that is amplified for investors of all nations, allowing easy comparisons of entities' financial statements. With greater confidence, investors will presumably be more intrigued to provide financing due to the supplementary lucidity provided by the convergence. The enhancement of capital flow internationally is a reasonable expectation as well.

Companies entering foreign exchanges will see a reduction in costs, in addition to a more time-efficient process. With all markets adhering to the same rules and regulations, companies could seek new opportunities allowing markets worldwide to compete for new global investors. With investors seeking opportunities in new territories due to simplified, standard reporting measures, stock markets globally could potentially see a level of invested capital unlike they have historically. Financial reporting that is consistent across nations globally is appealing to stakeholders on all levels.

The GAP-FIRS convergence can lead to prosperous results for those seeking to invest, companies continuing to seek capital, and entire stock markets internationally. However, the process unfortunately appears to be quite difficult, and seemingly never-ending. What could be the most inhibiting drawback of GAP-FIRS nonviolence is the lack of cooperation across the globe. It is predictable that a number of nations will be unwilling to collaborate with standards that vary between regions' cultures, ethics, beliefs, and business standards.

The United States, while comparable with a number of nations, contrasts greatly with the atmosphere and style of conducting business greatly

distilled into the roots of foreign nations. Resolution on a wide variety of issues may be extremely difficult across the board. The United States and many of the FIRS nations frankly do not agree on a number of pivotal accounting issues. In addition, the U. S. Tax code and reporting regulations contain much greater depth and specificity than what is provided by FIRS. Critics are correct in arguing some of the U.

S code is unnecessary and only confuses the individual. Compromise will be difficult to reach on a number of issues as it would be unlikely for either side to back down. Many individuals worldwide argue that one nation, the United States, should have to comply with the regulations of an international body consisting of well over a hundred nations, not vice versa. One final roadblock in the process is that convergence will require a great deal of time and resources. In order to implement a new set of standards and regulations, it would take immense effort and dedication from all nations involved.

Not only do regulators, auditors, and accounting professionals have to become knowledgeable of the new procedures, but the companies, employees, and stakeholders will need to as well. Vigorous training, which requires a high level of capital and an abundance of time where employees are unable to pursue their daily work routine and tasks, will need to occur. Many professionals that are not in favor of convergence believe the transition period will be much more difficult than what is anticipated, with the expense of resources outweighing the return.

According to the SEC's 2012 analysis of FIRS, the future of FIRS in the United State is still uncertain. The SEC acknowledged that the SAAB produced

standards of a very high quality despite areas that need further development. The report questioned the Saab's funding and its ability to respond to widespread accounting issues in a timely manner by means of the FIRS Interpretation Committee. Adoption would undoubtedly be an expensive endeavor for US companies, but many believe that the SEC's indecision keeps the United States isolated and restricts US companies' ability to access international capital.

The indecisiveness of the SEC leaves businesses unable to make definitive plans for the future. What can US companies do to prepare? Without the SEC indicating its decision and timeline, many US companies do not have the motivation to plan for a change of this magnitude. According to Grant Thorn's FIRS Readiness Survey, "nearly three-quarters (72%) say they anticipate that the SEC will require public companies to adopt FIRS, while, at this time, about 70% of survey respondents have either limited or no knowledge of FIRS. Blank, Fabian, Little, Ruggeri, Vender Ham 8-12) One characteristic of many successful organizations is the ability to be forward-thinking. Regardless of the SEC's decision, there are several steps US companies should take to familiarize themselves with FIRS given the global nature of business in today's economic environment. A progressive organization should evaluate and build its knowledge base. Companies with foreign operations that already report under FIRS will be one step ahead. As mentioned, comprehensive FIRS training for staff members can be a costly investment engendering the uncertainty surrounding the issue.

By gradually building FIRS training into existing continuing education curriculum, companies can prepare their staff members as cost efficiently as <https://assignbuster.com/the-international-convergence-of-accounting-standards-flashcard/>

they choose. It is also important that companies balance their investment with anticipated outcome by training right people. These people would be the individuals who are still with the organization by the time FIRS knowledge is needed. It is essential for organizations to take a long-run approach in making important business decisions. When undertaking significant projects and making hiring sections, US companies should consider how the implementation of FIRS would affect their decision.

A modest amount of effort today can go a long way in assuring future FIRS compatibility. For example, if an organization is implementing a new software system, it should ensure that the new system is compatible with ' FURS. Small incremental cost, such as this, will prevent significant future expenditures to overhaul an entire software system. Organizations often have to structure long-term contracts. When doing so, an organization should understand how the contract would be modified if FIRS were used. This will prevent the costs and headaches associated with restructuring a contract in the future.

In a hiring decision, an organization should consider an individual's knowledge of FIRS. This is not to say a working knowledge of FIRS should be the sole driver in a hiring decision, but having professionals on staff with experience in FIRS will benefit the organization in the future. It is vital for an organization to assess how it would be affected by FIRS. A major concern with FIRS in the United States is the countless number of unknown effects the implementation will have on individual companies. Each company will be impacted differently.

Engaging in a high-level assessment of current operations and financial reporting using FIRS will benefit a company. This will expose the potential gaps, traps, pitfalls, and even the areas that will allow for a smooth transition with little investment. This could help an organization with future decision making. Organizations should not wait to learn about FIRS. They should start now and determine if there will be any complications that must be managed in the future. The challenges that face the convergence of international accounting standards are not insurmountable.

Progress has been made in the right direction, but with the SEC delaying its decision regarding FIRS it is difficult to estimate a timetable for the completion of the convergence effort. The adoption of FIRS by the United States does not seem to be a viable option. The American Institute of Certified Public Accountants spent years and years developing US GAP and will not completely disregard it by adopting FIRS. Therefore, common ground must be reached. That is why the convergence is the most practical approach. Although, some US companies are adopting FIRS to save time and money.

Ford Motor Company found that it is more cost efficient to convert from FIRS to US GAP, rather than converting US GAP to FIRS in the sixty jurisdictions in which it operates. The positives associated with converging with FIRS outweigh the negatives. The United States should take an approach to the convergence that will make both sets of standards as similar as possible, but with the mindset of doing what is best for the United States. Taking an approach similar to that of Germany could be successful. In Germany, historical cost attribute for measuring tangible assets is strictly adhered to.