

The world moving
towards at least three
versions of ifrs?
assignment



**ASSIGN
BUSTER**

Task 2: Discuss the fear expressed by the chairman of SEC (USA) that there is a possibility of the world moving towards at least three versions of IFRS- namely IASB IFRS, EU IFRS and US IFRS. Introduction With the introduction of International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), the world is one step closer to achieving a global set of accounting standards comprehensible by different users of financial statement worldwide. The benefits of using these standards are numerous and proven by European companies that are mandated to adopt IFRSs in their financial reporting.

These companies have been using IFRSs since 2005 and during these years they have seen and experienced firsthand the benefits promised. According to Cairn (2007), a survey conducted amongst European Union (EU) companies showed that companies and investors are of the opinion that it is the right decision by the EU to mandate IFRSs. Furthermore, it was found that consolidated financial statements' qualities have improved through the adoption of IFRSs. Other benefits of having a global set of accounting standards could be the introduction of new capital market for companies that seeks international funding or investments.

Investors could also make comparisons of financial performances between different companies across the world giving them more investment options. Also, corporate governance could be enhanced as financial reports follow a global set of standards. This is because more eyes are looking into financial reports resulting in more monitors in corporate reporting. In short, more investment opportunities and better corporate governance could be

achieved across the world through the use of common financial language and this is the goal of the International Accounting Standards Board (IASB).

With all the benefits from adopting IFRS, one would think that all countries would jump to its implementation. However, this is not the case. In order to achieve its goal in creating an international set of accounting standards accepted by countries worldwide, the IASB must recognize that differences in business and cultural environments, and respecting national sovereignty are critical elements in achieving a truly global set of accounting standards (Saudagaran, 2006). This had been the main problem that plagued the IASB resulting in the criticisms and rejection of IFRS in certain countries.

Many believe that the IFRS is dominated by the G4 countries and is based on US style accounting. Moreover, the IASB was also criticized for not taking other countries in regard when developing standards; only 8 countries are seated on the board with 5 being G4 countries (Alexander et. al. , 2007). This led to the many challenges issues that the IASB has to face leading to the fear of the SEC chairman that there will be 3 different IFRS- namely IASB IFRS, EU IFRS and US IFRS. In this assignment, we take a closer look at these issues in different area which include political, cultural, legal, economic, and even religious issues.

Political Issues Ever since the IASC was formed and later succeeded by the IASB, political matters have always been an issue in the standard setting process. One main issue is on the countries members in the IASB. The IASB board has been dubbed as “ G4 Plus 3” by dissatisfied parties, who believe the new board is dominated by members of the G4+1 Anglo-Saxon standard-

setter's club, with token members from Europe and Japan (Irvine, 2001). This brings challenges to the IASB in gaining global acceptance of IFRS.

An example is the negative reaction in Europe voicing concerns of a US style pronouncement, not truly representative of the world and the disregard of developing countries. The European Parliament has voiced its concern on its involvement in the development of the IFRS. They believe that the IASB should seek the European opinion before proceeding to approve standards to avoid any mishap (Insight, 2007). Moreover, national sovereignty plays a big part in this area causing objection of the IFRS. Certain countries feel that the IASB has disregard their country's interest and focus only on the opinion of developed economies.

This led to the dissatisfaction of IFRS causing non-compliance of IFRS. The French government, for example, is in the opinion that the IASB are not looking out for the interest of European business resulting in lobbying for more IFRS setting control (Nixon, 2006). The US, on the other hand, has been changing its view on whether they will converge IFRS with US GAAP as a change in the chairman of Securities and Exchange Commission (SEC) occurs (Austin ; Tschakert, 2009). The new chairman feels reluctant to delegate standard setting outside of the US while the FASB refuse to change certain standards requiring the IASB to make changes instead. In addition, the disclosure requirement of IFRS does not sit well with various political parties as some are reluctant to reveal sensitive details on certain areas such as related parties in state own entities. An example is in China who faces unique political issues due to its socialist view. The Chinese government faces enormous task of funding its state run defined benefit plans such as <https://assignbuster.com/the-world-moving-towards-at-least-three-versions-of-ifrs-assignment/>

funding retirement which is a big challenge that will be decided by politicians (Kemp, 2006). It is, therefore, not politically acceptable to disclose information about this challenge such as tax implication.

The impact that political issues has on the IASB is quite huge especially with regards to the EU countries. The proof is in IASB giving in to political pressure by allowing IAS 39 carve-out for European countries (Brussels, 2005). This brought on the issue of having a truly global accounting standards set as other countries might follow suit in creating their own carve outs through political lobbying. If various countries are successful in having their own carve outs, then the objective to have one set of global accounting standards will not be achieved.

Therefore, it is important for the IASB to hold their ground and not giving in to political pressure as this may result in the diversion from their original cause and manipulation from political powers causing the reduction of their credibility. As Mark Vaessen of KPMG (2011) commented, ' it is important that the IASB remains responsive to the political agenda, while at the same time keeping its independence intact. That is a balancing act and by no means an easy task'. Compromise is the key to achieving acceptable global standards and countries should recognize this if they want this to be achieved.

Cultural Issues Accounting, like any other area of business, is clearly affected by the culture of the country in which they operate. Therefore, the difference in culture would lead to difference in the treatment of financial statement items and interpretation of standards. IFRS, being principle-based, requires

accountants' judgments in its application. The cultural differences around the globe play a huge part in the different application and interpretation of IFRS. Campbell et. al (2009) found through a research that 'two accounting values directly influenced by national culture are conservatism and secrecy, which affect the measurement and disclosure of financial information in financial reports and have the greatest potential to affect cross-border financial statement comparability'. Countries with high conservatism would most likely defer the recognition of financial items that would increase profits while those with high secrecy would have a preference to limit disclosure of relevant information to those closely involved in the business.

A study by Schultz & Lopez (2001) shows that France and Germany is more conservative than the US with accountants in both countries suggesting higher warranty estimates. On the other hand, American accountants are less secretive in disclosing the existence of lawsuits to external parties than its Greek counterpart. A study by Tsakumis (2007) showed that American accountants have different interpretation of IAS37 regarding the classification of provisions, contingent assets, and contingent liabilities than that of German accountants.

It was found that Germany is more conservative in their interpretation of the word 'probable' than the US through its assigning of a lower percentage to the term 'probable'. From the examples given, we could clearly say that national culture is one factor that led to different level of IFRS adoption worldwide. This results in the fear of different IFRS practices causing the failure in achieving a truly global set of accounting standards as expressed

by the SEC chairman. This further fuels the need for IASB to include every country in the construction of standards so as to address these differences.

Whether or not countries would reach a compromise on their cultural differences is another issue. Legal Issues Every country has its own legal system and rules. Countries influenced by England have a similar legal system as England known as the 'common law' system where case law has a significant number over statute law. This kind of legal system traditionally does not prescribe rules on how companies should prepare financial statements; instead, an accounting body is relied upon in setting recommendations and standards (Nobes & Parker, 2002). Ireland, India, and Australia are three countries that apply common law system.

Other countries have doctrines of rules whereby rules are linked to ideas of justice and morality and are codified. According to Nobes & Parker (2002), countries that have this kind of legal system would have established rules for financial reporting an accounting in their company law or commercial codes. An example given is Germany where company accounting is a branch of company law. This impacts the adoption and implementation of IFRS worldwide as the legal system in certain countries might hinder certain practices or disclosures required in IFRS.

The US, for example, has in place the Sarbanes Oxley-Act which requires listed companies' audit committee to include members that have sufficient financial expertise. With the change to IFRS, companies may find it hard to comply to this requirement unless they provide sufficient training to audit committee members though it may still not be enough. This in turn would

lead to litigation challenging the competence of audit committees and their members, and of corporate decisions approved by audit committees who are alleged to have lacked the necessary competence (Chadbourne ; Parke, 2010).

Fearing this, US companies as well as the SEC are skeptical in adopting IFRS. Besides, US companies are obligated by law to report in US GAAP to state and federal agencies such as the IRS and this is out of the authority of the SEC. In the UK, company law has insert regulations on summary financial statements (SFS) provided by listed companies for shareholders who do not wish to receive full annual report (Smith et. al. , 2005). SFS format cease to apply in IFRS where IAS 34 for interim financial information are in place.

IAS 34 provides a looser and different financial statement format than the SFS resulting in the dispute of the standard by UK companies. With the different legal system in place and in authority, companies may not comply fully with IFRS requirement. This results in the different IFRS adoption in different country. The need to comply with the law led to countries adding different quirks in the compliance of IFRS resulting in what has become known as ' IFRSs as adopted in...'(Insight, 2007). This brings great challenges in the creation of a truly global set of accounting standards. Economic Issues

Every industries and organizations have their own circumstances and business practices. Due to these differences, the effect of adopting IFRS in certain industries might be higher than others. The real estate sector, for instance, would experience a significant impact on their revenue in changing to IFRS. This is largely due to the IAS 18 on the recognition of revenue where

it is stated that revenue could only be recognized after a property is constructed and ownership right has been transferred. Traditionally, realtors are allowed to recognize revenue after completing 20-25% of construction work mainly to protect investors (Deloitte, 2009).

National GAAP allows for these practices such as India GAAP where revenue could be recognized the moment an under-construction property has been booked (Murali ; Bala, 2010). This change in practice would majorly increase the volatility of revenue in the real estate sector resulting in the objection of developers to comply with IFRS. This could be seen in India's large real estate firms seeking exemption from adopting the proposed IFRS (Khan & Iyer, 2010). A similar issue plagues the infrastructure industry service concession arrangements will have extensive consequences.

Murali & Bala (2010) explain that expenditure incurred by the infrastructure provider is capitalized as fixed or intangible asset, depreciated usually over the term of the service concession agreement while revenues are recognized during the construction period and infrastructures are not recognized as property, plant and equipment of the operator under IFRS. Furthermore, the insurance and banking industry also objects the fair value treatment of IFRS and the recognition of measurement and revenue as both industries have different practices.

Insurance company, for instance, is different from other industries in that it receives revenues before it incurs its principal cost (Jones & Searby, 2003).

The IASB should account for the differences in business practice of various industries when setting standards. The recent lobbying of industries due to

the IASB lack of attention in this area might lead to the different level of IFRS implementation causing the comparability of IFRS to decline. This in turn would impose challenges for the IASB in gaining acceptance of IFRS as an international set of standards fully complied worldwide.

Different industries might create their own version of IFRS if the IASB does not take action. Religious Issues When we talk about religious issue here, it is referring to the Islamic banking and finance system. Initially seen as a niche area, Islamic finance is now growing rapidly with assets of over \$700bn and is set to grow to \$4trn by 2013. The industry has grown by 23% yearly and is projected to grow by 15-20 per cent annually despite the crisis (Ibrahim & Hameed, 2007). Furthermore, various countries have started to take interest in this industry with 34 countries engaging in Islamic banking including UK.

China and India has also expressed their interest in Islamic Banking. Due to the rapid growth of Islamic finance which reached global standard, there is a need to account for Islamic finance on an international basis. However, this task seem daunting as Islamic finance's underlying principles are often at odds with mainstream finance system especially banking where Islamic accounting must be in accordance with the Shariah principles and compliance with Islamic business values. IFRS does not account for Islamic accounting but the IASB is in discussion on its convergence with Islamic finance.

This resulted in the fear of a different set of IFRS in accordance with Islamic banking and finance. In order for IFRS to be accepted by the Islamic accounting system, the IASB must take care in not tainting compliance with

Shariah. Pricewaterhouse Cooper (2009) argues that ' the principles-based nature of IFRS makes it possible to recognise, measure and disclose the economic substance of Islamic finance without compromising Shariah principles'. However, the many differences in the IFRS and Islamic finance principles make it hard to accept such statement.

One differing principle is on IAS 30 which cannot be followed by Islamic banks due to their different functions and contracts. Another issue is on the contra of IAS 17 with Islamic banking whereby leasing contracts cannot be accounted as financing leases due to Shariah requirement. IFRS 4 and IAS 2 are two other examples of which Islamic banking cannot comply with as it differs with Shariah principles. With all these differences in mind, it is hard to imagine one set of global accounting standards for Islamic finance and conventional practice.

As commented by Khairul Nizam, the director of technical development at AAOIFI, there will always be gaps and difference in the standards issued in Islamic finance with conventional standards, the issue is on whether the IASB will tolerate these differences or conform to Islamic accounting principles (Ibrahim ; Hameed, 2007). This only strengthens the claims of potential IFRS carve-outs for Islamic banking and finance and the IASB would once again deviate from its goal in reaching a truly global set of accounting standards.

Conclusion From the discussion put forth, it is clear that the road to achieving a truly global set of accounting standards is one that is full of challenges. Political pressures are bound to be the biggest challenges in attaining this goal as political powers become the main issue in the

acceptance of IFRS. Various political groups want to exert their authority and control in the creation of IFRS and are reluctant in giving in to opinions of other group as they view this as losing their control.

Cultural differences also plays a part in this as unwillingness to accept IFRS practices that differs from their cultural view exists. Accountants and other stakeholders are hesitant in changing their cultural practices in which they are comfortable with to comply with IFRS requirement. The same goes for the Islamic finance practices whereby they are unable to accept or compromise with IFRS requirement that goes against their religious principles. Industries' disinclination of adopting IFRS that would bring significant changes in their financial reports also imposes challenges to the IASB in attaining acceptance of IFRS.

In addition, regulators are unenthusiastic in changing their requirement as they want to keep their authority in areas in which they could exert their influences. All these issues result in different implementation of IFRS which could be permanent leading to the failure of IASB in providing a truly global set of accounting standards. Besides, while many recognize the need and benefits of having one global accounting standard, not everyone thinks that this is advisable. Buttell (2010) expressed her disagreement that one international standard is the correct approach.

She states that alternative system should always exist as the best ideas are not likely to come forth if only one standard exists. This seems to suggest that the success rate for the IASB in achieving its goal is very slim. The attainment of such goal could only be realized if political powers and cultures

are able to compromise with each other and this seems to be light-years away. References Nixon, S. , 2006, Paris Mounts the Barricades Against Global Standards, Wall Street Journal, Nov. 6, online, available from: <http://online.wsj.com/article/SB125745803777731785.html> [Date accessed: 1st May, 2011] Brussels, F. 2005, Commission endorses “ IAS 39 Fair Value Option”, European Commission, online, available from: http://ec.europa.eu/accounting/ias/index_en.htm [Date accessed: 1st May, 2011] Austin, S. , & Tschakert, N. , 2009, Major Differences in the US GAAP and IFRS and Latest Development, May 18, online, available from: <http://www.swensonadvisors.com/assets/MajorDifferencesBetweenUSGAAPandIFRS.pdf> [Date accessed: 5th May, 2011] Kemp, R. , 2006, The Reality of Accounting Standards – Political and Economic Challenges, Accounting and Financial Analysis, University of Virginia, Nov. 28, online, available from: <http://www.glgroup.com/News/The-Reality-of-Accounting-Standards—Political-and-Economic-Challenges-6291.html?cb=1> [Date accessed: 5th May, 2011] Campbell, D. R. Sr, Tsakumis, G. T. , & Douppnik, T. S. , 2009, IFRS: Beyond the Standards, Journal of Accountancy, Feb. , online, available from: <http://www.journalofaccountancy.com/Issues/2009/Feb/IFRSBeyondtheStandards.htm> [Date accessed: 5th May, 2011] Tsakumis, G. , 2007, The Influence of Culture on Accountants’ Application of Financial Reporting Rules, Abacus, March Nobes, C. , ; Parker, R. , 2002, Comparative International Accounting, 7th ed. , Prentice Hall, United Kingdom Smith, H. Lutz, G. , ; Stibbe, 2005, IFRS – an update on legal and regulatory issues, online, available from: <http://www.herbertsmith.com/NR/rdonlyres/90ED356F-3AA6-4635-AEAF-7985806FD80C/1140/5204Corp.pdf> [Date accessed: 6th May, 2011] Chadbourne ; Parke, 2010, SEC’s <https://assignbuster.com/the-world-moving-towards-at-least-three-versions-of-ifrs-assignment/>

March Toward Adoption of Global Accounting Standards Raises Potential Litigation Challenges for U. S. Issuers and their Auditors, Client Alert, March 31, online, available from: <http://www.chadbourne.com/files/Publication/533d7ac9-fa64-4f51-9c59-031cad8e34c3/Presentation/PublicationAttachment/7c95aae4-1efb-4f4f-8150-0da142a95d1a/Global%20Accounting%20ClientAlert.pdf> [Date accessed: 6th May, 2011] Ibrahim, M. , & Hameed, S. , 2007, IFRS vs AAOIFI: The Clash of Standards? , Munich Personal RePEc Archive, March 6, online, available from: http://mpra.ub.uni-muenchen.de/12539/1/MPRA_paper_12539.pdf [Date accessed: 6th May, 2011] Pricewaterhouse Cooper, 2009, Open to comparison: Islamic finance and IFRS, online, available from: http://www.pwc.com/im/en/assets/document/Open_to_comparison_Islamic_finance_and_IFRS_Final.pdf [Date accessed: 6th May, 2011] Khan, S. , & Iyer, A. , 2010, Realty cos not ready for IFRS switch, The Economics Times, Apr. 6, online, available from: http://articles.economictimes.indiatimes.com/2010-04-16/news/27567202_1_ifrs-norms-new-accounting-norms-convergence [Date accessed: 7th May, 2011] Murali, D. , & Bala, V. , 2010, IFRS impact on a few key sectors, The Hindu Times, June 14, online, available from: <http://www.thehindu.com/business/article455320.ece> [Date accessed: 7th May, 2011] Deloitte, 2009, Summary of IFRS developments that may impact the Real Estate Industry, Deloitte Touche Tohmatsu, online, available from: http://www.deloitte.com/view/en_LU/lu/industries/real-estate/article/931c6d4de4e76210VgnVCM100000ba42f00aRCRD.tm [Date accessed: 7th May, 2011] Buttell, A. , 2010, SEC in a Quandry over Its Push for IFRS, The Finance Professionals' Post, Apr. 27, online, available from: <http://post.nyssa.org/nyssa-news/2010/04/sec-in-a-quandry-over-its-push-https://assignbuster.com/the-world-moving-towards-at-least-three-versions-of-ifrs-assignment/>

for-ifrs. html [Date Accessed: 6th May, 2011] Irvine, J. , 2001, New IASC Is G4 Plus 3, Say Critics, Accountancy Magazine. com, Feb. 5, online, available from: <http://www.pro2net.com/x29212.xml> [Date accessed: 5th May, 2011] Epstein, B. , 2009, The Economic Effects of IFRS Adoption, The CPA Journal, Vol. 3(12), March 23 Jones, R. , ; Searby, S. 2003, International Accounting Standards: Threat or Opportunity? , IASplus, Sept. 8, online, available from: <http://www.iasplus.com/resource/sandp0309.pdf> [Date accessed: 5th May, 2011] KPMG, 2011, International Harmonisation, KPMG. com, online, available from: <http://www.kpmg.com/UK/en/WhatWeDo/Audit/Assure/Pages/International-harmonisation.aspx> [Date accessed: 5th May, 2011] Alfredson, K. , et. al. , 2005, Applying International Accounting Standards, Wiley, Australia Worldbank, 2001, Report on the observance of standards and codes (ROSC) – Kenya, online, available from: <http://www.orldb.org/ifa/kenyarosc.pdf> [Date accessed: 4th April, 2011] Wong, P. , 2004, Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs, online, available from: http://www.ifac.org/Members/Source_Files/Other_Publications/Wong_Report_Final.pdf [Date accessed: 4th April, 2011] Nordin. , Z. , 2010, Deloitte Insight: IFRS implementation draws nearer, Deloitte Touche Tomashu, online, available from: http://www.deloitte.com/view/en_MY/my/mysvc/myaud/6b49890264d82210VgnVCM100000ba42f00aRCRD.htm [Date accessed: 4th April, 2011]