

Investigating the harmonization of accounting practices



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Growth in international trade has been on the increase over the years necessitating several organisations to be involved in the efforts to harmonise accounting practices either regionally or internationally. Among those, leading in this effort were the European Union (EU) and International Accounting Standards Board (IASB) (formerly International Accounting Standards Committee, IASC).

This essay will look at background and harmonisation process of the two organisations and evaluate their achievements to date. It is considered that 'harmonisation' maybe defined as a means by which differences are reduced hence harmonisation of financial practices will be regarded as the process by which the differences in accounting practices across countries are reduced ultimately resulting in a set that is comparable (Nobes and Parker, 2010).

Background and Objectives

The European Union (EU) is an economic and political union of 27 member countries located in Europe. The EU was established on 1 January 1958 following the Treaty of Rome 1957 (Nobes and Parker, 2010). The objective of Treaty had established rules to encourage free movement of persons, products and services, and capital. This establishment drives the needs of harmonization of accounting and financial reporting.

Thus, the most important objective of EU is to create a common market for the member countries. Uniformed accounting standards are required regionally in all parts of EU to encourage the flow of capital, enhance the protection of the shareholders and other stakeholders, and increase the reliability and comparability of companies' financial information. The EU

shows a contribution to regionally harmonizing accounting practices by established Directives and Regulations which are the two main instruments to harmonize company law and accounting standards (Nobes and Parker, 2010).

As as an economic and political union, the EU have issued and established many directives to harmonize accounting practice in regional term. However, in international scope, the IASC is one of bodies are effecting on harmonization of accounting rules and disclosure and it reported a number of international standards (Nobes and Parker 2010).

IASC was founded in June 1973, and the Board of IASC was constituted simultaneously by main accountancy bodies in nine different countries such as Canada, France, Germany, UK, and USA etc. The IASC was established to harmonize international accounting standards. IASC has received board range of support for its effort to harmonize international accounting, which has been considered as leading force to harmonization (Larson, 1999). The harmonization of accounting is also supported by IOSCO (International Organization of Securities Commissions), large public accounting firms, trading unions and most national public accountancy bodies. The basic objective of IASC is considered as publishing accounting standards to be observed in the financial statement preparation and encourage their acceptance and observance globally (Nobes and Parker, 2010). In 2001, the IASC restructured and renamed to the IASB. The new organization has shown new more comprehensive objectives compared to the IASC. To be able to understand the objectives of IASB, the conceptual frameworks should be explained. The IASC's conceptual framework included the objectives and the <https://assignbuster.com/investigating-the-harmonization-of-accounting-practices/>

qualitative characteristics. The following table 1 shows the detailed objectives of IASB under the IFRS Foundation Constitution.

IASB's Objectives

To develop high quality and understandable international accounting standards to guide high quality, transparent and comparable information in financial reporting. Thus accounting standards will help the global capital market participants and other users' decision making.

To encourage the use and rigorous application of standards

To fulfill the (a) and (b), and take account the interest of small, medium size entities and emerging economic account appropriately.

Give high quality solutions about convergence of national and International accounting standards.

Source: IFRS Foundation Constitution (ias. com, 2010).

The qualitative characteristics of financial statements made by IASC followed the FASB. In order to forecast the risk, the accounting information must include all these three characteristics: relevance, reliability and comparability.

The motives of harmonizing accounting practices by these organizations:

One is tempted to consider 'harmonisation' objective as having shifted from reducing differences to coming out with a standard or model for uniformity.

The motives of the two most influential international bodies involved in the <https://assignbuster.com/investigating-the-harmonization-of-accounting-practices/>

process of harmonisation of the different national accounting systems, therefore (as stated on their web sites), seems to suggest that they aim to 'develop' or 'create' a single set of high quality, understandable and enforceable global accounting standards, (Elliott and Elliott, 2009). It is more of standardization than harmonization as it is less flexible. This therefore raises suspicion as to the true purpose of their efforts especially when we consider their respective current compositions, history, their headquarters and the majority of stakeholders who are likely to benefit. Perera (1989) as quoted in Deegan and Unerman (2006) argued that the accounting standards themselves tend to reflect the circumstances and patterns of thinking of the representatives that makes the committees. Already, IASB seems to have noted similar criticism and Nobes and Parker (2010) states that the trustees will gradually increase the Board membership to include members from Europe, North America, Asia/Oceania, Africa and South America by 2012.

Similar concerns were once echoed by Gray, et al (1981) while commenting on the proposal to introduce "standards" specifically for MNCs and the question seems to be still valid. He submitted that the term standard could be used broadly to mean a set of statements which may include reference to disclosure or measurement issues for the benefit of Multinational Companies. He found such statements to have a different meaning from that intended to achieve strict uniformity to those capable of more flexible interpretation; from those derived from statutory authority, to those which are effectively advisory. However, he relented that the fact that they exist as guidelines or

criteria against which MNCs accountability is assessed, qualified such statements to be described as ' standards.

Whittington (2005) stated that the motivation for the creation of the IASC was due to the need for a common international language of accounting to serve capital markets. He highlighted that a common set of accounting standards increased the comparability of companies in different countries and facilitated the easy consolidation of group of companies based in different countries. Although IASB sets standards after close scrutiny from different national standard setters, it is evident that it is involved more with convergence than harmonisation. This may in a way also support the sentiments expressed by UK finance directors during a survey that IFRSs undermined UK (and obviously of all other countries) reporting integrity, (Elliott and Elliott, 2009). Countries still need to maintain their national pride as they exhibit substantial economic and cultural differences.

On another hand, it is important to note that we now have more of a global economy hence the development of international standards makes it easier to raise cross-border finance and to compare performance of companies by users who include prospective investors, (Elliott and Elliott, 2009). To summary, Epstein and Mirza (2001) and Choi et al.(2002) gave reasons for the harmonization process of accounting practices in the preparers and user perspectives, they stated that harmonization created huge advantages as listed in the following tables:

Process of harmonization on IASC/IASB and EU

The IASC and its successor are considered to be the most successful body that evolved in harmonization of accounting practices (Nobes and Parker, 2010). The harmonization efforts of IASC can be classified in three phases. Simultaneously, the IOSCO and IFAC have supported to the IASC/IASB and EU.

First phase: 1973 to 1988

This period of time is called the first stage of development of IASC. During this period, the IASC set up most of its standards which covered major accounting topics like accounting for inventory (Epstein and Mirza, 2001). IASC focused on achieving compatibility between the existing standards and IAS and giving a 'lowest-common denominator' approach cross the countries. At the same time, the strategy of IASC allowed multiple methods that used in various countries. IOSCO accepted that IASs for financial statement of foreign companies that listed in their stock exchange market (Larson, 2011). Additionally, the IFAC was founded in 1983 to develop the areas which were uncovered by the IASC, such as auditing and management accounting (Nobes and Parker, 2010). The following table shows the detail information of process:

Table : Harmonization Process from 1973 to 1988

Harmonization Process 1973-1988

Context

1973

The IASC was founded.

1976

The Economic Cooperation and Development published an announcement on investment in MNCs to develop guidelines on disclosure of information (Choi et al., 2002)

1977

A Report about IASs for transitional corporations was issued by an expert group of United Nations (Choi et al., 2002).

1981

In order to set IAS widely, the IASC had forums with other organizations.

1983

Foundation of IFAC helped IASC to get a closer relationship with other bodies (Nobes and Parker, 2010).

1984

The London Stock Exchange issued a number of incorporated companies to follow IAS in the UK or Ireland (Choi et al., 2002).

Second phase: 1989 to 1993

During this period IASC started to cooperate with IOSCO, and made agreement with IFRS for cross-border securities offerings (Nobes and Parker, 2010). However, the IASC was decreasing the choices under the IAS and the IASC needed more capital market so that the IOSCO would accept it in the period between 1989 and 1993 (Fritz and Lämmle, 2003). IASC published a framework to prepare financial statement in 1989 and “Comparability/Improvement Project” was carried out to narrow the alternative accounting treatment in this period. Furthermore, 10 standards was revised in 1993 (Nobes and Parker, 2010). Table 4 shows the processes in this period.

Table : Harmonization Process from 1989 to 1993

Harmonisation Process 1989-1993

Context

1989

Exposure Draft 32 was issued by IASC

Third phase: 1993-2001

IASC started agreement with IOSCO and IOSCO supported 30 core standards that were developed or revised by IASC. From 2001, IASB started to improve existing International Accounting Standards, deal with the problem that IASC haven't addressed and enhance quality of financial report. IASB also involves in reducing the international differences in standards with FASB (USA)

(Nobes and Parker, 2010).

Table : Harmonization Process from 1993 to 2001

Harmonization Process 1993-2001

Context

1995

The European Commission planned to support the IASC to make IAS link with EU accounting requirements.

1996

The SEC manifested that it “ supports the IASC’s objective to develop, as expeditiously as possible, Accounting Standards that could be used for preparing financial statements that could be used in cross-border offerings.” (Choi et al., 2002: 296)

1998

The IOSCO published an announcement “ International Disclosure Standards for Cross Border Offerings and Initial Listings by Foreign Issuers” (Choi et al., 2002: 296); the IASC began to explore a new strategy and organization structure.

2000

The IOSCO accepted the IAS, especially for foreign registers (Nobes and Parker, 2010).

2001

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IASB was set up by supporting from the IOSCO and SEC (Nobes and Parker, 2010).

The fundamental of EU accounting harmonization is a harmonization of company law which is aim to create a uniform business environment (Mueller, 1997). Harmonization of company law taken by EU is directives, which have publicized 12 directives. Moreover, the fourth and the seventh directives made the contribution to the accounting harmonization process in the Europe (Hulle, 2001). In details, the fourth directive in 1978 combines Member States' provision and provide a guideline of the presentation and content of annual accounts, valuation methods and the publication. The Directive also pointed out that the annual report must include a fair review of firm's financial position and the 'true and fair' view brought from UK was firstly mentioned in mandatory term. Also, the seventh Company Law Directive in 1983 combines National laws on consolidation accounting and the fourth directive together, and sets out the methods of preparing consolidated accounts.

Choi (2002) suggested that IASs as the new accounting standards are the preferred choice for EU countries by European Union. In terms of international harmonization of accounting standards, the policy stated by European Commission in 1995 pointed out that it was more efficient to associate EU with IASC and IOSCO than amend existing directives (Epstein and Mirza, 2001). In 2000, a further step in harmonization process was made by EU, which required enterprises on a regulated market to prepare their consolidated accounts under IAS (Fritz and Lämmle, 2003).

The important obstacles faced by EU and IASC are differing accounting practice, which caused by different countries, nationalism, as well as lack of strong professional bodies and international enforcement agency. Also, the difference in regulatory sources is the challenge for EU and IASC (Houssain, nd).

IASC is broadly focused on removing unnecessary differences in accounting principles and practice around the whole world (McComb, 1982). That A lack of synchronization between release of standards in different countries and the formulation of standards by IASC will be an obstacle for harmonization (Rivera, 1989). Furthermore, lack of the professional bodies takes a challenge to implement IAS's. It is said that IASC can only implement its accounting standards by its member bodies, not through the own authority. Taking France and Germany as examples, the professional accounting bodies in these two countries have rarely influence setting of accounting rules than setting by the government and governmental bodies, so that IAS's can only promoted by persuasion (Nobes, 1995).

In terms of nationalism, there is an unwillingness to change accounting practice by accepting compromises. Nationalism may be brought out when attempting to maintain independence of sovereignty. It can be observed that some countries did not make a reaction to attempts of harmonization by IASC (Nobes and Parker, 2002).

Another challenge is the economic consequences of a particular country. Various in economic consequences of standards could result in de-harmonization unless considered by those who set the standards (Nobes and

Parker, 2002). The international accounting firms are also worried about the increasing interest of outsiders in the profession and the wish the standard setting process to be kept outside of the hands of the government (Samuels and Piper, 1985).

The achievements or successes of both EU and IASC/IASB in harmonising accounting practices:

In order to decide whether EU and the IASC were successful, it is important to review the objectives of these 2 organizations.

First of all, the achievements of EU would be evaluated. In the past, countries in European used control of bookkeeping system instead of the financial statements which were lack of law and format. The EU set two main directives to improve financial reporting practices and brought about some harmonisation. These directives approached rapidly throughout Europe and nowadays most countries in the continental Europe followed the EU's accounting system rather than Anglo-American type. The Table 6 describes the extent of harmonization that has been achieved in descending order.

Table : Extent of harmonisation achieved between 8 EU countries in descending order

The balance sheet translation

Differences in translation treatment

Value of inventory

The income statement translation

The way to approach depreciation

Examination and improvement

Value of Fixed Asset

Goodwill

Approach for cost of inventory

Source: Herrmann & Thomas, 1995, p264

Besides those successes, EU had some failures. Montagna (1986) stated that weak regulations, general and vague disclosure made European accounts be the same. In addition, Blake and Amat (1994) concluded that because of no direction for foreign currency translation, deferred taxation and accounting for lease commitments, the EUs' directives was failed itself. Some countries have explained the directives paralleling with the national accounting tradition. Some individual companies might refuse to agree to the rules given by EU. For example, 90% of German companies failed to publish their accounts. The EU harmonization also failed at the material level of actual accounting practices. The Table 6 shown above have presented 9 material harmonisation completed by 8 European countries. Some of these areas are not concealed by the EU legislation.

Secondly, we will determine whether IASC succeeded. The term "issuing standards" is clearly successful. IASC released forty-one standards coming along with conceptual framework. However, because of that the standards were criticized for allowing many options. Another objective which should be

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considered is promotion and observance of standards. We have to study four types of country: developing countries, emerging nations, continental Western Europe and Japan, and capital market countries in order to decide IASC's success. In developing countries type, Saudagaran and Diga (2003) achieved that the harmonization in ASEAN countries would go on and be based on IASB's standard. In addition, IASC had advantages as a global standard-setter to be a major impact in some emerging nations which moved from communist to capitalist economics. In the continental Western Europe and Japan type, IASC has achieved limited success. Some countries considered IASC as a Trojan horse trying to inflict the accounting standard in EU. Some companies in Switzerland chose IASs for their financial statements, and until 1994 IASs were used by several large companies all over Europe. The last type of countries including United States, Canada, the United Kingdom, Australia, South Africa and Netherlands seems influence the IASC. Furthermore, IASC could be considered as a successful organization as it had a support from IOSCO and EU commission in 2000. Nevertheless, IASC has accomplished their objectives.