ABSTRACT

Whilst the impact of globalisation and harmonisation is currently being witnessed around the globe, and the need to embrace the adoption of International Financial Reporting Standards (IFRSs) is becoming increasingly evident, certain jurisdictions have been much quicker in their embrace, adoption and adaptation of International Financial Reporting Standards, than others.

As well as highlighting the need for the adoption of International Financial Reporting Standards, this paper also aims to provide an explanation for the pace of response in the adoption and adaptation of IFRSs in selected jurisdictions. It does so partly through a consideration of the impact of accounting and finance theories which have impacted the standard setting systems of certain jurisdictions.

Key Words: IFRS, accounting, finance theories, creative accounting, accounting reforms, transparency, financial reporting, disclosure, rules based, principles based approach

The Need for the Adoption of International Financial Reporting Standards: Some Explanations For the Pace of Implementation

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A. Introduction

Whilst the impact of globalisation and harmonisation is currently being witnessed around the globe, and the need to embrace the adoption of International Financial Reporting Standards is becoming increasingly evident, certain differences in the accounting and legal systems present persisting challenges for several jurisdictions in their efforts to embrace a set of global standards aimed at facilitating transparency, as well as consistency in their application and interpretation.

Differences in accounting and legal standard settings and systems are also considered to be contributory to explaining the level of financial development attained by various jurisdictions. The adoption of International Financial Reporting Standards across the globe also plays a crucial role in its facilitation of corporate transparency and is of immense importance given the need for reliability and relevance in matters relating to accounting information – such that investors (both foreign and domestic) are able to rely on such information to protect their investments.

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B. Adoption Of IFRSs in Nigeria and China

In jurisdictions such as Nigeria, and with regards to the need for a change in accounting standard setting in Nigeria, through the adoption of International Financial Reporting Standards (IFRS), drivers behind such a move are attributable to the need to "revamp age old legislations and develop accounting and reporting regulations acceptable and understandable to users – this having become an important policy issue confronting emerging nations such as Nigeria."[2]

The inadequacy of financial reporting practices in Nigeria was highlighted in a study conducted by the World Bank Group on the Observance of Standards and Codes for Nigeria.[3]

Furthermore, Umoren remarks that, over the years, extensive revisions have been conducted on IFRS – which have not been reflected in the SASs; large sections and paragraphs in IFRS which have been newly incorporated cannot be found in the SASs; and that the SASs do not address all aspects of financial reporting and are insufficient in constituting a basis for the preparation of high quality financial statements – in accordance with the IFRS.

Countries such as China have also encountered challenging situations in its adoption of IFRS.

Two main factors which, in Tang's view, are responsible for driving the standard setting process of Chinese accounting toward internationalisation are its i) economic reforms; ii) increasing international exchange activities.

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[2] A Umoren, "Accounting Disclosures and Corporate Attributes" 2008 at page 4.

[3] See A Umoren, "Accounting Disclosures and Corporate Attributes" 2008 at page 4 and World Bank, 2004 at page 1

The difficulties in the Accounting Standards Setting in China, according to Tang include the following:

- Many accountants in China did not have a thorough understanding of the theoretical reasoning behind the conceptual frameworks that were developed in other countries.
- The need for improvement in accounting education
- The fact that many accountants in China did not understand how to change or adopt to existing accounting practices in China to achieve conformity with the new basic accounting standards.
- The lack of readiness of the accounting profession
- The need for greater input on the part of academics in contributing to the development of accounting theory and practice.[4]

The Impact of Accounting Reforms on Financial and Economic Development

Certain studies have examined “whether differences in accounting standards are a key explanatory variable“ (in respect of certain international variations)[5], whilst other studies carried out by Levine, Loayza and Beck have resulted in discoveries and findings which include suggestions that “legal and accounting reforms that strengthen creditor rights, contract enforcement and accounting practices can boost financial development and accelerate economic growth.” [6]

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[4] See Tang, “Bumpy Road Leading to Internationalization: A Review of Accounting Development in China, Volume 14 No 1 March 2000 pp 93 – 102)

[5] See Lombardo and Pagano “Legal Determinants of the Return on Equity”

[6] Bushman and AJ Smith, “Transparency, Financial Accounting Information and Corporate Governance” FRBNY Economic Policy Review /April 2003 at page 75.

In Cunningham's view, certain reforms adopted in response to financial fraud require a two staged procedure to correct important inherent oversights:

- That the forward looking disclosure regime should include delineation of probable variability in financial data and that;
- Financial data should be presented in ranges rather than discrete numerals.

C. Has Enron Really Made a Difference in the Response to Adopt International Financial Reporting Standards in the United States?

Having regards to the consequences of Enron's collapse, it is reasonable to expect that the Securities and Exchange Commission (SEC) and the FASB could have been more responsive in its adoption of IFRS.

There may however be historical related explanations for the manner of response.

Historical Developments Influencing the Accounting Standards Framework in the United States

One historical related reason is particularly directed at the fact that financial reporting in the United States is not entirely premised on a rules based approach. Following the collapse of Enron, a lot of comparisons were drawn between the principles based approach which existed in jurisdictions such as the UK, and the US rules based approach.

The inference of an approach which is not entirely premised on a rules based system derives from the fact that the SEC has always relied on a more subjective and judgemental based approach which incorporates finance theory, rather than traditional accounting concepts, in "requiring extensive disclosure of forward looking information." In other words, finance theory's influence over the area of accounting and corporate reporting.

"Finance theory is considered to diminish (and to have diminished) the relevance of accounting information. Following the exposure of widespread frauds, Congress passed laws that address the symptoms of finance's futurism – and not the underlying and fundamental problem of regulatory mandates requiring extensive disclosure of forward looking information. Finance theory's rise to intellectual and policy influence began in the 1970s. Until the 1970s, the SEC had prudently prohibited such futuristic disclosure as inherently unreliable.[7]

According to Cunningham, Enron's managers were influenced by modern finance theory. Its practices "reflect widespread cultural obsession with cash flows, justified by systematic diminishing of another longstanding principle of accounting, the accrual system).

In view of the greater emphasis dedicated by IFRS to fair value accounting, it could be argued that this should not present significant changes to the environment in which accounting standards are currently operating in the U.S.

[7] L Cunningham "Finance Theory and Accounting Fraud: Fantastic Futures versus Conservative Histories", 2005

It could also be argued that the adoption of IFRS in the U.S should facilitate greater disclosure and transparency than is the case at present – hence supporting Cunningham's proposal for correcting oversight of reforms aimed at addressing fraud in the U.S (that, is his proposal that financial data should be presented in ranges rather than discrete numerals).

Whilst the impact of Finance Theory (in the United States) on financial reporting pre Enron and post Enron (and even following the adoption of IFRS in many jurisdictions), cannot be denied, it is also important to highlight the impact of the principles based approach to financial reporting and the fact that judgemental or subjective approaches do not necessarily facilitate creative accounting practices – as long as these are exercised within the mandated boundaries of legal and stipulated requirements.

D. Conclusion

Perhaps the level at which principles operate with the IASB has been a deterrent factor in the FASB's efforts to embrace IFRS. The IFRS focus on fair value accounting however, should not present such a deterrence.

Further, where corporate governance practices are effectively exercised, these should narrow down the possibilities for abuse of the use of cash flows as instruments for predictive purposes.

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