NORTHERN ILLINOIS UNIVERSITY

# INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE AND THE HARMONIZATION OF INTERNATIONAL ACCOUNTING STANDARDS

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## ABSTRACT

This study deals with the works of the International Accounting Standards Committee (IASC) and the problems faced by it in the process of harmonizing international accounting standards. Sources used include books written by experts in the field of international accounting, articles written by accounting practitioners, and interviews conducted with the aid of a self-prepared questionnaire (attached). While concentrating on the IASC as the sole standards-setting body, this study also briefly discusses the roles of other organizations such as the International Federation of Accountants (IFAC) and the International Organization of Securities Commission (IOSCO) in the development of international accounting standards. The IFAC and the IASC have a joint agreement where the IFAC has the right to nominate members to the IASC Board and is required to recognize and promote standards developed by the IASC. While discussing the IASC, minor topics such as its members, board structure, and its objectives and provisions have also been covered. The Consultative Group, which is formed of representatives from non-accountancy organizations, is also briefly discussed.

The international accounting standards developed so far have begun to be accepted by the developing nations and a few European nations in order to save the costs of maintaining separate standard-setting bodies in their own countries, and to ease the flow of capital in the international arena where financial statements based on international accounting standards are slowly being recognized. However, there are major issues that still need to be handled by the IASC and major nations such as the U.S. that need to accept the IASs. Major issues include recognition and amortization of goodwill, deferred taxes, and leases. Advantages and disadvantages of an international set of accounting standards have also been discussed in this study. The environmental factors such as culture, social, legal and economic issues that influence standard-setting bodies are also mentioned. It is important to understand the differences among the thought-processes of the countries in order to understand why difficulties exist in developing these international standards.

The process may be difficult, but not impossible. And, if success is to be completely achieved in developing a set of standards to satisfy the needs of the global consumer, then all organizations and countries need to come together under the common banner of the IASC and concentrate on the similarities, and not the differences, between national accounting standards and international accounting standards.

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# INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE AND THE HARMONIZATION OF INTERNATIONAL ACCOUNTING STANDARDS

## INTRODUCTION

Multinational corporations, exports, imports, international capital markets, joint ventures with foreign companies, etc. have become the hi-fi of the business world today. The international arena has indeed become a very exciting field to be in for any business student. But, a future accountant like me could not comprehend the accounting side of it. Accounting for international economic activity must play a key role in how these activities take place. It has to, for accounting rules are based on social and political environment of a country, and are consistent with what investor groups want to see in a corporation's annual and other financial reports.

How does a multinational corporation report its activities? Or for that matter, how are any international economic activities accounted for by a U.S company. It was the quest for the answers to the above questions that led me to the International Accounting Standards Committee, its works, and the problems faced by it in the process of harmonizing international standards. As my interest in the works of IASC grew, I decided to do my Honors thesis on this topic. In the pages that follow, I present how various organizations have been formed since the beginning of this century to reduce the diversity amongst the national accounting standards. As the International Accounting Standards Committee is currently the sole international standards-setting body, I have concentrated my research on its efforts towards harmonization and have also touched on the works of its sub-groups. In addition, I discussed the International Federation of Accountants with which IASC has worked closely. Next, I have discussed the advantages and the disadvantages of standardizing accounting policies, especially the effects of international accounting standards on the business environment in the United States. Articles written by various experts in the field have been used to support both sides of the argument.

'International' is the first word of the title of this paper. It screams at us in the daily newspapers and the six o'clock news, be it morning or evening. It has become the buzz word of the 20th century. Politicians and representatives from the business field use this word and its sister term, 'global' with great abundance. Some fear it, as it brings strange foreign notions, and some look at it as the hope of a new and bright future. Individual opinions may differ, but the terms and the concepts such as 'internationalization' and 'globalization' are here to stay, along with the changes and the adjustments that come with them.

There has been a direct relationship between the growth in international trade and an increased emphasis on international accounting. The character of international trade has changed over the past half-century, contributing greatly to its growth. According to Evans, Taylor and Holzmann[1], prior to the middle 1940's, the dominant theory of international trade was based on the classical economic theory of comparative advantage. That is, each nation should offer goods and services that it can produce relatively efficiently and should export those goods. The nation should also import other goods, and thus international trade has been very much import and export oriented. So, in the past nations have relied upon any factors of production available to them and produced and exported goods. This meant that even though a nation had the raw material to produce certain goods, it may not necessarily have enough skilled labor or the technological know-how to produce the goods. On the basis of the comparative advantage theory, this nation was not able to produce enough to export to other nations. This theory assumed that the factors of production (land, labor, and capital) were fixed nationally. Soon, it was realized that the factors

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[1] Thomas G. Evans, Martin E. Taylor and Oscar J. Holzmann, *International Accounting and Reporting,* Cincinnati, Ohio: South-Western Publishing Co., 1994.

of production are mobile and from then on international investment and financing became the focus of international trade. New grounds were broken and new international markets for goods, services and capital were created. Now, nations have realized the crucial importance of taking advantage of low-cost skilled labor, and other factors of production that may be easily available in nations other than their own. As global competitiveness and flow of products increases, so will the importance of mobility of the factors of production. This gave raise to an entire new line of accounting problems to be dealt by international accounting.

In the midst of international trade exists a special entity, the multinational corporation. As defined by Gerhard G. Mueller, a multinational corporation is internationally owned and controlled. It is not a domestic corporation with some foreign business. It is a business organization with a truly international organization for all its business functions, including management, production, marketing and finance.[2] Excellent examples of multinational corporations are McDonald's, Pepsi, Coca-Cola and IBM.

The concept of multinational corporation is not new. In the seventeenth and eighteenth centuries, British multinationals greatly assisted in the spread of the British Empire and the colonization of much of the New World, as exemplified by such firms as the East India Company, the Virginia Company, and the Massachusetts Bay Company. The birth of multinational corporations and their increased numbers have greatly resulted in significant developments and also created specific internal and external problems in the field of international accounting. Internal problems include, among others, transfer pricing, foreign exchange, risk

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[2] Gerhard G. Mueller, "To International Significance of Financial Statements", *Illinois CPA*, Spring 1965.

exchange transactions and foreign currency translation. As international capital investment increases, so do the problems encountered in the accounting of the above mentioned transactions, which gives rise to the need for the development of specific standards.

2. *Abandonment of stable currency systems in International Monetary Systems* -

The International Monetary system is the structure within which 'foreign exchange rates are determined, international trade and capital flows are accumulated, and balance of payments are made'. The primary objective of the International Monetary Fund (created in 1944 by the Bretton Woods Conference) is to promote exchange stability. This has created a need for accounting in foreign currencies' transactions and translations.

3. *Rising resource and commodity prices and monopolies* -

The affluent nations such as the United States, Japan and most of Western Europe have greatly become dependent on resources that are found to be in abundance in the poor countries. As the demand for the resources increases, so do the resource prices. Also, the emergence of community monopolies and producers' associations such as The Organization of Petroleum Exporting Countries (OPEC), and The International Tin Council (ITC) are creating a special need for international accounting to account for the commodity price fluctuations and the instability created by these fluctuations.

4. *Growth of broadly based international capital markets* -

To ease external financing, a truly international capital market was created in response to the numerous controls restricting foreign access to national capital markets. This capital market is known as the Eurobond or the Eurocapital and has helped governments and corporate borrowers facing restrictions in the domestic capital markets to tap into its broad based resources. A major requirement to be met by the firms seeking capital in this market was a significant increase in their financial statement disclosures. In fact, in the United States, the Securities and Exchange Commission increased the amount of information U.S investors receive from foreign companies whose stock is traded over the counter (1983). This includes more detailed annual and quarterly reports.

5. *Growing economic aspirations of the third world* -

The struggle of third world countries in maintaining their independence gained after World War II, in the face of problems such as an unbalanced development, excessive foreign debt, backward agriculture and food shortage, etc. has resulted in the demand for a New International Economic Order by these countries. The new order basically demands for a balance between the developed and the developing economies such as to reform the international economic structure and increase of foreign debt by developed countries. This could create accounting problems such as 'the role of accounting in economic development, the measurement and management of political and economic risks, and accounting for the social costs and benefits of the operations of the multinationals' [5].

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[5] Ahmed Belkaoui, *International Accounting - Issues and Solutions,* Quorum Books, 1985, p. 12.

## THE BUILDING BLOCK

Now that I have discussed the factors that triggered international accounting, let me mention some of the significant developments in the history of international accounting as far as major conferences and institutions are concerned. It is extremely interesting to note that the struggle for the development of a specific international accounting standards started in different parts of the world almost a century ago. Starting from the beginning of this century to most recent years the following conferences/institutions were formed:[6]

| YEAR AND PLACE | CONFERENCE/CREATION OF AN INSTITUTION |
| --- | --- |
| 1. 1904, St. Louis | First International Congress of Accountants and subsequent congresses were held every four years. |
| 2. 1949, San Juan, Puerto Rico | First Inter-American Accounting Conference (IAA), focused on the problems of accounting developments in the western hemisphere. |
| 3. 1951, Paris | Union Europeenne des Experts Comptables Economiques et Financiers (UEC) was established with 12 professional accounting associations from Austria, Belgium, France, West Germany, Luxembourg, the Netherlands, Portugal, Spain and Switzerland. Meeting are held every three years |

[6] Thomas G. Evans, Martin E. Taylor and Oscar J. Holzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, pp.10-11.

and focus on accounting problems in Europe. The UEC has been very active since the establishment of European Economic Committee (EEC) in 1957.

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|---|---|
| 4. 1957, Manila | The First Convention of Asian and Pacific Accountants. Conferences held subsequently every three years and focus on special accounting problems in Asia and the Pacific area. |
| 5. Early 1960s | Establishment of committees on international accounting issues by the American Accounting Association (AAA). |
| 6. 1966 | The Accountants International Study Group (AISG) was established to issue comparative studies on accounting and auditing issues in the United Kingdom, Canada, and the United States. |
| 7. 1966 | The American Institute of Certified Public Accountants in cooperation with similar agencies in Canada and Mexico and various international aid agencies established the International Committee for Accounting Cooperation (ICAC). Its purpose was to facilitate the accounting development of Third World countries. |

At the Tenth International Congress of Accountants, major steps were taken to create two new organizations to effectively deal with the problems of international accounting.

76 One of the organizations established as a result of the 1972 decision was the International Accounting Standards Committee (IASC) in 1976.

. 1977 International Federation of Accountants (IFAC) was established.

11. 1976 United Nations' Commission on the Transnational Corporation.

12. 1976 Creation of the International Accounting Section, a special interest section of the American Accounting Association.

13. 1983 The International Accounting Standards Committee and the International Federation of Accountants agreed to link up.

The World Congress of Accountants, held every five years provided continuity in international accounting. The Fourteenth Congress was held in 1992 in Washington D.C. The strategies chosen to solve problems by the associations formed after 1972, were based on the framework created by the various activities before 1972.

In the last decade about ten accounting standard-setting bodies have emerged. Of these, main organizations are:[7]

International Accounting Standards Committee (IASC)

International Federation of Accountants (IFAC)

European Community (EC)

United Nations (UN)

Organization for Economic Cooperation and Development (OECD)

All of these organizations have been active in reducing diversity among national standards, but lately competitiveness amongst the organizations is proving to be a threat against the very goal that each of them is striving for. As the purpose and the functions of each organization differs from the other organizations, their methods of approach in solving any international accounting problems also differs, and each wants to satisfy their own goals which may not necessarily be the same as goals of other organizations. If there is to be any success achieved in the process of standards-setting for the field of international accounting, all of these organizations must develop a common front and common goals.

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7 Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 91.

# INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE

# AND ITS 'SISTER' GROUPS

As is suggested by the title of this work, I will be concentrating on the works of the ternational Accounting Standards Committee and the problems faced by them in the process of rmonizing accounting standards worldwide. I will also be discussing its members, board tructure, sub-groups and sister-groups in order to have a better understanding of this complex ommittee and its works.

## MEMBERS

As noted earlier, the IASC was established in 1973. The American Institute of Certified Public Accountants (AICPA) was one of the founding members of the IASC. It is important to note that individual countries are not members of the IASC; instead accounting bodies within these countries are members. The AICPA is a member of the IASC, but the FASB and the SEC are not. Thus, IASC does not yet have complete control over the accounting standards of any nation. Currently 101 accounting bodies representing 77 countries make up the IASC. "The IASC follows a due process procedure in its work of studying issues, preparing exposure drafts of proposed standards, considering written input on those standards from interested parties, and then issuing the international accounting standards. [8]

## BOARD STRUCTURE

In order to have a better understanding of the objectives and procedures of the IASC, it is important to note who exactly are involved in the process. In January 1975, the IASC

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[8] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, International Accounting and Reporting, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 88.

Preface to Statements of International Accounting Standards, which was later March 1978. A new document entitled Objectives and Procedures was approved in 1982 and published in January 1983. This document changed the structure and tion of the IASC Board which conducts the Committee's business. It recognized the need olve a broad membership base that was interested in the standard-setting process. The new structure stressed the inclusion of accounting representative organizations from developing countries.

Originally, the board consisted of the first eleven IASC member countries such as *Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and* reland, and the United States of America. "The IASC constitution now allows for a maximum f seventeen board members; thirteen professional accounting representatives (a minimum of three om developing countries), and up to four from international organizations that are not professional accountancy bodies but have an interest in financial reporting. The current board includes a representative from one such nonaccountancy body, the International Coordinating Committee of the Financial Analysts' Association."[9]

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[9] Ibid, p. 88.

## OBJECTIVES AND PROVISIONS

According to its Constitution, the IASC's objectives are:[10]

1. To formulate and publish, in the public interest, accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance;

2. To work generally for the improvement and harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements.

Basically, the International Accounting Standards Committee was formed to develop accounting standards in the international arena, and help harmonize these standards so they were accepted by all countries, which would then lead to ease in international capital flow and international trade, in general.

One of the provisions of the Agreement and Constitution of the IASC[11] calls for the members of IASC

> "to use their best endeavors:
>
> (i) to ensure that published financial statements comply with these standards or that there is disclosure of the extent to which they do not and to persuade governments, the authorities controlling

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[10] Dennis E. Peavey and Stuart K. Webster , "Is GAAP the Gap to International Markets ?", *Management Accounting*, August 1990, p. 35.

[11] *International Accounting and Auditing Standards,* Chicago, Illinois, CCH International Inc., 1991.

securities markets and the industrial and business community that published financial statements should comply with these standards;

(ii) to ensure (1) that the auditors satisfy themselves that the financial statements comply with these standards or, if the financial statements do not comply with these standards, that the fact of non-compliance is disclosed in the financial statements, (2) that in the event of non-disclosure reference to non-compliance is made in the audit report;

(iii) to ensure that, as soon as practicable, appropriate action is taken in respect of auditors whose audit reports do not meet the requirements of (ii) above...."

Such provisions indicated the means adopted by the IASC in making sure that the standards developed by them are accepted and observed by countries to the fullest.

## CONSULTATIVE GROUP

In order to extend its support to non-professional accounting bodies and get them involved in the standard-setting process, the Consultative Group was formed in 1981. The Group's main objective is to meet with the IASC regularly and discuss "policies, principles, and practical and conceptual issues associated with the IASC's work. It also suggests issues needing standardization..."[12] Representatives from various groups are members of the Consultative Group.

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[12] *International Accounting and Auditing Standards,* Chicago, Illinois, CCH International Inc., 1991.

e list is as follows:[13]

- European Commission
- International Federation of Stock Exchanges

  (Federation Internationale des Bourses de Valuers)
- Financial Accounting Standards Board
- International Association of Financial Executives Institutes
- International Finance Corporation
- International Bar Association
- International banking associations
- International Chamber of Commerce
- International Confederation of Free Trade Unions, and World Confederation of Labour
- International Organization of Securities Commissions
- The World Bank

The Consultative Group actively promotes the IASC's international accounting standards. It seeks cooperation from various other international bodies through United Nations (U.N) and the Organization for Economic Cooperation and Development (OECD). It also seeks endorsement

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[13] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, International Accounting and Reporting, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 91.

of its standards from U.N. The U.N. responds to the IASC's exposure drafts and suggests topics for consideration. The IASC, then makes progress reports to the U.N. and the U.N. then reviews the operations of the IASC on a regular basis.

## INTERNATIONAL FEDERATION OF ACCOUNTANTS

As I noted earlier, the International Federation of Accountants (IFAC) was established in 1977. But, earlier in 1972, when the Tenth International Congress of Accountants was held in Sydney, Australia, an organization called the International Coordination Committee for the Accounting Profession (ICCAP) was created and encharged with selecting the city for the next congress, coordinating the next meeting, and providing continuity. The ICCAP was replaced by the IFAC in 1977. The IFAC initially had two objectives:[14]

1. to arrange future international congresses, and
2. to achieve international technical, ethical, and educational guidelines for the accounting profession.

There are more than 101 members from 77 nations and a council in the IFAC.

## AGREEMENT BETWEEN THE IASC AND THE IFAC

In 1981, a special joint working party of the IASC and the IFAC recommended to the board of the IASC and the council of the IFAC that the two organizations join 'in a series of mutual commitment' that would provide (1) a permanent relationship between the two groups, (2) a guarantee from the IFAC of the full and complete autonomy of the IASC as the standard

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[14] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 91.

setter, and (3) that both groups widen input and encourage the acceptance and adoption of their standards.[15] The IFAC was also recommended to nominate the accounting bodies to serve on the IASC board and also help increase participation from the developing countries in the works of IASC by making contribution to IASC's budget. It was agreed that the IASC would be the sole standard setter in the international accounting field and the IFAC would recognize the standards. Also, the IASC gave IFAC the rights to nominate all members of the IASC board. All members of the IFAC would automatically become members of the IASC. As of May 1993, the following countries were appointed to the IASC board by the IFAC: Australia, Canada, Denmark, France, Germany, India, Italy, Japan, Jordan, the Netherlands, South Africa, Sweden, the United Kingdom, and the United States. Additionally, the IFAC has appointed the International Coordinating Committee of Financial Analysts' Associations to the IASC board.

The agreement between IFAC and the IASC has that potential of bringing together professional accountants from all over the world under the same banner of the IASC. Also, it was this agreement that sparked the harmonization of the world's accounting standards. As mentioned earlier a common front between the organizations involved in the standards-setting process needs to be established. I believe that the agreement between the IASC and the IFAC is a major step towards establishing a common front between all standards setting organizations. This has already, and will also in the near future help accelerate the process and achieve the major goals of all organizations involved if they remain under the common banner of the IASC.

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[15] Ibid, p. 94.

## INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSION

The International Organization of Securities Commission (IOSCO) has over sixty securities regulatory agencies around the world as members, including the SEC. It will eventually determine the acceptability of the IASC's accounting rules along with the individual securities commissions making up IOSCO. IOSCO's major objective is to facilitate cross-border securities offerings and multiple listings without compromising the presentation of financial statement information. It recognizes that the primary impediment to the free flow of capital is the differences among countries in financial accounting and reporting. These differences lead to premium payments by securities issuers in foreign markets for preparing their financial statements using different accounting standards.

## THE CURRENT POSITION OF THE IASs

As I noted earlier, with the advent of the multinational corporation and the increased need for corporations to globalize, financial executives have become aware of a growing need for international accounting standards. One factor slowing the adoption of international accounting standards has been the need to develop standards which ease cross-border capital movement without sacrificing the interests of domestic companies. The Financial Accounting Standards Board believes that agreements on setting international standards will be difficult to obtain. Currently, foreign countries address standard-setting from conceptual foundations which are dissimilar and this fact may hinder any progress in developing international accounting standards. According to Wyatt and Yospe, there are two approaches to facilitate cross-border securities offerings:[16]

1. *Mutual Agreements:* Mutual agreements between specific countries (bilateral agreements) are agreements by two countries' securities or government officials to accept domestically prepared financial statements when raising capital in each other's country. While these agreements make life easier for securities regulators, they do not help investors and creditors, who still must deal with financial statements prepared in accordance with different accounting rules, with the attendant risks and uncertainties.
2. *Professional Initiatives* - A quality body of international accounting standards should be developed through a collaborative effort of many countries' accounting professions. Such a set of standards must have relatively few acceptable alternatives and require disclosure of information as needed by investors and creditors to make investment decisions. The IASC has been concentrating on this approach for the past few years, with the expectation that the first major step - eliminating a large number of previously acceptable alternatives will be accomplished by the end of 1993.

In fact, the IASC has taken a significant step in reducing the number of free choices of accounting through the issuance of Exposure Draft #32 (ED-32) in January 1989, entitled "Comparability of Financial Statements". ED-32 proposes changes to twelve IASC standards and

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[16] Arthur R. Wyatt and Joseph F. Yospe, "Wake-up Call To American Businesses: International Accounting Standards Are On The Way", *Journal of Accountancy*, July 1993, pp. 80-85.

eliminates most of the free choices of treatments. If multiple treatments are allowed a particular treatment is identified as a benchmark, or preferred, and any others are designated as alternatives.[17] The larger the number of alternatives available, each country may then choose the alternative that best satisfies their social and economic needs. But this leads to the same problem of different accounting standards in the midst of the struggle to achieve free-flowing international trade. Therefore, it is extremely important to reduce the number of available alternatives so there is a good chance that most countries will choose the same standard. I believe the IASC has realized the importance of less available alternatives and is working on its previous standards and their alternatives to make a compact set of international accounting standards that will serve a common purpose for all countries. (See attached Table I for the recent list of changes for the Comparability of Financial Statements)

In July 1990, the IASC issued a Statement of Intent which intended to issue a new and complete set of standards, which will incorporate ED-32's changes. This change is still in progress. The following actions were taken in the Statement:[18]

1. Approval of the proposed changes to two of the twelve covered in ED-32.
2. Deferral of a decision on two other standards.
3. Major changes to three standards.

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[17] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 91.

[18] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 91.

4. Minor changes to four standards.

5. Agreement that one standard will not be changed

Accounting standards such as those developed by the FASB are statements regulating the representation and disclosure of figures within financial statements. International accounting standards do not however nullify local standards or laws and may not be in complete compliance with local legislation. In the near future, the objectives of the IASC are to further develop international accounting and financial disclosure standards that will meet the needs of the international business community and capital markets, develop and assist with the implementation of accounting standards that will address the financial reporting needs of developing countries, and enhance the compatibility of national accounting requirements and international accounting standards.[19] It is the linkage of worldwide capital markets that has proved to be one of the driving forces behind the movement toward a single set of accounting rules. The IASC encourages countries to adapt the IASC's international accounting standards to met their specific local conditions and structures. Most IASC standards apply to developed countries, but many have also been developed or modified to meet the specific needs of developing countries. The IASC standards that were modified to meet the needs of developing countries are in the areas of foreign exchange rates, property, plant and equipment, and related party disclosures.

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[19] David Cairns, "IASC's Blueprint for the Future", *Accountancy,* December,1989, p.80.

The current level of success the IASC has achieved is partly due to the fact that it is a truly interna ional organization with its standards developed through an extensive international consulting process. *The future of IASC in developing truly international standards will be a futile* task if individual countries still retain their own national accounting standards.

David Cairns, Secretary-General of the IASC in 1989, stated that the IASC has always recognized the importance of involving national and regional standard-setting bodies in its work.[20] Currently, the IASC regularly visits national standard-setting bodies, and the IASC has done much to gain the approval and involvement of these bodies. In return for greater involvement in IASC activities, national standard-setting bodies must show sufficient flexibility so that they can reach an international consensus where there are equally acceptable treatments for like transactions and events. During 1989 there was a growing willingness by national standard setting bodies to participate in the process of the IASC and to reconsider their national requirements. This is something the IASC would build on; with such cooperation IASC can lead the way to truly international accounting and disclosure standards.

Between 1989 and 1991 there were 31 standards issued by the International Accounting Standards Committee, most of which were already included in the opinions of the American Institute of CPAs, Accounting Priniples Board and in Financial Accounting Standards Board statements. (See attached Table II for a list of the 31 international accounting standards) According to Arthur Wyatt, Chairman of the IASC in 1991, the issuance of international

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[20] Ibid, p.80.

accounting standards has had virtually no impact on U.S. practice.[21] Although most U.S. companies don't follow the international accounting standards set by the IASC, most U.S. companies state that their financial statements were prepared in accordance with these standards. In general, the American business community does not appear to believe that accounting rules ever will be standardized on a global basis. Most have the attitude that the United States has the best accounting standards and disclosure requirements in the world; therefore, the United States will never lower its standards to accommodate the rest of the world. As a result of this attitude, U.S. businesses have not paid much attention to the activities of the IASC. (It seems to me that those businesses and the accounting professionals who live in the 'rosy' world of the FASB and the U.S. GAAP can be easily compared to the frog in a well who thought that the entire world was the size of his well and everything was hunky-dory until the day he left the well. Or this attitude can be compared to the executives at IBM who thought nothing could touch IBM and lived in a glass dome high above the reach of the consumer. But they experienced their fall when a little ant like Apple almost trampled them with their innovative products and customer service.) This proved to be very much evident when I interviewed professionals in the field as most of them did not know much about the IASC and its activities. At this point I would like to quote a few statements made by some of the professionals in the field during the interviews I conducted with the help of a self-prepared questionnaire (attached). Mr. Viraj Patel, a Controller of Corporate Consolidation at a multinational company in New York has an extensive background in international operations of foreign and multinational companies and also has spent seven years at Price Waterhouse.

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[21] Peter D. Fleming, "The Growing Importance of International Accounting Standards", *Journal of Accountancy,* September, 1991, p.101.

Mr. Patel believes that the IASC's efforts will result in harmonization of a lot of financial reporting items around the world. However, to achieve this goal is more difficult because of complex capital and tax structures of various countries and the local laws that restrict the flow of capital. This is absolutely true, but at the same time it is also true that foreign-based companies who have to spend on accounting and legal costs upon conversion of their financial statements to U.S. GAAP, or others, are more willing to go through this difficult process and achieve a harmonized set of standards. As far as the decision of the SEC to allow foreign investor companies to enter U.S. capital markets by presenting financial statements based on international accounting standards, Mr. Patel does not believe it would be advantageous to the U.S. companies as U.S. GAAP is more conservative than others. But, if stock exchanges around the world, such as London and Hong Kong start a similar practice, then countries that are adopting IASs will raise capital in London and Hong Kong where they do not have to spend on conversion costs, and the U.S. will be unable to lure other countries into its capital markets.

I also had the opportunity to interview three individuals from DeKalb Genetics Corporation: Jerry Zakosek, the Director of International Accounting, Jane Coffey, a Senior Analyst (Canada and Europe), and Christa Ojeda, also a Senior Analyst (South America). Mr. Zakosek agreed that there is a need for international accounting standards, but a lot of difficulties were involved in bringing together different systems and creating a new harmonized system. Besides, he could not envision the U.S. relaxing its standards in order to accommodate the rest of the world. All three were definite about the SEC not accepting financial statements based on IASs. As far as the problems faced by U.S. investors in evaluating potential foreign investments, everyone agreed that it was the inconsistency of foreign GAAPs with the U.S. GAAP. Jane

Coffey cited that French standards are geared towards the needs of taxing authorities, which is different from U.S. standards. Ms. Coffey agreed that some of the features of foreign accounting models could very well be incorporated into U.S. GAAP; for example: the ability to expense goodwill and other intangibles if they are found to be worthless. Some European nations allow the expensing of goodwill in the year it is found to be worthless. This method avoids the unnecessary amortization expense charge since there is no revenue generated by the asset, and therefore, complies with the matching principle.

I also conducted an interview with a partner at a local accounting firm in Northbrook, Illinois. He did not have any extensive background in international accounting, but he was in agreement with the other interviewees as far as the need for international standards and the difficulties faced by the IASC due to the vast differences in the accounting models.

Based on the interviews I conducted, one could mistakenly conclude that most U.S. companies have no need or desire to know about the IASC and its activities, because foreign companies coming into the U.S. are required to convert their financial statements to U.S. GAAP. U.S. companies do not face many problems when they go abroad because the U.S. standards are very similar to the IASs which are being accepted as local standards in most of Europe and Asia. The adoption of IAS's would help defray the cost of maintaining a standard setting body and eliminate the commonly used alternatives. The United States on the other hand has not decided whether to completely adopt the standards set by the IASC, even though they continue to participate in their development.

Based on the articles and books I have read on international accounting standards I believe t there are businesses in this country that may be directly affected by these standards and would e to see increased involvement by FASB and the SEC in ISAC activities. In the United States, e first group likely to be concerned with international accounting standards are accounting firms rvicing multinational corporations, as these corporations, due to their very nature and their volvement in Europe and Asia, will be forced to comply with the international accounting tandards in reporting and disclosures in the financial statements.

In 1992, the FASB made a decision to play a more active and supportive role in setting nternational standards, thus considering international implications as much as possible in domestic projects. The FASB hopes to expand its international role by [22]:

1. Intensifying consideration of International Accounting Standards Committee (IASC) standards in all domestic FASB projects.
2. Engaging in multinational joint standard-setting projects with the IASC on mutually selected topics.
3. Considering the adoption of IASC or foreign national standards that are judged to be superior to U.S. standards.
4. Convincing the IASC and worldwide countries to adopt U.S. standards judged to be superior to international or foreign national counterparts.
5. Reaching agreement on a choice of standards where U.S., IASC or foreign national standards are not demonstrably superior to each other.

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[22] "FASB Plans More Active International Role", *Journal of Accountancy,* February, 1992, p.16.

I believe this is a major step taken by the FASB in getting involved with the standards-setting process of the IASC along with similar organizations in other countries. As long as FASB keeps up with its involvements in the international arena, the United States has a better chance of convincing other countries and the IASC of accepting comparatively superior U.S accounting standards.

Wyatt and Yospe also have suggested that U.S. businesses must change their perception and recognize the fact that the rest of the world is considering accepting IASs for cross-border securities offerings.[23] U.S. businesses will be at a competitive disadvantage if they do not also adopt the same accounting rules. In order to avoid this situation U.S. businesses must familiarize themselves with the IASC's proposals, otherwise, IASs will be finalized without the appropriate consideration of the majority views and opinions of the United States.

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[23] Arthur R. Wyatt and Joseph F. Yospe, "Wake-Up Call to American Business: International Accounting Standards Are On The Way", *Journal of Accountancy,* July 1993, pp.80-85.

## *THE FRAMEWORK* -

## A GUIDE FOR THE PRESENTATION OF INTERNATIONAL FINANCIAL STATEMENTS

The approved text of international accounting guidelines and concepts is called [illegible] FRAMEWORK. The Framework was approved in April of 1989 for publication in July of [illegible]9, and the approved text of the Framework is published by the International Accounting [illegible]dards Committee in the English language. It is a set of international standards for the [illegible]aration and presentation of financial statements. *One of the stated purposes of the Framework* [illegible] assist national standard-setting bodies in developing their own standards.

The Accounting Standards Committee (ASC) has committed itself to support the work of [illegible]IASC. The ASC has agreed to recognize the Framework as a set of guidelines in developing [illegible] standards in the United Kingdom and the Republic of Ireland.

In other parts of the world a considerable amount of time and energy have been spent [illegible]eloping a conceptual framework for accounting. The IASC is committed to narrowing the [illegible]ferences that are present in standard-setting across the world, and is seeking to harmonize [illegible]ulations, accounting standards and procedures relating to the presentation of financial [illegible]tements.[24]

The Framework, as developed by the IASC, sets out the concepts that underlie the [illegible]eparation and presentation of financial statements for external users. The Framework is not

[24] Roy Chandler, "Framework for the Preparation and Presentation of Financial [illegible]tatements", *Accountancy,* September, 1989, p.141.

meant to be a set of international accounting standards, and therefore does not define standards for any particular measurement or disclosure issue. In those instances where there is a conflict between the requirements of an international accounting standard and the Framework, the international accounting standards will prevail. However, the IASC is guided by the Framework in its development of future standards and in its review of existing standards.

The purpose of the Framework is to:[25]

a) assist the Board of the IASC in the development of future international accounting standards and aid in its review of existing international accounting standards;

b) assist the Board of the IASC in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by providing the alternative accounting treatments permitted;

c) assist national standard-setting bodies in developing national standards;

d) assist preparers of financial statements in applying international accounting standards and with topics that have yet to form the subject of an international accounting standard;

e) assist auditors in forming an opinion as to whether financial statements conform to international accounting standards;

f) assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with international accounting standards; and

[25] Roy Chandler, "Framework for the Preparation and Presentation of Financial Statements", *Accountancy,* September, 1989, p.141.

g) provide those who are interested in the work of the IASC with information about its approach to the formulation of international accounting standards.

The Framework is mainly concerned with general purpose financial statements. These general financial statements are prepared at least annually, and are directed toward the information needs of a wide range of users. These financial statements form part of the process of financial reporting. The Framework applies to the financial statements of all commercial, industrial, and business reporting enterprises, whether in the public or private sectors. A reporting enterprise is an enterprise for which there are users who rely on financial statements as their major source of financial information about the enterprise.

Next, I will discuss the advantages and disadvantages of harmonizing international accounting standards. Prior to noting the disadvantages, I have discussed in some detail the varieties of financial objectives in the international accounting and the possible various causes of differences in international accounting standards, as this is the main reason why the harmonization process is proving to be so tedious and costly - which are the disadvantages of harmonizing international accounting standards.

## THE ADVANTAGES OF INCORPORATING INTERNATIONAL ACCOUNTING STANDARDS

But just where do the advantages lie for U.S. companies to implement the international accounting standards developed by the IASC? This is a question asked by many United States M.N.C's. All over the world those with capital to lend base their lending decisions on the cial statements presented to them. Because the U.S. has yet to fully implement the standards loped by the IASC, companies based in the U.S. are currently at a disadvantage when mpting to raise capital in foreign markets. In today's global economy, capital is available ywhere in the world. Because of this global availability, the use of international accounting ndards is highly desirable and extremely important. When international accounting standards e not used, confusion is likely to result as the concepts utilized to develop the financial atements may vary significantly between the two countries involved.

The fact that the U.S. has yet to fully implement the use of the International Accounting Standards has diminished U.S. lenders' ability to compete in the capital market. Currently, the SEC requires any non-U.S. company, which desires to raise capital in the U.S., to file financial statements in accordance with or reconciled to the U.S. generally accepted accounting principles (GAAP).[26] According to Arthur Wyatt, there is no other country in the world where securities regulators have similar requirements. This requirement has discouraged non-U.S companies from raising capital here.

When a foreign company does decide to raise capital in the United States it faces two significant expenses: the accounting costs of restating or reconciling financial statements to U.S. GAAP in order to meet the SEC requirements and the legal costs of meeting other SEC filing requirements.[27] These added costs have a significant impact when the interest rates are the same or lower in different countries. For example, a company may elect to go to London where the

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[26] Peter D. Fleming, "The Growing Importance of International Accounting Standards", *Journal of Accountancy,* September, 1991, p.104.

[27] Ibid, p.104.

added filing costs do not exist, and get money at the same rate. This places the U.S. capital markets at a disadvantage in the world market, as foreign companies often go elsewhere to raise capital because there are no added costs involved.

The best alternative for solving this problem would be for the United States to get involved in the standards-setting process of the IASC and adopt the International Accounting Standards developed by the IASC, and get the SEC's counterparts in other countries to do the same. It appears it would be in the United States' best interest to assist in the worldwide adoption of international accounting standards, despite the fact that this may take a while. However, U.S. CPAs must have a willingness to listen to the rationale behind it, and ultimately implement the changes as suggested by the IASC.[28]

## VARIETY OF OBJECTIVES IN FINANCIAL REPORTING

The two-day international conference held in London in 1993 proved all too clearly the *variety of objectives in financial reporting. The purpose of this conference was to provide a* forum for standard-setters around the world to debate on accounting issues and in particular the harmonization of accounting standards, problems in individual jurisdictions and accounting for leases. I found the various debates and issues discussed during this conference to be very interesting as they proved easily the different levels of thoughts and viewpoints that representatives from various countries shared or did not share.

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[28] Peter D. Fleming, "The Growing Importance of International Accounting Standards", *Journal of Accountancy*, September, 1991, p.106.

Various case studies were discussed by the participants and debates were held on the nting issues involved. One such case study that I would like to cite is a clear example of differences exist in recognizing the same concepts or issues. This has resulted in the culties faced by the IASC in bringing representatives from different accounting bodies ther and harmonize the accounting standards. The case study I will use here deals with recognition of self-insurance as an expense or a liability.[29] A fictional retail store paid out *GBP30,000 on one injury claim from a customer in three years* and on the basis of this experience decided to charge to profit and loss (income) GBP10,000 each year as a 'self-insurance' expense 'recognizing that a corresponding liability would grow in so far as no claims are settled', The debate was whether the store should recognize this liability for self-insurance? The debate resulted in seven participants arguing that it was a business risk and should be accounted for only as and when the expense actually took place. But five participants argued that it was a liability and should be recognized as such. Goodwill was the subject of another such heated debate. International practice on goodwill varies widely. For instance, in France there has been much pressure by the industry for flexible rules on intangible to match those of the United Kingdom. As was mentioned in the article, three years ago, France had moved to allow goodwill to be carried, but amortized. However, numerous kinds of new intangibles such as brands, patents, lists, etc. were emerging and these were more and more difficult to measure and in most cases they were not depreciated materially. The length of the amortization period is another cause of differences in the accounting of goodwill. In U.S. goodwill and other intangible assets may be

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29 "Standard-Setters Strive for Unified Purpose", *World Accounting Report*, Financial Times Business Information, Ltd., December 1993.

rtized over a period of forty years. But in some other countries such as Japan goodwill may amortized over five years. In U.K. and Germany goodwill is written off directly against areowners' equity. It is clear that the same asset of goodwill is treated differently in different untries depending on which entity has a major influence on the creation of accounting standards nd their needs.

## ENVIRONMENTAL FACTORS

The fact that there are differences in the accounting objectives, standards, policies, and techniques of different countries was established ages ago. Major difference seem to revolve around such issues as consolidation and accounting for goodwill, deferred taxes, long-term leases, discretionary reserves, inflation and foreign-exchange translation gains and losses.[30] The accounting objectives, standards, policies and techniques in each country result from the environmental factors in that country. If the environmental factors differ significantly from country to country, and they most certainly do, then it should not surprise anyone that the accounting concepts and practices also differ. Various attempts have been made to identify the environmental conditions that are likely to influence the standard-setting bodies. The environmental conditions include cultural, social, economic factors and also other environmental factors that may affect business behavior in general and development of accounting concepts and practice in particular. In order to have a better understanding of the importance and the

[30] Ahmed Belkaoui, *International Accounting - Issues and Solutions,* Quorum Books, 1985.

omplexity of the works of the IASC, I think it is equally important to understand the various actors in a country's environment that establish the record-keeping and reporting system. In order to achieve this, I have adopted and utilized a list of factors as discussed by Ahmed Belkaoui. I believe the next few pages explain very well what goes into the development of an accounting system of a country, as the same factors also influence the decisions made by the standards-setting bodies in each country. After going over these factors the reader will hopefully understand the reasons for years of arguments and heated debates over matters as to whose accounting standards are better, and the resulting hard work and length of time consumed by organizations such as the IASC in developing one set of international accounting standards.

As listed by Ahmed Belkaoui, the following lead to reporting and disclosure system of a given country:[31]

1. Cultural Relativism
2. Linguistic Relativism
3. Political and Civil Relativism
4. Economic and Demographic Relativism
5. Legal and Tax Relativism

1. *Cultural Relativism*:

'Cultural Relativism refers to the need to judge any behavior in terms of its own cultural context, and not from another cultural context. Applied to accounting, cultural relativism rests on the fundamental assumption that accounting concepts in any given country are as unique as any

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31 Ahmed Belkaoui, *International Accounting - Issues and Solutions,* Quorum Books, 1985.

other cultural traits.' Culture constitutes of both physical culture, which is man-made, and subjective culture, which is the 'subjective response to what is man-made'. Subjective culture refers to the cognitive structures used by individuals in their information processing in a particular world-setting. These structures affect the information processing of individuals from different countries.

Cultures differ and humans in different cultures develop different degrees of cognitive complexity. As a result, cultures may be differentiated along the degree of cultural complexity. The degree of complexity is measured by Murdock and Provost by using the following ten scales to rate societies:[32]

1. *Writing and records*: a high score when there is an indigenous system of writing, a zero score when there are no records of such a system
2. *Fixity of residence*: differentiating between permanent residence (high longevity) and nomadic existence
3. *Agriculture*: focusing on the importance of agriculture to the culture's food supply
4. *Urbanism*: focusing on the size of settlements
5. *Technical specialization*: focusing on the number of different crafts and skills
6. *Land transport:* focusing on automotive versus human means of transport
7. *Money:* focusing on an indigenous currency versus barter

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[32] Ahmed Belkaoui, *International Accounting - Issues and Solutions,* Quorum Books, 1985, p. 35

8. *Population*: density

9. *Level of political integration*

10. *Degree of social stratification.*

Societies were found to differ along the variables of cultural complexity. An attempt to account for cross-cultural differences and similarities has generated various findings on cross-cultural differences of interest to international accounting. Belkaoui quotes Lonner as he identifies four consistent basis for making comparison across cultures within a universalistic framework. "Biologically, we are all of the same species; socially, the societies is governed by generalized functional prerequisites; and ecologically, the species must adapt to a limited range of geographic and environmental conditions (ecosystems). These three bases likely converge in various patterns to form a finite number of culture types. Once this is done, the behavior of individuals within the culture can be compared along a fourth baseline, the psychological, which would assume an interspecies commonality of processes."[33]

Culture plays a major role in the psychological makeup of individuals. This is well illustrated in the area of cultural differences in 'motivation to work, values and orientations to work, job satisfaction, managerial needs, satisfaction, management goals, attitudes towards compensation, motivations, norms and attitudes, effects of values on organizational efficiency and work habits, management and supervision, managerial styles, the meaning of authoritarianism,

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[33] Ahmed Belkaoui, *International Accounting - Issues and Solutions,* Quorum Books, 1985.

he concept of participation, the distribution of control in organizations and perception and cognition.' Cultural differences found in each of the above mentioned areas may have an impact on the acceptance and conduct of accounting in various cultures.

Various studies regarding whether the same accounting information may be perceived differently by different culture groups, have been done. Chang and Most examined different groups from various cultural settings. These groups included individual investors, institutional investors and financial analysts from three countries - the United States, the United Kingdom and New Zealand - all three with large capital markets and well-organized stock exchanges that function in a similar manner. The purpose of the study was to investigate the uses of financial statements by the representatives from these three countries. The study showed the importance of corporate annual reports as a source of information for investment decisions and that the most important parts of the annual report for this purpose were those pertaining to the financial data. The study also found that the institutional investors and financial analysts comprised homogeneous groups while the individual investors were a diverse group.

Belkaoui et al. did another study where he examined the different needs of financial analysts in Canada, the United States and Europe. Any difference in perception were hypothesized to be primarily due to the differences in the European and American methods of investing. One important difference is the European approach being more debt-oriented, with analysis concentrated on the balance sheet. The reports offer a convenient means of achieving European comparison of European accounting information. In contrast, the American method is more equity-driven - towards income statement and corporate earning power. The study demonstrates that "there is a high degree of consensus by North American financial analysts on e informational items of value to equity investors but there is quite a divergence of opinion when he North Americans are compared with their European counterparts. This difference was ttributed to institutional differences in the accounting and investment environments of Europe and North America, as well as to differences in outlook, with Europeans more interested in balance sheet information while North Americans tended to be more concerned about the income statement.

Basically, culture plays an important role in what a society expects from its individual members as well as the institutions. The more complex a society gets, the higher is the level of expectation from its members. Expectations of reporting and disclosures in the financial statements of a U.S based company is greater than that for a company based in Bangladesh, as cultural complexities differ greatly and so do the expectations.

2. *Linguistic Relativism*:

Language also has played a major role in the development of cognition and perception. The role of language in culture has always been emphasized in anthropological studies. Language can be viewed both as an instrument and as communication of thought. Language reflects the metaphysics of a culture. These metaphysics constitute the unstated promises which shape the perception and thought of those who participate in that culture and predispose them to a given method of perception.

Accounting is called the language of business. It is a means of communicating information about a business. The recognition of accounting as a language rests on the identification of the two components to a language, namely, symbols and grammatical rules. Symbols are 'linguistic objects' that identify particular concepts. Accounting has symbols too - as numerals and words, and debits and credits. Accounting also has grammatical rules which is the general set of procedures used for the creation of all financial data.

The school of linguistic-relativism emphasizes the role of language as a mediator and shaper of the environment which implies that accounting language predispose 'users' to a given method of perception and behavior. Another factor is the affiliation of these 'users' with different professional organizations or communities with their distinct interaction networks may create different accounting language codes. According to Belkaoui, various affiliations in accounting create different linguistic codes for intra- or inter group communications.

3. *Political and Civil Relativism*:

Political and civil relativism refers to the need to judge any behavior in terms of its own political and civil context and not from any other context. It is assumed that accounting concepts in any given country are influenced by the political and civil context of that country.

According to Belkaoui, the political freedom of a country is significant in the development of accounting concepts, and reporting and disclosure procedures. If people are unable, due to a lack of political rights, to choose the members of a government or influence government policies, they are also less likely to be able to create an accounting profession that is based on full and fair disclosure (i.e.) reflects the demands of the interested and vested parties. A general loss of freedom hinders the growth of accounting profession as it negates the freedom to report financial statements and disclose. This may be evident from the fact that certain developing countries' political environment were powers are vested in the government resulting in a slow development of the accounting profession compared to developed nations where the profession has a touch of sophistication to it.

4. *Economic and Demographic Relativism:*

Economic and Demographic relativism refers to the need to judge any behavior in terms of its own economic and demographic context.

The economic environment is also important for the development of accounting in general and reporting and disclosure in particular. Economic development constitutes economic growth and various structural and social changes for the betterment of the society. An important change is the need for financial and reporting devices that measure and record the performance of each sector of the economy. Accounting development is dependent upon and also interwoven with economic development. Economic development of a country results in complexities that need to sorted, organized and measured and recorded in a manner that satisfies the needs of the interested parties. Economic development may be achieved by the following:

a. Type of economic system:

A capitalistic system may be more favorable to accounting development than other systems such as capitalist-statist, capitalist-socialist, and socialist. This is so because, 'in a capitalist economic system, the survival of private enterprises depends on not only the production of goods and services but adequate information to various interest groups from investors and creditors to the capital market, in general.'

b. Level of growth and income:

The higher the level of growth and income, the higher the political and economic freedom and the better the adequacy of reporting and disclosure. The higher the level of government expenditures the higher the level of government intervention and the better the adequacy of reporting and disclosure.

c. Government Intervention:

Need for government intervention to provide economic security to all sections of society and to take the form of industry and opportunity creation. Intervention may be followed by an effort to report and disclose and may be favorable to the development of an accounting program and a tradition of reporting and disclosure.

d. Level of Exports and Imports:

The higher the level of exports and imports, the higher the need for better reporting and disclosure. Free-trade policies and export promotion increase cooperation with other countries, the flow of human and physical capital and the need for comparable accounting.

e. Population:

Population also affects economic development. Larger the population, the higher the number of people interested in the accounting profession, and the greater the need for a well-developed accounting profession and need for fair disclosure and reporting.

. *Legal and Tax Relativism:*

Legal and tax relativism refers the need to judge any behavior in terms of its own legal and tax content. Each country has its own separate legal system. The law defines most directly and frequently the conduct of business and hence the practice of accounting. As there are differences in the legal systems of countries, it is natural to say that there are differences in the accounting systems also. General differences include the size and sophistication of government and the number of regulatory agencies and commissions. Other differences are in the nature of legal entities, welfare policy, property ownership restrictions, monopoly policy, and applicability of national laws.

Countries have different tax systems too. The tax system also defines most directly and frequently. The conduct of business and hence the practice of accounting. Differences in tax systems may include differences in personal income taxes, corporation income taxes and indirect taxes. Value-added tax is one major difference in the tax systems of U.S. and the EC. Tax incentives in underdeveloped nations to attract new capital and businesses is another difference

## LIMITATIONS TO HARMONIZATION

We have just seen the differences between national accounting standards of countries due to a variety of cultural, social, economic, legal, and tax influences. These are the driving forces for the creation of accounting standards of a particular country. It can be said, without a doubt, that the greatest disadvantage of the phenomenal attempt to harmonize international accounting standards is the difficulties involved in trying to bring together various groups of people from different backgrounds, and making them agree with each other. For analogies' sake, this is equivalent to daring a staunch Hindu to eat beef. Now, that is almost impossible. People don't give up their beliefs, and ideologies very easily. It the basic human nature of sticking to what you were brought up to believe in, which will now provide the biggest obstacle to the harmonization of international accounting standards. The difficulty in establishing economic cooperation between countries is proved by the 1992 breakdown of the General Agreement on Tariffs and Trade.

According to Cameron M. Weber, the creation of accounting standards is a political process, which is very true. Even in the United States, FASB standards are the result of complicated political processes, negotiations,[34] and need I add, compromises. Those with political power have a vested interest in domestic standards. This is just another 'bone in the steak' for the IASC to chew upon.

Also, to complicate matters further, there are three different levels of national accounting differences. The accounting system of any nation consists of underlying concepts, broad principles, and specific practices. Accounting differences between nations can exist on any one of the three levels. Usually, at the conceptual level, which is the most fundamental, the differences are closely related to a particular nation's economic environment. As each nation's economic environment differs from that of other nations, it goes without saying that the accounting concepts also differ invariably. Differences at the fundamental, conceptual level will naturally lead to differences in the principles and practices. If harmonization is to be attained, it

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[34] Cameron M. Weber, "Harmonization of International Accounting Standards- Processes and Policy Steps", *The National Public Accountant,* October, 1992, pp.40-42.

e conceptual level that must be worked on first, as greater harmony in concepts will naturally ce the diversity in principles and practices.[35]

Some of the obstacles to international harmonization are created by accountants themselves ough national strict licensing requirements. For example, in 1976, the French accounting fession required foreign accountants practicing in France to sit for an oral examination.

Another disadvantage that follows the difficulties is the cost involved. It is argued that the ts of creation and adoption of IAS standards would not be worth the benefits. It is true that ltinational companies will save by eliminating the need for multiple sets of records to fulfill orting and disclosure requirements of different nations. But the initial conversion to comply th these standards could be costly in some areas such as pension accounting and income tax counting.[36]

Goeltz believes capital markets have already adjusted to the existence of a global market ithout a standardization) and investors and issuers have been able to make investment decisions. e also argues that full harmonization is probably not practical nor valuable.[37]

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[35] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, *International Accounting nd Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, . 85.

[36] Nancy Anderson, "The Globalization GAAP", *Management Accounting*, August, 1993, p. 52-54.

[37] Ibid. pp. 52-54

Evans et al. note that Irving Fantl cited a number of practical impediments to instant uniformity, and warned against reliance on the prospect of uniformity as a cure-all for the problems associated with international diversity. The obstacles are listed as follows:[38]

1. Accounting itself as a judgmental and social discipline, reflecting the needs of its particular business environment:
2. National traditions, and business and accounting attitude differences among the nations;
3. Legal and economic differences among the nations;
4. State sovereignty; and
5. Economic gaps between developed and developing nations.

Fantl wanted accountants to shift their emphasis away from the prospect of a universal accounting system. Instead, he wanted them to foster stronger links with accountants in other countries and establish an international body of accountants, economist, politicians, and educators to codify accounting systems to help in reconciling the differences.

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[38] Thomas G. Evans, Martin E. Taylor and Oscar Holzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, p. 85.

## GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND THEIR EFFECT ON INTERNATIONAL MARKETS

With the restructuring of the Eastern Bloc into a free-market economy, and the relaxing the Soviet socialist system, a market containing over 400 million people has opened up for eign investment opportunities. This expanded world market creates even more of a problem, d accelerates the need for a common accounting language and the implementation and use of ternational accounting standards by all countries involved in this new larger world market.

If developing countries, on the other hand are to also become competitive in the world pital markets, the international accounting standards as developed by the IASC need to become ore widely accepted. Local companies in these less developed countries cannot be expected to knowledgeable about the requirements in each of the capital markets that otherwise might be vailable to them.

Every country that currently sets its own accounting standards believes theirs to result in e best financial reporting. Perhaps this is true for the individual countries involved; however, n an international level there may be no right answer or standard accounting principle, as dividual countries handle accounting procedures differently. The United States, for example, one of only a few major industrial countries to allow LIFO as a method for valuing inventory r financial reporting. Most accounting theoreticians readily agree that LIFO has no conceptual basis, but it has become so deeply ingrained in U.S. tax laws that U.S. companies may not be willing to give up LIFO for the sake of world-wide acceptance of international accounting standards.[39] United States' accounting standards are arguably the most highly developed in the world, and have evolved around an atmosphere of technological change and a desire to serve a maturing investment community. A far different view exists in countries where strong ties exist between banks and private companies. It is in these countries, where traditionally, banks have maintained an ownership equity interest in addition to providing debt equity. Holding an equity interest no doubt clouds lending practices in these institutions because debt equity generally is viewed as temporary, whereas equity is viewed as permanent.[40]

Another problem with imposing generally accepted accounting principles on developing countries is the fact that they have moved from simple record-keeping techniques to a highly complex means of representing multifaceted events. Because of this fact, imposing the accounting standards of a highly developed country on the financial market of a developing country serves no purpose, as the standards do not fulfill their needs.

Currently, compliance with international accounting standards is voluntary. However, if the economic world is to open up to all markets, compliance with international accounting standards must become mandatory. Perhaps who is right, and whose accounting standards are the best is not the real issue here. The average investor, whether an individual or an institution does not really care about which standards are used. The important issue seems to be that everyone plays by the same rules (standards) or at least has the capability of being compared by the same rules.

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[39] Dennis E. Peavey and Stuart K. Webster, "Is GAAP the Gap to International Markets?", *Management Accounting*, August 1990, p.32.

[40] Ibid, p.32.

In the future, the IASC must continue its work with national accounting standard-setting bodies such as the FASB, if a true set of international accounting standards are to be developed and implemented on a worldwide basis. Only when international standards are implemented on a worldwide basis, will the world markets become easier to enter and participate in. The process may be difficult, but not impossible. If the IASC has to achieve its goals of developing a complete set of international accounting standards to satisfy the needs of global consumers, then all organizations and countries must come under the common banner of the IASC and concentrate on the similarities and not the differences between the national accounting models.

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## APPENDIX A

| | | |
|---|---|---|
| TABLE 1 | - | SUMMARY TABLE OF CHANGES FOR THE COMPARABILITY OF FINANCIAL STATEMENTS |
| TABLE 2 | - | INTERNATIONAL ACCOUNTING STANDARDS |

# TABLE 1

## SUMMARY TABLE OF CHANGES FOR THE COMPARABILITY OF FINANCIAL STATEMENTS

| ISSUES | PROPOSALS: Required or Preferred Treatment | PROPOSALS: Allowed Alternative Treatment | PROPOSALS: Treatment Eliminated |
|---|---|---|---|
| IAS 2 Assignment of cost to inventories | FIFO and Weighted Average Cost formulas | LIFO formula | Base Stock formula |
| IAS 8 Correction of fundamental errors and omissions and adjustments resulting from accounting policy changes | Adjust opening retained earnings | Include in income of the current period | |
| | Amend comparative information | Present amended pro forma comparative information | |
| IAS 9 Recognition of development costs | Recognize immediately as assets | Recognize as assets when they meet specified criteria | |
| IAS 11 Recognition of revenue and net income on construction contracts | Percentage of Completion method | | Completed Contract method |
| | When the conditions for profit recognition are not met, recognize revenue to the extent of related costs | | |
| IAS 16 Measurement of property, plant, and equipment | Measure at cost | Measure at revalued amounts | |
| IAS 16 Measurement of property, plant, and equipment acquired in exchange for another asset | Fair value for dissimilar assets acquired | | Net carrying amount of asset given up for dissimilar assets acquired |
| | Net carrying amount of asset given up for similar assets acquired | | Fair value for similar assets acquired |
| IAS 16 Recognition of a revaluation increase relating to a revaluation decrease previously charged to income | Recognize in income of the current period | | Recognize in shareholders' interest |
| IAS 17 Recognition of finance income on finance leases by a lessor | Net Investment method for finance leases other than leveraged leases | | Net Cash Investment method for finance leases other than leveraged leases |
| | Net Cash Investment method for leveraged leases | | Net Investment method for leveraged leases |
| IAS 18 Recognition of revenue on transactions involving the rendering of services | Percentage of Completion method | | Completed Contract method |
| IAS 19 Determining the cost of retirement benefits | Accrued Benefit Valuation methods | Projects Benefit Valuation methods | |
| IAS 19 Use of projected salaries in determining the cost of retirement benefits | Incorporate an assumption about projected salaries | | Do not incorporate an assumption about projected salaries |
| IAS 19 Recognition of past service costs, experience adjustments, and the effects of changes in actuarial assumptions | Recognize systemically over a period approximating the average of the expected remaining working lives of participating employees | | Recognize in income of the current period as they arise |
| IAS 21 Recognition of foreign exchange gains and losses on long term monetary items | Recognize in income of the current period | | Defer and recognize in income of current and future periods |

SOURCE: Thomas G. Evans, Martin E. Taylor and Oscar J. Holtzmann, *Internatio*

# TABLE 1 (cont.)

## SUMMARY TABLE OF CHANGES FOR THE COMPARABILITY OF FINANCIAL STATEMENTS

| ISSUES | PROPOSALS: Required or Preferred Treatment | PROPOSALS: Allowed Alternative Treatment | PROPOSALS: Treatment Eliminated |
|---|---|---|---|
| IAS 21 Recognition of foreign exchange losses on the acquisition of an asset that result from a severe devaluation against which there is no practical means of hedging | Recognize in income of the current period | Recognize as part of the cost of the asset | |
| IAS 21 Exchange rate for use in translating income statement items of foreign entities | Exchange rates at the dates of the transactions (or average rate) | | Closing exchange rates |
| Treatment of differences on income statement items translated at other than the closing rate | Recognize in shareholders' interests | | Recognize in income of the current period |
| IAS 21 Subsidiaries operating in hyperinflationary economies | Restate financial statements in accordance with IAS—Financial Reporting in Hyperinflationary Economies—before translation | | Translate financial statements without prior restatement |
| IAS 21 Treatment of exchange differences on foreign operations integral to those of the parent | Recognize in income of the period unless hedged | Recognize as part of the cost of an asset when they result from a severe devaluation against which there is no practical means of hedging | Defer and recognize in income of current and future periods |
| IAS 22 Accounting for business combinations | Purchase method for acquisitions<br><br>Pooling of interests method of uniting of interests | | Purchase method for uniting of interests |
| IAS 22 Treatment of positive goodwill | Recognize as an asset and amortize to income on a systematic basis over its useful life. The amortization period should not exceed 5 years unless a longer period can be justified which should not, in any case, exceed 20 years | | Adjust immediately to shareholders' interests |
| Treatment of negative goodwill | Allocate over individual nonmonetary assets. After such an allocation, if negative goodwill remains, treat as deferred income and recognize on a systematic basis as for positive goodwill | Treat as deferred income and recognize in income on a systematic basis as for positive goodwill | Adjust immediately to shareholders' interests |
| IAS 22 Measurement of minority interest arising on a business combination | Measure at preacquisition carrying amounts | Measure at postacquisition fair values | |

## TABLE 1 (cont.)

## SUMMARY TABLE OF CHANGES FOR THE COMPARABILITY OF FINANCIAL STATEMENTS

| ISSUES | PROPOSALS | | |
|---|---|---|---|
| | Required or Preferred Treatment | Allowed Alternative Treatment | Treatment Eliminated |
| IAS 23 Recognition of borrowing costs | Recognize immediately as expenses | Recognize as part of the cost of an asset if it takes a substantial period of time to get it ready for its intended use or sale | |
| IAS 25 Measurement of long-term investments | Measure at cost | Measure at revalued amounts | |
| Measurement of marketable equity securities held as long-term investments | Measure at cost, recognizing declines in value that are other than temporary on an individual investment basis | Measure at revalued amounts | Measure at the lower of cost and market value on a portfolio basis |
| Measurement of investment properties | Measure at cost with depreciation | Measure at revalued amounts | Measure at cost without depreciation |
| Measurement of current investments | Measure at market value | Measure at the lower of cost and market value on an individual investment basis | Measure at the lower of cost and market value on a portfolio basis |
| Recognition of increases and decreases in market values of current investments | Recognize in income of the current period | | Recognize in revaluation surplus |
| Recognition of a realized gain previously recognized in revaluation surplus | Transfer to retained earnings | | Recognize in income of the current period |

## TABLE 2

### INTERNATIONAL ACCOUNTING STANDARDS

**IAS 1:** Disclosure of Accounting Policies, issued in January 1975, requires the disclosure of all the significant accounting policies that have been used in the preparation of financial statements. Effective on January 1, 1975.

**IAS 2:** Valuation and Presentation of Inventories in the Context of the Historical Cost System, issued in October 1975, requires that inventories be valued at the lower of historical cost and net realizable value when presented in financial statements. Effective on January 1, 1976.

**IAS 3:** Consolidated Financial Statements, issued in June 1976, requires the presentation of consolidated financial statements for a group of related companies under the central control of one parent firm. It provides for the use of the equity method of accounting for certain kinds of long-term investments. Effective on January 1, 1977, but superseded by IAS 27 issued in April 1989 and described below.

**IAS 4:** Depreciation Accounting, issued in October 1976, requires that fixed assets be depreciated on some systematic basis over their useful lives. Effective on January 1, 1977.

**IAS 5:** Information to Be Disclosed in Financial Statements, issued in October 1976, specifies minimum disclosures of information in the annual report: a balance sheet, income statement, notes, and other statements and explanatory material to make financial statements clear and understandable. Effective on January 1, 1977.

**IAS 6:** Accounting Responses to Changing Prices, issued in June 1977, requires that financial statements disclose how they reflect the impact of changing prices. Effective on January 1, 1978, but superseded by IAS 15 issued in November 1981 and described below.

**IAS 7:** Statement of Changes in Financial Position, issued in October 1977, requires the presentation of a statement of changes in financial position as a part of the financial statements. Effective on January 1, 1979.

**IAS 8:** Unusual and Prior Period Items and Changes in Accounting Policies, issued in February 1978, requires the disclosure of prior period items and adjustments resulting from changes in accounting policies. Effective on January 1, 1979.

**IAS 9:** Accounting for Research and Development Activities, issued in July 1978, requires that research and development costs be charged to expense in the period in which they were incurred. Deferral is permitted in special circumstances. Effective on January 1, 1980.

**IAS 10:** Contingencies and Events Occurring After the Balance Sheet Date, issued in October 1978, defines the circumstances in which a contingency loss should be accrued for by a charge against current income, and distinguishes between those post financial-statement events that require an adjustment of the statements and those that only require disclosure. Effective on January 1, 1980.

**IAS 11:** Accounting for Construction Contracts, issued in March 1979, requires that accounting for construction contracts follow either the completed contract method or the percentage of completion method. Effective on January 1, 1980.

**IAS 12:** Accounting for Taxes on Income, issued in July 1979, requires that the tax expense for an accounting period be determined by using "tax effect" accounting, employing either the deferral or the liability methods. Effective on January 1, 1981.

**IAS 13:** Presentation of Current Assets and Current Liabilities, issued in November 1979, concerns the disclosure of current assets and liabilities in financial statements and defines current assets and liabilities. Effective on January 1, 1981.

**IAS 14:** Reporting Financial Information by Segment, issued in August 1981, requires the presentation of segment information on the basis of industrial and geographical segments in the financial statements of publicly traded firms. Effective on January 1, 1983.

**IAS 15:** Information Reflecting the Effects of Changing Prices, issued in November 1981, requires that firms that prepare consolidated financial statements indicate which method they use to adjust for changes in the price level in both the balance sheet and the income statement (the items to be reported include the effect of price changes on depreciation, the cost of goods sold, and the effect on net monetary liabilities position). Effective on January 1, 1983, but withdrawn in late 1989.

**IAS 16:** Accounting for Property, Plant, and Equipment, issued in March 1982, defines the measurement base for property, plant, and equipment and gives guidelines for the presentation of these items in the balance sheet under the historical cost approach and when this basis has been revalued. Effective on January 1, 1983.

**IAS 17:** Accounting for Leases, issued in September 1982, requires that the asset and liability created for a firm under a finance lease be reflected in the firm's balance sheet and that information regarding the terms of the lease and the amount of assets that are the subject of finance leases be disclosed. Effective on January 1, 1984.

**IAS 18:** Revenue Recognition, issued in December 1982, concerns the basis for revenue recognition and provides guidelines to be followed in the recognition of revenue from sales of goods and the rendering of services. Effective on January 1, 1984.

**IAS 19:** Accounting for Retirement Benefits in the Financial Statements of Employers, issued in January 1983, defines various types of employee pension plans and establishes the accounting guidelines to be followed for each and the related disclosure requirements. Effective on January 1, 1985.

SOURCE: Thomas G. Evans, Martin E. Taylor and Oscar J. Holtzmann, *International Accounting and Reporting*, Cincinnati, Ohio: South-Western Publishing Co., 1994, pp 106-110

## TABLE 2 (cont.)

### INTERNATIONAL ACCOUNTING STANDARDS

*IAS 20:* Accounting for Government Grants and Disclosure of Government Assistance, issued in April 1983, requires that governmental grants and other forms of financial assistance be recognized in firms' income statements, systematically matched against the costs for which they are intended to compensate. Effective on January 1, 1984.

*IAS 21:* Accounting for the Effects of Changes in Foreign Exchange Rates, issued in July 1983, requires that firms generally use the closing rate method for translating the financial statements of foreign subsidiaries for consolidation purposes. Effective on January 1, 1985.

*IAS 22:* Accounting for Business Combinations, issued in November 1983, requires business combinations to be accounted for by the purchase method and allows any resulting goodwill to either be recorded as an asset and amortized or adjusted against shareholders' interests in the period of acquisition. The pooling-of-interests method may only be used if a combination qualifies as a uniting of interests. Effective on January 1, 1985.

*IAS 23:* Capitalization of Borrowing Costs, issued in March 1984, requires an enterprise to consistently apply a policy of either capitalization or noncapitalization of borrowing costs for assets that take a substantial period of time to make ready for their intended use. Guidelines for capitalization and disclosure requirements are outlined for companies opting to capitalize. Effective on January 1, 1986.

*IAS 24:* Related Party Disclosures, issued in July 1984, defines related parties, requires any related party relationships involving control to be disclosed, and requires the elements and types of any transactions between any related parties to be disclosed. Effective on January 1, 1986.

*IAS 25:* Accounting for Investments, issued in March 1986, applies to all investments other than interests in joint ventures, subsidiaries, and associates. It requires short-term investments to be carried at market value or the lower of cost and market value and long-term investments to be carried at a cost revalued amount, applied on a portfolio basis. Effective on January 1, 1987.

*IAS 26:* Accounting and Reporting by Retirement Benefit Plans, issued in January 1987, defines the contents of retirement benefit reports to all participants as a group, requires that investments be carried at fair value, and requires the actuarial present value of the benefits to be disclosed. Effective on January 1, 1988.

*IAS 27:* Consolidated Financial Statements and Accounting for Investments in Subsidiaries, issued in April 1989, defines subsidiary ownership on the basis of control; requires consolidated financial statements from all groups except wholly owned, foreign and domestic subsidiaries; and provides guidelines for line-by-line consolidation and disclosure in a parent's separate financial statements of its investment in a subsidiary. Effective on January 1, 1990.

*IAS 28:* Accounting for Investments in Associates, issued April 1989, defines an associate as an enterprise in which an investor has significant influence although it is neither a subsidiary nor a joint venture. Such investments are generally required to be carried under the equity method unless the investment is exclusively acquired with the intention of disposal in the near future, in which case the cost method must be utilized. Effective on January 1, 1990.

*IAS 29:* Financial Reporting in Hyperinflationary Economies, issued in July 1989, requires the financial statements of enterprises reporting in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date, by applying the change in the general price index. It applies whether the financial statements are based on the current cost or historical cost method. Effective on January 1, 1990.

*IAS 30:* Disclosures on the Financial Statements of Banks and Similar Financial Institutions, issued in August 1990, requires such institutions to include specific items in the income statement and balance sheet. An analysis of assets and liabilities divided into maturity groupings is required, and significant concentrations of asset, liability, and off-balance-sheet items must be disclosed. Other required disclosures include losses on loans and advances, assets pledged as security, and amounts accrued for general banking risks. Effective on January 1, 1991.

*IAS 31:* Financial Reporting of Interests in Joint Ventures, issued in December 1990, requires a venturer to report interests in jointly controlled assets, operations, and entities in the financial statements. Transactions between the venturer and the joint venture must be reported to reflect the substance of the transaction. Effective on January 1, 1992.

## APPENDIX B

QUESTIONNAIRE

# QUESTIONAIRRE

Q1. Please give your background in International Accounting. (Name, title, experiences in international accounting, etc.)

Q2. Do you feel there is a need for the development of international standards for measuring and reporting economic activities? Why or why not? (Most U.S. companies are not taking these standards seriously)

Q3. What would be the pros and cons of the FASB becoming an active member of the International Accounting Standards Committee?

Q4. Do you feel that the SEC should allow foreign investor companies to enter U.S capital markets by presenting financial statements based on International Accounting Standards? (London and Hong Kong stock exchanges allow this)

Q5. What problems are faced abroad by U.S investors (individual and corporate) when evaluating potential foreign investments for such purposes as market entry, mergers, joint ventures, etc.?

Q6. What features of other countries' accounting models would you like to see incorporated into GAAP?

Q7. How would NAFTA affect accounting standards in U.S., Canada, and Mexico?

Q7. According to you, what difficulties might be faced by a developing country such as China, India, Bangladesh, etc. in complying with the International Accounting Standards.

DO I HAVE YOUR PERMISSION TO USE YOUR NAME IN THIS PROJECT?
YES ______ NO _______

THANK YOU FOR RESPONDING TO THIS QUESTIONAIRRE

ADDITIONAL COMMENTS OR SUGGESTIONS ARE WELCOME!!

PLEASE FAX RESPONSES TO NEERU CERNY AT (708) 595-0647
HOME TEL. NO.-(708) 776-7432