**Harmonization of accounting standards; is it the solution?**

With the objective of reducing accounting differences around the world, i.e. enhancement of the comparability of accounting information (Barthe, cited in Barlev et al., p. 494), efforts to harmonize the accounting practices has been an ongoing process since the 19th century. The International Accounting Standards Board (IASB), since its setup in 1973 as International Accounting Standards Committee (IASC), is considered to be the leader in the harmonization process, while working hand in hand with other accounting bodies like FASB (Financial Accounting Standards Board) of the US, security exchanges and other related stakeholders.

**Harmonization supports educated investment decisions**

Harmonization of accounting standards fosters the 'comparability' of financial information by providing a single lens of evaluation. This improved comparability results in multi-fold benefits:

The adoption of internationally accepted accounting standards acts as the catalyst for increased flow of foreign investments to a country. This view is supported by multiple authors like Bae et al (cited in IFRS 2012: p. 66), who state that the foreign analysts are likely to provide accurate forecasts for firms when the accounting standard of the country is closely aligned with the internationally accepted standard; and Hope et al., (cited in Ann. p. 73) who find IFRS to be a vehicle through which countries can make capital markets more accessible to foreign investors.

The improved comparability of financial information supports the integration of capital markets, which results in easier access to cheaper capital and new opportunities to the investors for diversification. (Tweedie et. al, 2005: p. 590).

On the other hand, harmonization also leads to improved understanding of foreign investment opportunities for the domestic investors. This very argument was justified by the example in Australia, where the following the adoption of IFRS, there was an increase in the foreign equity investment from the country (Lee and Farghar, cited in Ann, p. 76).

**Harmonization leads to cost benefits**

Harmonization of accounting standards could bring benefits in terms of cost savings to multi-national companies, national regulators and audit firms with global networks. Currently, multi-national companies operating in multiple jurisdictions are required to prepare the financial statements that are compliant with different national standards. There’s also the additional effort to reconcile and consolidate these financial statements from multiple jurisdictions. It is widely agreed that this process is extremely costly and inherently wasteful of scarce resources. (Article 4 – Page 590).

Moreover, the harmonized accounting standards would mean that countries would not have to allocate resources to develop, enhance and regulate the accounting standards within their jurisdiction. Compared to these costs of maintain a nation’s own national standards, which has other indirect disadvantages, the cost to align with the internationally accepted standards would be low.

For the network of auditors, who operate in multiple jurisdictions, the harmonization of accounting standards would lead to more mobility and efficient allocation of the resources, possibilities of standard training and oversight approaches which would ultimately mean reduction in costs.

**Best of the breed developments**

A common accounting standard across the globe would mean that the resources involved in the development of the standards would be drawn from a very large pool of competencies. In addition, discussion of the accounting related problems and solutions would be performed with a broad context in mind, and the responses to proposed developments would be received from multiple ranges of stakeholders. While it could be argued that the involvement of more stakeholders and consideration of broad context, which in turn inherits differences in regulatory, accounting and auditing culture, could slow down or dither the standard setting process, it could also be argued that this understanding of broad context and involvement of wide stakeholders would ultimately lead to development of high quality standards, that can accommodate wide diversity of regulatory practices and environments.

Considering an example, the convergence project between IASB and FASB although stagnates the development time, it could be expected that the standards developed via common understanding of the regulators would lead to standards that are practical and applicable in multiple regulatory environments.

**Arguments Against**

While harmonization of accounting standards is widely discussed as the solution to the ‘comparability’ of accounting information, as demanded by the increasing globalization and cross-border investments, multiple arguments have been drawn against it. These arguments do not primarily talk about the disadvantages of harmonization itself but discuss the limitations of harmonization in solving the problems of comparability. On the other part, some arguments question if the ‘real problem’ is being addressed at all.

[ARGUMENTS]

As Tweedie et. Al (2005: p. 590) Article 4 put it, ‘there are multiple pillars that form a base for the effective functioning of the capital markets and the financial reporting mechanisms except a consistent, comprehensive accounting standards i.e. effective corporate governance practices and strong internal controls, auditing practices and enforcement or oversight mechanism.’

It could thus be argued that while harmonization itself is a positive process that brings benefits to the effective functioning of capital markets, corporations and regulatory bodies,

**1. Impact of Political Pressure on Accountability Standards**

It has been observed that at times of turbulence and financial crisis, the governance of accounting standards have not been able to keep up with the pressures from either corporations or the regulators. This has been seen during the crisis of [example for IASB and FASB]. These instances depict a possibility of similar instances in the future where the international accounting body would fall to undue political influences and pressures. However, it could be argued from the support of international accounting standards as well that the strengthening of a particular accounting body across the world could in fact improve the independence and support the objectives of true economic view.

*TOPIC 6 ARTICLE 3 P 497 Demonstration of Sovereignty*

This is clearly apparent in the EU ‘carve-outs’: in one (the fair value

option) the European Central Bank was clearly anxious to demonstrate its influence as a regulator, and

in the other (hedge accounting) a powerful industry lobby group (the European banking industry) was

concerned to maintain control of its own environment. Another example is the Australian carve-out of

certain options in IFRS, which are an example of a sovereign country asserting its right to vary the

standards to meet what it perceives as national needs.

**2. Cost of the Implementation**

Another common argument against the harmonization of accounting standard is the cost of transition in implementing the standards. This cost would be for both the regulators in terms of establishing the regulations, training the regulators while on the company’s part the additional costs would be the hiring of suitable pool of resources. The impact of cost is seen mostly on the small companies who are considered to have a disadvantage in compared to the large corporations. With this in consideration, a question of whether a common accounting standards should be implemented regardless of a corporation’s size or to harmonize different standards for companies of different sizes, as with the success of IFRS for SME’s which has already been adopted by .. countries is a case to assess.

Although these costs take higher share of expenses for smaller companies, the transition report on IFRS suggests that despite the limited resources and lack of prior experience of IFRS, there was very little evidence of problems identified. (European Union, 2007)

This argument of higher costs in implementation can however be rebutted considering the direct and indirect financial benefits of consistent and comparable high-quality financial information that is generated after the adoption. This is considered to ultimately reduce the costs of capital and consistent financial reporting withing groups and supported by views of adopters like Australia. (The report to trustees, 2012: p. 65).

TOPIC 6 ARTICLE 3 P 497

There are the obvious financial costs of setting up new systems but equally important are the adjustment costs of adapting to using and interpreting new data.

**3. Country Wise Differences that hinder Comparability despite IFRS adoption**

The country wise economic differences are seen to be a hindrance in comparability of the financial information despite the adoption of accounting standards. This case for example reflected in the differences in the impairment provisions of government securities of troubled economies such as Greece in 2011 (IFRS Foundation Staff Analysis, 2012: p. 41). Despite a common accounting standard being implemented, the impairment levels ranging from zero to 50 in different nations certainly is hindrance to comparison and comparability.

Presented as the notion of complementarities, (Leuz, 2010: p. 236) provides a

explanation as to why reporting regulation

differs across countries and markets. It also has two

further implications. First, it is unlikely that there is

a reporting regime that is optimal for all countries

around the world. The net benefits of high-quality

corporate reporting are likely to vary significantly

across countries, and forcing certain disclosures can

impose substantial costs on firms. Thus, regulators

and standard-setters need to carefully weigh the

confluence of costs and benefits of reporting

regulation to firms, investors, and other parties in

the economy.

the notion of complementarities implies

that we have to be careful in evaluating particular

reporting requirements in isolation from other

elements of the institutional framework.

Seemingly successful reporting regulation in one

country may not translate well to other countries.

For the same reason, unilateral changes in account-

ing standards (such as IFRS adoption) may not yield

the desired outcomes (e.g. Ball, 2006; Hail et al.,

2009).

Two systems, outsider and insider. Outsiders is when companies primarily raise capital in the form of equity and loans, while on the other hand insiders are companies that raise capital primarily through coordination with the banks

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changes in reporting regulation cannot be con-

sidered in isolation and independent of other

elements of the institutional infrastructure.

Changing one element can make the system (or

economy) worse off even when the element itself

improves unambiguously.

n order to preserve institutional fit,

countries need to change (or adjust) several elem-

ents when they change one.

even if countries

harmonise their accounting standards at a given

point in time (e.g. by adopting the same set of

standards), it is questionable that this harmonisation

is stable over time. The new set of standards will be

subject to the same institutional and market pres-

sures that shaped the old standards in the first place.

Thus, unless other key institutional factors converge

as well, countries adopting the rules (e.g. a common

set of accounting standards) are likely to drift apart

over time, in part due to local adaptation of the

rules.

(Leuz, 2010: p. 249)

*Changing a country’s way of enforcement and the strength of enforcement is a very complicated thing as opposed to changing the accounting standard.*

*Countries’*

enforcement systems are an important case in

point. As discussed in Section 4, they differ

considerably across countries and even when

enforcement systems appear to be similar in design,

there can be substantial differences in enforcement

intensity (or practices). Eliminating these differ-

ences, especially as they pertain to countries’ legal

systems, is probably much harder than agreeing to a

single set of accounting standards.

ARTICLE 5.2

Obstacles to Global Financial Reporting Comparability and Convergence

p 291

The business and finance culture differences

- incentives and disincentives in the tax law

- executive compensation packages and retirement benefits, they differ from country to country.

- different corporate structures

herefore, one may raise the

question whether a standard on consolidated financial statements in its application in Japan and Korea would

produce anything like comparability with countries that have a clear hierarchical relationship between

subsidiaries and the ultimate parent or holding company. An identical standard in such circumstances

would do little more than accentuate the differences between the countries’ different way of structuring

intercorporate enterprise.

- pubic vs private ownerships

- asset pricing markets – the pricing markets may not provide data to revalue many assets reliably. This again leads to differences and lack of comparability.

- equity vs long-term financing i.e. many disclosures vs non-disclosures, because of these differences there’s a chance for conflicts.

ARTICLE 5.2

Obstacles to Global Financial Reporting Comparability and Convergence

P 293

accounting culture

*Tax mentality. This could be understood with examples in countries where some expenses are tax deductible while in some countries they are not. Because of these variations in incentives, the financial statements might not be comparable.*

influence a company in the UK not to recognise an impairment loss, using its judgement

appropriately, as opposed to a German company that might like the tax deduction and therefore may be

willing to show the loss in its financial statements?

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Auditing Culture

different mentality, a different auditing culture, across countries and therefore could lead to a

diminution in comparability, especially if a company knows that it can depart from IFRS without having to

suffer an auditor’s qualification. Because of differences in auditing culture, companies may be more willing to

depart from the IASB’s standards and interpretations in certain countries than in others.

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Regulatory Culture

- the strictness of enforcement and the requirements

- and the actions that are taken after finding errors and mistakes

Article 5.3 P 834

Cultural Differences

Fifth, and this challenge does fall under the control of the IASB, proper cognizance must be

taken in the development of standards and interpretations of the differences in the fundamental way

in which business is done in different countries. For example, how can a standard on consolidated

financial statements be designed to reflect the substantive relationships in Japan’s keiretsu and

Korea’s chaebol, the networks of affiliated companies that may not have a parent company? In

China, most business is done by state-owned entities, not by private-sector enterprise. To what

degree should accounting standards make explicit provision for the different way that business is

done in Islamic countries? An insistence that a single accounting method in a standard be used in all

countries may, in some instances, do no more than accentuate these differences, not promote

genuine worldwide comparability. Achieving global comparability is not the same as achieving

comparability within a single national environment, where there are common tax incentives and

business customs (Zeff 2007b). The IASB must make its decisions wisely and in the light of what

seems to be required to promote genuine worldwide comparability, which may mean providing for

optional approaches attuned to expressly specified national circumstances.

**4. Requires Enforcement of Standards**

While authors (Li, cited in Ann, p. 69), Landsman et al. cited in Ann, p. 69, DeFond et. al, cited in Ann, p. 70, Daske et. al., cited in Ann, p.70 argue that adoption of internationally agreed standards brings many benefits, they have been vocal in suggesting that these benefits are only observable in regulatory environments that are able to enforce the standards stringently. It is thus inappropriate to expect that harmonization alone is the solution. Wang and Yu, cited in Ann. 72 find better accounting standards (for example, IFRS) have beneficial effects for the information content of share prices in countries with common-law legal origins, better shareholder protection and stricter legal enforcement.

**6. Differing incentives for companies**

(Leuz, 2010: p. 249)

*A firm’s reporting incentives plays more role in the quality of the reporting rather than the quality of the accounting standard itself.*

sises that firms’ reporting practices are

shaped by more than the accounting standards (or

the enforcement of these standards) pointing to the

importance of firms’ reporting incentives as a key

driver of observed reporting practices and hence the

quality and comparability of the reported numbers.

(Leuz, 2010: p. 250)

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Research cont.

Daske et al. (2008)

provide evidence that, in many countries, manda-

tory IFRS adoption had little impact on market

liquidity or other capital market outcomes.

Moreover, they show that countries’ institutional

differences, including legal enforcement, play a key

role for the capital market effects around IFRS

adoption.

*Article 5.3 p 833*

*Challenge in Consistent Reporting Regulation*

Third, there is a need for the IASB to inspire the improvement of performance by securities

market regulators in obtaining listed companies’ compliance with IFRS. There is a great deal of

variability in the effectiveness of regulator performance even within the EU, let alone from country

to country in the rest of the world, and especially in emerging economies and developing countries.

A commitment by a country that its listed companies are required to use IFRS lacks credibility if it

is not backed up by a vigilant and proactive regulator, whether in the private or public sector.

**5. The role of audit function**

The role of auditing in the quality of financial statements that are generated by corporations cannot be underestimated. The quality of audit firm’s output is highly questioned around the world with cases like, where the auditors were involved in window dressing and helping produce inaccurate, incomparable low standards. It can thus be argued that harmonization is not the solution to all, there should be complementary developments in the sector of audit controls and oversight, only after which the harmonization can be expected to yield benefits.

The other consideration here is the differences in the enforcement of auditing standards, the cultural differences in approaches to audit and the independence of the auditors itself. These factors might yield the harmonization to be just another prescription of the solution with no controls on the implementations.

**6. Exceptions in Adoption of Global Standards**

Another highly debated question is whether the ‘harmonization’ of accounting standards in substance is the adoption of standards with no exceptions or no possibilities of being hand-picked? It has been argued that exceptions to the adoption of international accounting standards diminish the harmonization itself. When countries can selectively choose or drop standards while still being able to report as being fully compliant, as with the case of Australia, which has enforced its own accounting standards, the effectiveness of the accounting standards and so called ‘harmonization’ is itself brought into question. This undermines the benefits of global standards.

Comparability Issues with IFRS In 2011 the SEC published a review of IFRS reporting, based on the 2009 financial statements of 183 IFRS applying companies listed in the US. The SEC staff found general compliance with IFRS requirements, but noted the transparency and clarity of disclosures

could be enhanced. Further, they concluded diversity in application presented challenges to

the comparability of financial statements across countries and industries (SEC 2011a: 2 cited in Ann, p. 75). The report also mentions the use of options in IFRS, insufficient and inconsistent disclosure and

a lack of guidance in some areas as potentially undermining comparability.

*TOPIC 6 ARTICLE 3 P 496*

*The flexibility and trend that countries are regulating what aspects of IFRS are incorporated in the local standards and what are not.*

With regard to implementation, apart from

the EU ‘carve-outs’, Australia has restricted certain options within the standards, and there is fear that,

if this practice becomes more widespread, the international comparability of the standards will be lost:

one country might require one option whilst another country required the alternative

A related danger is that the enforcement of the stan-dards may vary significantly across jurisdictions, so that the quality of so-called IFRS financial reports is not comparable.

**7. Flexibility available in the standards**

(Leuz, 2010: p. 249)

*There’s flexibility in the accounting standards for some reason, but this very reason could be exploited by the companies who have other incentives.*

Managers may also have incentives to

obfuscate economic performance, achieve certain

earnings targets, avoid covenant violations, under-

report liabilities, or smooth earnings – to name just a

few. Given managers’ information advantage over

investors and even auditors and enforcement agen-

cies, it is difficult to constrain such behaviour.

**8. Setting in which enforcement takes place**

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Setting of IFRS reporting is more important than the standard itself many researchers have concluded the setting in which IFRS reporting takes place has a strong influence on whether potential

benefits of IFRS can be realised (Daske et al., 2008; Beuselink et al., 2009; Flourou and Pope,2011; Landsman et al., 2011; Christensen et al., 2010 and 2012). The success of common

standards depends not just on the quality of the standards issues by the IASB. Critically,

success also requires an infrastructure to support IFRS to be in place at a national and

international level.

**9. Difference in references to the accounting standards**

ARTICLE 5.2 P 292

The diversity in the references to the International Accounting Standards do no promote comparability.

This is determined by the level of information available to the investors about what actually is going on in the regulatory reporting arena and whether the standards applied are a form of IFRS or the nation’s own.

10. Accounting Standards is not the ‘real problem’ and thus harmonization is not the solution

TOPIC 6

ARTICLE 1

p 377

In other words, it matters whether governments respond

to financial crises by developing strong international and

domestic institutions capable of governing financial

markets, constraining the financial services industry, and

protecting populations from the often devastating conse-

quences of systemic instability, or rely instead on the

rather thin promise that markets will self-correct given

sufficient transparency, harmonized accounting standards,

and surveillance by commercial auditing firms.

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The notion that

financial reporting and auditing reduce information asym-

metry and thereby enable self-regulating financial markets

to operate efficiently is a normative theory that neither de-

scribes the world nor explains the historical origins of

accounting practices and institutions. If left unchallenged

by accounting scholars, the belief will persist that ‘‘getting

the accounting ‘right’’’ (Young, 1995) will somehow ensure

financial stability even in the presence of institutionally

weak international and domestic financial regulatory

structures and a highly financialized and crisis-prone

world economy. Arguably, the illusion that financial trans-

parency aided by harmonized financial reporting standards

and auditing surveillance can substitute for stronger forms

of oversight and constraints on financial speculation con-

tributes to financial instability by providing ideological

support for dangerous levels of financial speculation and

minimal regulation. This was true in the aftermath of the

East Asian crisis in the late 1990s and remains so today.

TOPIC 6

ARTICLE 2

Critical Perspective on Harmonization of Accounting Standard in a Globalized World

p 989

Accounting, and its internationalisation,

remains caught within a fundamentally flawed global economic-liberal system that perpetu-

ates poverty, alienation and anomie. The concern is that international accounting processes

are part of a limited conception of civil society itself, built on a totalising consumer society

which appeals primarily to the economic appetite of consumers.

P 989

It is now more important than ever before that accountability and accounting research

begin to explore different notions of the rule of law and how new institutions of global

governance might be able to keep business as separate from politics as possible. Moderating

the adverse effects of globalising capitalism, given that there are limited prospects for

revolutionary change, involves the creation of an accountability and democratic mechanism

to open space for citizens to express their cultural values. This broader accountability model

developed in this article, therefore, questioned the role of accounting procedure which,

in turn, was based on a narrow definition of human agency and ignored relationships of

significance.

the accounting profession

and large transnational corporations prefer accounting policy to be determined according

to the processes of self-regulation. Having explored notions of decision-usefulness, glob-

alisation, harmonisation and accounting reform, two interrelated premises become critical

for future research. The first is that globalisation impacts on the sovereignty of nation states

and accounting is implicated. The second is that to manage the global commons involves

democratising organisational relationships and involves working to combat the adverse im-

pacts of global capitalism. It was argued that the dominant accounting discourse is based

on a regime framework, which reflects strict individual liberal assumptions and supported

private organisations as the most efficient and effective motor of social change. Yet, the

dominant discourse ignores the genealogy of modern conceptions of the human agent, and

limits our understanding of the local communities to which that agent belongs. Accounting

is a fiction which can help in this regard, but it is something far easier to suggest than to

effect.

**Conclusion**

Harmonization itself is a positive process that brings benefits to the effective functioning of capital markets, corporations and regulatory bodies; it would require parallel improvements to other complementary tools like auditing, strong enforcement, consistent regulations, etc.:

‘There are multiple pillars that form a base for the effective functioning of the capital markets and the financial reporting mechanisms except a consistent, comprehensive accounting standards i.e. effective corporate governance practices and strong internal controls, auditing practices and enforcement or oversight mechanism'. Tweedie et. Al (2005: p. 590)

Moreover, the weaknesses of the standard setting process, like exposure to political pressures, allowances in 'hand-picking' the standards while being able to declare compliance, needs to be improved to support the objective of 'comparability' more strongly. Harmonization of accounting standards is thus not the ultimate solution to the problem of 'comparability' but a part of parallel developments that can collectively solve the issue.

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