GLOBAL CONVERGENCE OF ACCOUNTING: BENEFITS AND CHALLENGES

Manju B[1]
Assistant Professor of commerce,
Dept. of Commerce,
Kodachadri Govt. First Grade College, Hosanagara,
Shivamogga (District),
Karnataka, India

Sunil Naik S[2]
Lecturer
Dept. of Commerce and Management
Sahyadri Commerce and Management College
Shivamogga,
Karnataka, India.

ABSTRACT: Accounting developments made by different international organizations which come under two categories; those backed by International or Political agreements and Voluntary organizations. The first category includes the United Nations and the European Union. The second category includes IASB, IFAC, IOSCO, and the European Financial Reporting Advisory Group. Further it includes, Confederation of Asia Pacific Accountants, American Accounting Association, The British Accounting Association, The Indian Accounting Association etc. This paper focus on the, Early Developments in convergence, Need for Convergence, Challenges of Convergence, Organizations involved in Convergence, It also includes the structure of IFRS foundation the esteem organization which involved in the process of internationalization of Accounting practices.

Keywords: Accounting, IFRS, International Accounting, convergence, IASB.

I. INTRODUCTION

"The global economy continued to expand vigorously in the first half of 2007. China's economy gained momentum by eleven and a half per cent, while India and Russia continued to grow very strongly. These three countries alone have accounted for one-half of the global growth over the past year". (World Economic Outlook, 2007), in the opinion of Kenneth S. Most, Accounting is a service activity. Its function is to provide quantitative information, primarily in nature, about economic entities that is intended to be useful in making economic decisions, in making reasoned choices among alternative courses of action. While studying financial reporting regimes of various countries, it is important to differentiate between accounting regulations and actual accounting practices that prevail in the country. The proximity or distance between accounting regulations and accounting practices often depends on the level of enforcement. Countries with high levels of enforcement, accounting practices of business entities are largely compliance with accounting regulations. Countries with low levels of enforcement, accounting practices of business entities are likely to be exhibit very little compliance with accounting regulations. The level of enforcement also affected by number of factors;

- Willingness to enforcement
- Ability to enforce
- Type of political system and leadership of the country.

Businesses crossed the boundaries. The Globe today is a configuration of Interdependent national economies. Rapid globalization of capital markets led to the Use of different accounting frameworks which requires inconsistent treatments and presentation of the same underlying economic transaction creates confusion in the minds of readers of financial statements. That leads to inefficiency in capital markets. The globalization of economic activities has resulted in an increased demand from all quarters for high quality internationally comparable financial information. Considerable divergence exists with regard to accounting policies and practices. Accounting is no longer limited to book-keeping and preparation of financial statements. It helps in designing policies besides facilitating day-to-day operations of the business. It has developed into basically an information system that provides economic information to decision-makers (Internal and External)

II. REVIEW OF LITERATURE

Chand & White (2007) in their paper on convergence of Domestic Accounting Standards and IFRS, demonstrated that the influence of Multinational Enterprises and large international accounting firms can lead to transfer of economic resources in their favour, wherein the public interests are usually ignored.

Zhou et al (2009) in one such study of Chinese firms' data concluded that the firms adopting IFRS are less likely to smooth earnings in the post IFRS adoption period. Their findings also pointed out the need for a stricter enforcement mechanism of financial reporting standards in emerging markets.

Yhlas Sovbetov (2015) made a study on "How IFRS Affects Value Relevance and Key Financial Indicators? Evidence from the UK", he examined the impact of adoption of IFRS by public listed firms of UK using three groups of ratios, profitability, capital structure and efficiency and liquidity considering pre and post IFRS adoption stages. According to the author, the increase on return on assets and profit margin ratios were observed as an impact of IFRS adoption in UK.

Agca and Aktas (2007) made a study on "GAAP vs. IFRS Treatment of Leases and the Impact on Financial Ratios", they examined that the adoption impacts on financial ratios of 147 listed firms in Istanbul stock exchange during 2004-2005, considering one year as pre-adoption, and the other as post-adoption periods. They observed the results with F-Test tool, and found out that CR and net asset turnover are significantly affected. The authors based this variation to the fixed assets adjustment.

Prof. K.V. Achalapathi Dr. P. BhanuSireesha (June, 2015) made a study on "Impact of IFRS adoption on financial statements of select Indian companies", in their article they opined that there are many accounting standards in the world, with each country using a version of their own Generally Accepted Accounting Principles, also known as GAAP. These allow firms to report their financial statements in accordance to the GAAP that applies to them. The complication lies within when the firm does business in multiple countries. Under such circumstances, various questions arise, like, how can investors deal with multiple standards, which ones are accurate, and how can corporations be compared based upon their financials, and the like.

Abhinaya L P, Vidyashree N S and Manu H (March, 2016) made a study on "IFRS in India- its impact on Indian corporate: benefits and challenges", in their article they opined that India adopting the International Financial Reporting Standards (IFRS) can not only ensure justice to investors but also bring huge opportunity for the country to emerge as a dominating force in the new accounting standard, experts today claimed. IFRS are standards and interpretations adopted by International Accounting Standards Board (IASB). Regulators in India have set a 2011 deadline to adopt the system. The new accounting standard, adopted by more than 100 countries, replaced the International Accounting Standards (IAS) after 2001. It is based on understandability, relevance, reliability and comparability.

III. OBJECTIVES OF THE STUDY

- To discuss the IFRS adoption procedure in India;
- To discuss the utility for India in adopting IFRS;
- To discuss the ways through which these problems can be addressed.
- To study the challenges faced by corporates in India with implementation of IFRS
- To know the India's internationalization of accounting practices

IV. METHODOLOGY

The present study includes secondary data through the various means such as books, reports of various committees', Indian financial survey reports, journals, various announcements, websites of IFRS home, standing committee reports, newspapers, ministry of Finance, interpretation committee reports, etc.

V. EARLY DEVELOPMENTS ON CONVERGENCE

- The concept of international standards for accounting initiated at the first International Congress of Accountants held at St. Louis in 1904 but little progress was made.
- Again in 1959, the issue was resurrected by Jacob K Kraayenhof, a European accountant. He called for the establishment of national accounting committees to exchange information about their accounting practices with a view to reducing diversities.
- In 1966, the Accountants International Study Group (AISG) comprising leading professional accounting bodies in the USA, the UK and Canada was established. The primary objective of the Group was to publish comparative studies of accounting principles in these three countries so as to help each to resolve its own problems.
- Alhashim and Arpan (1998) have also referred to three models of accounting uniformity which have been identified in accounting literature. These include:

- **The Absolute Uniformity Model:**

This model adopts a very radical and inflexible approach and proposes only one set of accounting methods and reports irrespective of the differences in circumstances under which the accounts are prepared, or the needs of the users. A common set of internationally accepted accounting would perhaps be the ideal solution to the diversity prevalent for it would enhance the comparability of international financial statements and eliminate misunderstanding about their reliability. This is what the IAS is attempting to achieve.

- **The Circumstantial Uniformity Model:**

This model was proposed in 1965 by a special committee of the AICPA and it is aimed at reducing the alternative practices prevalent in accounting. It suggested that different accounting methods and reports to be used for varying economic facts under different conditions. The method, according to the committee, takes its analogy from the field of medicine where, though the doctor may encounter the same disease among his patients, the treatment would vary according to the circumstances. Analogously, in accounting, variations may be justified and perhaps even necessary in situations where the circumstances surrounding the application of given principle are substantially different.

- **Purposive Uniformity Model:**

This model is based on the utilitarian concept, which means that the appropriate accounting methods, standards, and reports are determined by the purpose the accounting information seeks to serve. Thus, whereas the circumstantial model is flexible for different circumstances, the purposive model is flexible for both different circumstances and different purposes. It will thus seen that the

importance of harmonization was by and large recognized by accountants even in the 1960s. However, there was no unanimity on the approach to be followed to achieve the same.

- There were two schools of thought for reduction of accounting differences. They are:
- Informal Approach
- Formal Approach

There were two schools of thought prevalent at that time with regard to the issue. The first school of thought focused on the role of evolution in the development of accounting principles. It recognized the fact that diversity in accounting principles and practices arose primarily on account of the differences in the legal systems, and stages of economic development of the different countries. Economic progress with the passage of time would lead to natural evolution of accounting principles, thus reducing the degree of diversity. Other natural forces such as international competition would also be conducive (favorable) to narrowing the differences in accounting principles and practices. This approach advocates informal consultation among the standard-setters of the major nations of the world.

- The second school of thought recommended formal action for achieving internationalization of accounting principles and practices. The solution lay in establishing an organization with multi-country membership to formulate standards. Consistent with the second school of thought, the last few decades witnessed the emergence of quite a few standard setting bodies. The difference between harmonization and convergence is well explained by the Australian Standards Board (2002).

"International convergence means working with other standard-setting bodies to develop a new or revised standard that will contribute to the development of a single set of accounting standards for worldwide use. On the other hand, harmonization of accounting refers to the process which leads to these standards being compatible with the standards of international standard-setting bodies to the extent that this would result in high quality standards."

VI. NEED FOR CONVERGENCE

Convergence is the process by which standard setters across "the globe to discuss accounting issues, drawing on their combined experiences in order to arrive at the most appropriate solution." The difference between harmonization and convergence is well explained by the Australian Standards Board (2002). "International convergence means working with other standard-setting bodies to develop a new or revised standard that will contribute to the development of a single set of accounting standards for worldwide use. On the other hand, harmonization of accounting refers to the process which leads to these standards being compatible with the standards of international standard-setting bodies to the extent that this would result in high quality standards." With the growing internationalization of trade and the globalization of business and capital markets, financial information prepared according to the national accounting system of one country no longer satisfies the needs of users of the other countries, whose decisions are more and more global in scope. The pressure to adapt to the new global environment therefore comes not only from the users of the financial information, but also from those who regulate and prepare them, that is the multinational corporations, the accounting profession and the government and revenue authorities.

- Investors and Financial Analysts
- Multinational Corporations
- Accounting profession
- Government and revenue authorities

VII. BENEFITS AND CHALLENGES OF CONVERGENCE

Recognizing the fact that, global capital markets require high quality, globally consistent and uniform regulatory and accounting standards regime (system), most major capital markets are actively supporting the efforts of convergence towards a single set of globally accepted accounting standards.

- It improves the comparability of investors to compare investments on a global basis and thus lowers their risk of errors of judgment.
- For companies with global operations, it facilitates accounting and reporting and thus eliminates that cost involved in preparing multiple reports to meet regulatory requirements of different countries.
- Lowers the cost of capital. The adoption of global standards such as IFRS may reduce the risk premium and, consequently, the cost of capital.
- More efficient allocation of resources, as it would eliminate barriers to cross-border listings.
- High economic growth.

Challenges of Convergence

To reap the full benefits of converged global standards a number of practical implementation challenges need to be addressed. As Wong (IFAC, 2004) rightly observes, "Achieving international convergence, however, requires more than theoretical support. It requires reaching consensus (consent) as to the international standards that will serve as the foundation for financial reporting and auditing globally, determining how to facilitate the adoption of those standards, and ultimately taking the actions necessary to encourage implementation". The benefits of convergence have overcome the nationalist sentiment associated with standards in the past. The challenges may be grouped into three major categories:

- Environmental issues
- Enforcement issues
- Technical issues

- **Environmental issues**

- Legal Issues (governing corporate reporting, parliamentary legislations, commercial codes and company acts).
- Economic issues (valuation of financial instruments, and statements).

- **Enforcement issues**
- Exchange Commissions/Boards
- Stock Exchanges
- Banking and Insurance supervisory authorities
- Professional bodies
- Facilitating systems like Financial Reporting Review Board in India (FRRB), 2002 for tackling with the problems on convergence of Accounting standards
- In Germany, the German Accountancy Act of 2004 set up a 2 tier enforcement system that is;
- The German Financial reporting enforcement panel
- The federal financial supervisory authority.

- **Technical issues**
- International Standards are complex
- Shortage of competent accountants and auditors
- Translation of the standards into domestic language
- Limited availability of training material
- Lack of experts on IFRS
- Frequent changes in standards
- Non-availability of actuaries

VIII. ORGANIZATIONS INVOLVED IN CONVERGENCE

The organizations involved in convergence may be put into two categories;

- Those backed by International or Political agreements
- Voluntary organizations

The first category includes the United Nations and the European Union. The second category includes IASB, IFAC, IOSCO, the European Financial Reporting Advisory Group. Further it includes, Confederation of Asia Pacific Accountants, American Accounting Association, The British Accounting Association, The Indian Accounting Association etc.

01. The United Nations

The involvement of UN in this sphere is mainly restricted to disclosure of accounting and non-accounting information by MNC's. In 1973, The UN Economic and Social Council charged a 'Group of Eminent Persons' the task of advising on matters related to TNC's, the official term for MNC's and their impact on the development process. The Group of Eminent Persons reported that, information about the activities of the MNC's was not easily available and are lacked comparability. The Group therefore recommended that, formulation of an International system of standardized accounting and reporting.

The UN Council established the Centre on TNC in 1974, to assist the above said objective. The Group of Experts on International Standards of Accounting and Reporting(ISAR) was created in 1976 with 14-members. The group submitted its report on ISAR for TNC's to the Secretary General of UN in 1977. One of the important recommendation was that the UN set up a permanent accounting body for achieving the afore said objective.

According to the Group recommendation, the accounting disclosures required related;

- Financial statements relating to individual companies within a consolidated group including that of the parent as a separate entity
- Information regarding segments both by line of business and geographic area
- Information regarding a controversial area, i.e., transfer pricing policies.

The report was not accepted because the Group of experts were not the Government representatives. In May 1979, the Commission, therefore set up an ad hoc intergovernmental group of experts on accounting and reporting standards, selected by the member governments. The ad hoc group held 6 sessions between 1980 and 1982. The final report submitted in 1982 which incorporated;

- The information needs of both the host and home countries should be considered by TNC's when accounting and reporting
- The information provided should be comparable
- The cost of providing the information should be reasonable
- Business confidentiality should be given due consideration
- Regarding disclosure of information, the principle of non-discrimination between home and host countries should be followed by the TNC's.

Through the recommendations of ad hoc intergovernmental group of experts, International Standards of Accounting and Reporting was established in 1982.

International Standards of Accounting and Reporting (ISAR)

"ISAR is the intergovernmental working group devoted to corporate transparency and accounting issues at the corporate level. It addresses a variety of issues in corporate accounting and reporting with a view to improving the global comparability and reliability of corporate reports."

02. International Accounting Standards Foundation

The seed for the convergence tree had been sown, over three and a half decades ago when the IASC, the predecessor body of the IASB, was founded in June 1973 at the tenth International Congress of Accountants, as a result of an agreement made by professional accountancy bodies from 9 countries which included, Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the UK, Ireland and USA. In 1981, IASC and IFAC agreed that IASC would have complete autonomy in the setting of IAS and in 1982 all the members of the IFAC became the members of IASC.

During the tenure from 1973-2000, the IASC promulgated a substantial body of standards, interpretations, a conceptual framework and other guidance, widely made use of by companies and national accounting standard setting bodies. Due to the LPG in mid-1990 and Asian crisis in 1996, all brought out the need for better financial reporting.

A strategic working party was formed in 1997 which published its report in1998 in the form of discussion paper. The final recommendations came in 1999, which were approved by the relevant bodies and the new IASB constitution took effect from 1st July 2000. The standard setting body was renamed IASB to operate under an independent foundation named the International Accounting Standards Committee Foundation (IASCF). The IASB assumed its standard setting responsibility for establishing IFRS from 1st April 2001 from IASC, adopting all the IASs and Standing Interpretation Committee (SICs) in existence.

IX. STRUCTURE OF IFRS FOUNDATION

The IFRS foundation has a three-tier governance foundation, based on an independent standard-setting board of expert i.e., International Accounting standards Board, governed and overseen by Trustees from around the world who in turn are accountable to a monitoring board of public authorities i.e., IFRS foundation Monitoring body. The "IFRS advisory council" provides advice and counsel to the trustees and the board, whilst the board also consults extensively with a range of other "standing advisory bodies and consultative groups".

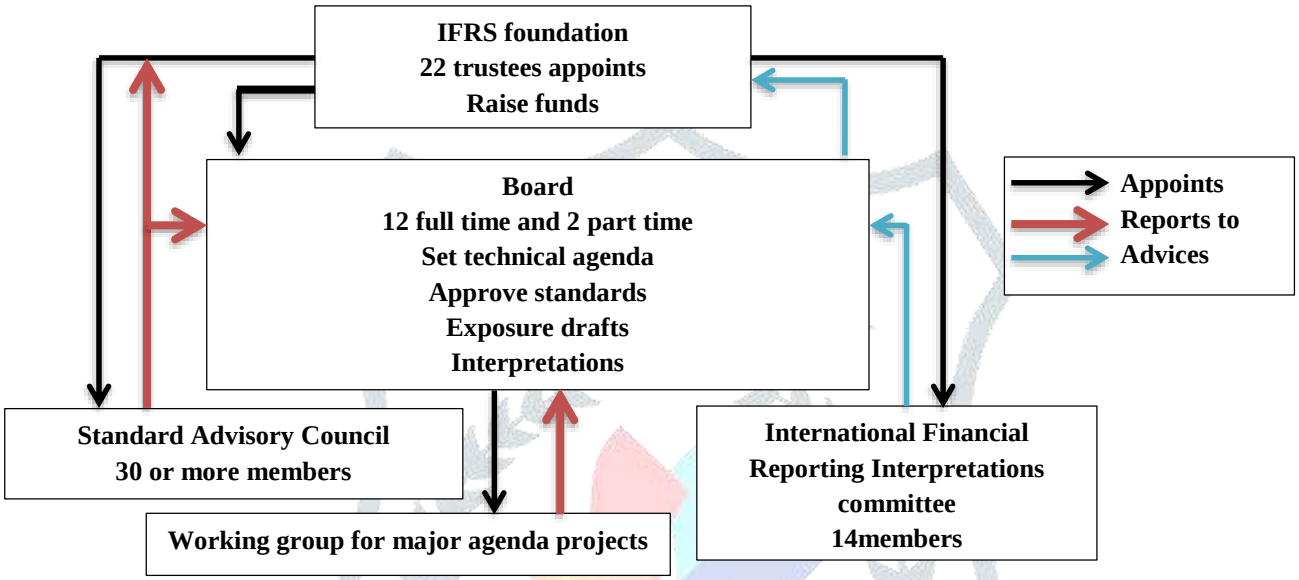

Figure: 1 International Standard-Setting Structure
Source: www.ifrs.org

- **IFRS Foundation**

This foundation board of trustees has 22 members. The constitution requires an appropriate balance of professional backgrounds, including auditors, preparers, users, academics and other officials serving the public interests. The trustees are from; 6 from North America, 6 from Europe, 6 from Asia and remaining 4 are from any area.

The responsibilities of trustees are;

- Appointment of members of the IASB, the IFRIC and the Standards advisory council (SAC).
- To review annually the strategy of the IASB and its effectiveness, and approves its annual budget
- To establish and amend operating procedures for IASB, SAC IFRIC
- To raise funds

International Accounting Standards Board

The IASB is an independent private sector body that develops and approves IFRS. Formed in 2001 to replace the IASC, it operates under the oversight of the IASCF.

Objectives of IASB;

- To develop in the public interest, a single set of high quality, understandable and enforceable global accounting standards that requires high quality, transparent and comparable information in financial statements
- To promote the use of rigorous application of those standards.
- To take account of the special needs of small and medium enterprises and emerging economies in fulfilling the first two objectives.
- To bring about convergence of national accounting standards and IASs and IFRSs to high quality solution.

Standards Advisory Council (SAC)

The SAC provides a forum for participation by organizations and individuals, with an interest in international financial reporting, having diverse geographical and functional backgrounds, with the following objectives of;

- Advising the IASB on Agenda decisions and priorities in the IASB's work.
- Informing the IASB of the views of the organizations and individuals on the council on major standard setting projects.
- Giving the advice to the IASB or the trustees.

International Financial Reporting Interpretations Committee (IFRIC)

The IFRIC (until 2002 it was known as SIC) has 14 members appointed by the trustees for a term of 3 years. The trustees of the IFRIC are to interpret the application of the IFRSs and provide timely guidance on financial reporting issues not specifically addressed in IFRSs or IASs, in the context of IASBs framework, and undertake other tasks at the request of the board.

X. CONCLUSION

The present focus on convergence is a mix of different views. It is driven by competition and the need for faster economic growth is evidenced by the fact that the pace (speed) of convergence accelerated at the beginning of the 21st century when cross-border investments surged. The support and facilitation by international and political bodies on the other hand, and professional bodies, on the other is also essential for the success of the endeavor. From the above, it is clear that the terms harmonization and standardization were found in accounting literature even in the early 1960s. Let us see what the terms tend to imply. The term accounting standard is generally defined as, an authoritative statement on how particular type of transactions and other events should be reflected in financial statements. The Accounting Standards Board of Canada (AcSB, 2008) gives a more comprehensive definition of the term, "Accounting standards are authoritative standards for financial reporting developed through an organized standard-setting body. They specify how transactions or other events are to be recognized, measured, presented and disclosed in financial statements."

- ✓ Since the beginning of the 21st Century the term harmonization is losing ground to convergence. More so since the IASB assumed its responsibilities.
- ✓ One of the objectives of the IASB is "to bring about convergence of national accounting standards and IFRS to high quality solution."

Here the attempt made to analyze the internationalization of the accounting practices through the process of convergence which has provided a way for the integration of worldwide capital markets. Convergence is having two aspects, international convergence and national gaap convergence. The convergence process will help to ensure the comparability of financial statements and allows the companies to enjoy the lower cost of capital as a result of their financial statements being more radically understood.

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