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Convergence in accounting standards: Insights from academicians and practitioners

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ABSTRACT

The efficiency and competitiveness of global capital markets depends on the ability of financial statement preparers to communicate effectively with investors through financial reports. Despite the global movement to adopt IFRS, US adoption of IFRS is still uncertain. To assess potential for convergence, this study compares perspectives of academicians and practitioners regarding convergence to a set of global accounting standards. The majority of respondents believe that effective convergence to a set of globally accepted accounting standards would be beneficial to preparers, users, auditors, analysts, and standard setters. Convergence in accounting standards can require extensive and possibly costly changes to the standard-setting infrastructure and enforcement process in the US and other countries, and will also require proper training for management, auditors, and investors.

1. Introduction

A high-quality set of accounting standards enables investors to receive suitable and reliable financial information. Currently, more than 100 countries require or allow their companies to prepare their financial statements using International Financial Reporting Standards (IFRS) (Johnson and Leone, 2008). Nonetheless, IFRS is not universally perceived as a panacea because convergence is a very complex process influenced by political, cultural, and regulatory differences that often generate significant uncertainty and resistance.

Accounting has been regarded as "the language of business," and the question that has been recently the center of attention is, "Can all accountants worldwide speak the same language?" In other words, "Is a set of globally accepted accounting standards feasible through an effective convergence?" Convergence in this paper is defined as a process of the gradual elimination of differences between IFRS and United States generally accepted accounting principles (US GAAP), as contemplated in formal agreements, such as the Norwalk Agreement of 2002 between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).This process entails changes in both US GAAP and IFRS to eliminate differences, collaboration in establishing accounting standards and ultimate adoption of IFRS in place of US GAAP.

This study attempts to provide answers to questions about convergence to IFRS by obtaining opinions and insights from a sample of academicians and practitioners regarding the relevance, benefits, and ways of convergence in accounting standards. This issue is both significant and timely, as adoption of IFRS by all US companies is expected to happen as early as 2014, with some US companies adopting IFRS in 2009 (AICPA, 2008a). However, in early 2009, SEC Chairperson Mary Schapiro expressed reservations about the progress and proposed timetable of IFRS Convergence. She criticized the IASB and indicated reluctance to adopt IFRS (WebCPA, 2009). Despite misgivings expressed earlier by SEC Chairperson Mary Schapiro, FASB Chairman Robert Herz said that the US should consider adopting IFRS in the next three to five years even if all differences between US GAAP and IFRS are not resolved (Pickrell, 2009).

Perspectives of academics and practitioners gathered for this study are quite relevant to the matter of convergence and are useful to: (1) policy makers and regulators: (2) investors as they invest worldwide and benefit from comparable global financial information; (3) companies in reducing complexity and improving comparability and quality of their financial reports: (4) auditors in opining based on a set of globally accepted accounting standards; and (5) educators in integrating global accounting standards including IFRS into the accounting curriculum.

This study compares views of academicians and practitioners on convergence to a set of global accounting standards, including approaches to the adoption of IFRS. Results indicate that (1) the majority of respondents believe that convergence would be beneficial to preparers, users, auditors, analysts, and standard setters; (2) an appropriate framework for the global acceptance and enforcement of IFRS should be agreed on and a transition option should be given; (3)

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convergence to IFRS can improve cross-border integration of capital markets, create uniformity in global financial reporting, minimize barriers to global competition for capital, increase global comparability, and promote a more informed global marketplace; (4) lack of uniformity in the application of IFRS in all jurisdictions, lack of coverage of IFRS in financial accounting textbooks, coordination and collaboration among global regulators, required changes in regulatory regime, and initial cost of convergence should be addressed; and (5) a proper plan to transition all US companies to IFRS requires IFRS training for management, auditors, and investors and IFRS education in the accounting curriculum. These results can be insightful to companies worldwide that plan to adopt IFRS for their financial reporting, as well as regulators and standard setters in promoting convergence.

2. Review of literature

Several studies have addressed harmonization and convergence in global accounting standards. Earlier studies, such as Anderson (1993), present the advantages of convergence to a global accounting system. Belkaoui (1994) and Choi, Frost, and Meek (1999) present the factors that influence the development of an international accounting system and the harmonization process. Saudagaran (2001) examine impediments to the harmonization of accounting, including cultural and political barriers. This study argues that the harmonization process provides several advantages, such as improving the comparability of international accounting information, enabling the flow of international investments, and making consolidation of divergent financial reporting more cost-effective. The most severe impediments to harmonization are the extent of differences in accounting policies and practices of various countries, lack of vigilant, effective standard-setting bodies in some countries, and diversity in political and economic factors worldwide.

Studies reporting improvements in financial reporting quality following voluntary IFRS adoption include Barth, Landsman, and Lang (2007) and Gassen and Sellborn (2006). Barth et al. (2007) find that a sample of firms that voluntarily adopted IFRS exhibited lower levels of earnings management and more timely loss recognition compared with firms that used local GAAP. Other studies (e.g., Goncharov, 2005, Van Tendeloo and Vanstraelen, 2005) find no differences in earnings management between firms that voluntarily adopted IFRS and those that did not.

Daske, Hail, Leuz, and Verdi (2007) examine the economic consequences of requiring IFRS for financial reporting worldwide, finding an increase in market liquidity and equity valuations around the time of the mandatory introduction of IFRS. However, evidence of the effect on firms' cost of capital is mixed. Furthermore, Daske et al. (2007) report that capital market benefits were more pronounced in countries with strict enforcement regimes and for firms that voluntarily switch to IFRS, but less pronounced for countries when local GAAP is closer to IFRS or an IFRS convergence strategy is in place, and in industries with higher voluntary adoption votes. The use of IFRS is expected to improve the comparability of financial statements, strengthen corporate transparency, and enhance the quality of financial reporting. Armstrong, Barth, Jagolinzer, and Riedl (2007) argue that IFRS reporting makes it less costly for investors to compare firms across countries and capital markets. Covrig, DeFond, and Hung (2007) suggest that convergence toward IFRS reporting can facilitate cross-border investment, and thus, the integration of capital markets.

Prior studies pertaining to convergence either investigate market reactions to several events regarding the European Union's movement toward mandatory IFRS reporting or examine the impact of mandatory IFRS adoption in financial reporting in different countries. Results of market event studies of mandatory IFRS reporting are mixed and inconclusive. Comprix, Muller, and Standford-Harris (2003) find insignificant but negative market reaction to four key events associated with mandatory IFRS reporting for EU firms. Armstrong et al. (2007) report a positive (negative) market reaction to 16 events that increase (decrease) the likelihood of IFRS adoption from 2002–05 with more positive effects for firms with high pre-adoption information asymmetry or lower quality pre-adoption information environments and firms that are domiciled in common law countries.

Some academic studies (e.g., Lang, Smith Raedy, & Wilson, 2006 and Leuz, 2006) support anecdotal evidence (e.g., KPMG, 2006, KPMG, 2007, E&Y, 2007a, and E&Y, 2007b) that suggests that IFRS financial reports are not only affected by home-country institutions, but also retain a strong national identity. Application of accounting standards is affected by unique cultural and economic factors of the country in which the standards are applied (Smith, 2008a). Daske et al. (2007) find that serious IFRS adopters experienced significant declines in their cost of capital and substantial improvements in their market liquidity compared to later adopters. Furthermore, IFRS can be perceived as being designed for large corporations and detrimental to the reporting needs of smaller firms. The emerging interest in converging accounting standards and inconclusive results of related studies motivate us to conduct a survey to determine the relevance and feasibility of such convergence.

Recent studies (Barth, 2008, Ball, 2006, and Nobes, 2006) examine the feasibility of convergence to IFRS, including the potential advantages of producing more accurate, timely, and complete financial information, eliminating international differences in accounting standards, and removing barriers to the global capital markets. Barriers to IFRS convergence addressed in these studies are the persistence of international differences under IFRS, the existence of market, legal, and political differences, and IFRS enforcement issues (Smith, 2008a). Barth (2008) identifies challenges and opportunities created by global financial reporting for the education and research activities of U.S. academics.

Some challenges that need to be addressed to facilitate convergence toward IFRS are: (1) consistent interpretation and application of IFRS across jurisdictions; (2) the feasibility of adoption of IFRS by US multinational companies in general and US companies in particular; (3) educating market participants regarding the differences between US GAAP and IFRS; and (4) effects of switching from national accounting standards to IFRS for regulatory filing purposes and auditing. Members of the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) predicted that by 2011, significant progress toward convergence in the global financial reporting process would be made (AccountingWeb, 2006). Leading accounting experts expect that IFRSs will be accepted, not necessarily required, for financial reporting, in place of US GAAP, for all companies listed in US stock market, as early as 2012 or 2013 (Smith, 2008b). The SEC proposed a timeline for adoption of IFRS in 2014 for all US publicly traded companies; early adopters could use IFRS as early as 2009 (AICPA, 2008a).

A recent survey conducted by the International Federation of Accountants (IFAC) reveals that convergence to a single set of international accounting standards is key to economic development, as the majority of respondents (89%) consider compliance with IFRS very important (IFAC, 2007). The American Institute of Certified Public Accountants (AICPA) also supports the current move toward convergence and the use of IFRS for financial reporting, while recognizing that “changes need to occur in the U.S. auditing, regulatory, and legal environments” (AICPA, 2007). Securities and Exchange Commission (SEC) Chairman Christopher Cox, while promoting convergence by stating that “IFRS is coming,” warned that “U.S. generally accepted accounting principles (GAAP) aren't going away anytime soon” (Rummell, 2008).

Until quite recently, regulators worldwide, including the SEC, required that financial reporting by companies traded in their capital markets either follow national GAAP or be reconciled to the national