Harmonization of International Accounting Standards

Introduction

As there has been a tremendous growth in the market place with the existing accounting practices, this leads us to question why do we need harmonization of International accounting standards, what are its advantages and what are the barriers that hinder harmonization? Although accounting may be the "language of business," a common language has never been necessary -- at least as long as the world economy consisted of a set of more or less distinct national economies.

(Mednick 1991) (Cited in: www.wetherhead.cwru.edu) This, however, is no longer true. We now have a global economy and it has affected the entire business world. For instance, today's global corporation may have more than one headquarters, and its production and distribution facilities are probably scattered throughout the world. Commodity prices, interest rates and currency exchange values have become internationally linked -- with the result that governments around the world are increasingly supporting harmonization of accounting practices and national policies. (Walters) (Cited in: Bisgay and Jayson 1989) Harmonization is necessary because standard national financial statements are virtually useless; financial markets in more regulated countries are threatened with a loss of market share; and multinational corporations must prepare multiple reports for different nations they do business in.

(Nobes and Parker 1991) (Cited in: http://ecocomm.anu.edu.au) There is a need for harmonization for accounting standards in order to help the foreign investor to understand the financial statements of the foreign companies whose shares they might want to buy. (Iqbal, Melcher and Elmallah 1997) Financial information is a form of a language. And if the language of financial information is to be put to use, so that investment and credit decisions can more readily be taken, it should not only be intelligible, it should also be comparable.

(Belkaoui 1994) These new environmental factors of the global economy, the international monetary system, the Multinational Corporation and foreign direct investment create an environment in which business transactions, their conduct, measurement and disclosure, takes new and distinctive form that call for a specific accounting sub discipline or the harmonization of accounting practices.

Advantages of Harmonization

(Turner 1983) The greatest benefit that would flow from harmonization would be the comparability of international financial information. Such comparability would eliminate the current misunderstandings about the reliability of foreign financial statements and would remove one of the most important impediments to the flow of international investment. (Choi, Frost and Meek 1999) Harmonization would save time and money that is currently spent to consolidate divergent financial information when more than one set of reports is required to comply with the different national laws or practice. It will also improve the tendency for accounting standards throughout the world to be raised to the highest possible level and to be consistent with local economic, legal and social conditions.

(Nobes and Parker 2002) It would be beneficial to those countries which still do not have adequate codified standards of accounting and auditing and to international accountancy firms with clients of
firms which have at least one foreign subsidiary. It would also help in raising foreign capital as investors, financial analysts and foreign lenders will be able to understand the financial statements of foreign companies (Samuels and Piper 1985) (Cited in: Blake and Hossain 1996) and they would be able to compare the investment opportunities which will help them to make the right investment decision. The benefit International accounting firms will have with the harmonisation of accounting practices will be the movement of staff across national boundaries will become easier and it will be less expensive to provide training to their staff.

(Lawerence 1996) As taxes are levied on the total global income of an organisation, it would be of great assistance to the national tax authorities around the world if net income was computed on similar accounting principles and practices. (O'Malley 1993) Global accounting and disclosure standards would make it easier to conduct the competitive and operational analyses needed to run businesses. It will also make it easier for financial executives to manage critical relationships with customers, suppliers and others. The group that would benefit the most out of the harmonisation of accounting standard would be the Multi-national companies (Lawerence 1996) as the communication of financial information within the groups would become easier. With the harmonization of reporting standards it would be easier for MNC's to fulfil the disclosure requirement for stock exchanges around the world.

Obstacles in Harmonisation of Accounting Standards

(Nobes & Parker 2002) The most fundamental of obstacles to harmonization are the size of the present differences between the accounting practices of different countries, lack of strong professional accountancy bodies in some countries, and the differences in political and economic systems. (Saudagaran 2001) Nationalism also poses a threat to harmonisation as countries are wary of ceding control of their accounting regulation to outsiders, especially if it is perceived as replacing their own accounting regulations with those of other countries. (Mednick 1991) (Cited in: www.wetherhead.cwru.edu) If accounting measurement rules were the only difference among countries, then straightforward translations would be sufficient to enable reports to be universally understood and interpreted. However, countries also exhibit substantial economic and cultural differences that preclude simple interpretations, even when the figures are generated using the same accounting principles. Accounting standards in any society are an outgrowth of that society’s needs and perspectives. For example, British and U.S. accounting rules reflect the concepts of fairness and substance over form as opposed to the Napoleonic Code, which is much more compliance-oriented. The degree to which the government is involved in standard-setting also varies from country to country. Whereas professional organizations set the standards in Britain, for example, the government assumes this responsibility in France. The U.S. is in between: standards are basically set by professional organizations, but with the government acting as the ultimate enforcer. In any event, close government scrutiny of accounting standards adds an additional political dimension to any effort to change those standards. (Salin 2001) Another barrier that the governments of different countries will have to face is the coordination of their accounting policies with policies prevailing in other countries in order to minimize negative externalities and to maximize positive externalities. There are other barriers to harmonization as well. For example, users might have different needs in different nations (e.g., debtor vs. creditor nations; countries that have very active stock markets and those where banks primarily accumulate and invest capital; investor vs. investee countries; etc.). (Wyatt 1997) (Cited in: Saudagaran 2001) Further, states that the divergence between the needs of large multinationals and smaller business entities in developing countries might thwart the harmonisation of accounting standards. In addition, there may be different levels of sophistication and influence among different national accounting professions. Finally, there is the high cost of requiring issuers to change accounting principles, or to keep a “separate set of books” for multinational offerings. The existence
of these barriers reinforces the belief of some that active public policy initiatives to set international accounting principles may not be desirable; and that harmonization of accounting principles and financial disclosure has an overstated benefit. It has been asserted that, for instance, if a particular financial market requires too much accounting information or has too many regulatory burdens; firms will migrate to another region. On the other hand, if a financial market provides too little accounting information or regulatory guidance, private firms will find it in their interests to supply more.

Criticisms of Harmonisation of Accounting Standards

(Blake and Hossain 1996) First criticism is that underdeveloped countries and developing countries see harmonisation of international accounting standards as an imposition of standards by economically superior countries. Another criticism is that the fact that accounting is flexible in nature and can adopt to different number of situations but if accounting standards are harmonized it is believed that they won’t be flexible enough and the standards set internationally cannot possibly cater for the wide range of national circumstances, legal systems, stages of economic development, and cultural differences. Furthermore the committee of standard-setters (IASB) may find it difficult to reach unanimous agreement on some of the accounting standards and they might have to make compromises so that these accounting practices are accepted globally. This implies that these standards will be permissive and inadequate.

(Choi, Frost and Meek 1999) Moreover, others have expressed the view that international harmonisation may create “standard overload”. This implies that corporation that have to deal with the national, social, political and economic pressure will be more hard pressed to comply with additional complex and costly international requirements. Harmonization of international accounting principles is unlikely to come about because too many different national groups have vested interests in maintaining their own standards and practices which have developed from widely different perspectives.

(Parker 2002) (Cited in: Financial Times) Harmonisation of accounting standard could prove dangerous to the companies as the standards could cut profits and inject volatility into the balance sheets of the companies. Therefore the companies must educate their investors about the effects harmonization will have on their reported profits and liabilities. In support of this (Vaessen 2002) (Cited in: Financial Times) states that harmonization of accounting standards will change the complexion and quality of financial information in ways not seen before, therefore it is vital that companies understand the extent of the impact and ensure stakeholder understand it too.

Conclusion

(Berton 2000) Harmonization of accounting standards has been worked on for 26 years by IASC now known as the IASB, it has representatives from 140 countries and the research shows that a large number of companies are complying with International Accounting Standards (IAS) issued by the IASB. (Roberts, Weetman and Gordon 2002) The European Union Commission has also declared that all the EU listed companies will use IAS for consolidating their accounts from 2005, but it still has a long way to go. There are a number of barriers and hurdles discussed earlier in the essay that the IASB needs to overcome in order to bring about the harmonization of international accounting standards. (Dunn 2002) In order to ensure the uniform application of accounting standards across cultural and political boundaries IASB needs to ensure that there are strong audit practices in order to bring about the integrity of the standards.

USA is also heavily involved in developing international accounting standards with IASB. Most of the
countries which trade with USA prepare their accounts according to US GAAP this in turn makes US GAAP accepted not only in USA but in other countries as well. As USA being the biggest and the strongest economy in the world and its ability to control a large part of the capital market poses a great challenge for the IASB because the companies in USA using IAS issued by the IASB need reconciliation with the US GAAP. This implies that IAS cannot be adopted without the approval of FASB. Furthermore IASB will have difficulties in refusing the proposals made by USA because of its heavy involvement. This will hinder the harmonization of account standards. One can argue that countries which are economically superior to other countries will have their way out in setting the international accounting standards.

However there are a number of benefits as well which will come with the harmonization of international accounting standards. It will bring uniformity in the preparation of accounts and will make the accounts of companies more transparent and comparable which in turn will help the investors to make the right investment decision. There are other benefits as well which the harmonization of international accounting standards will bring which have been discussed earlier in the essay. Sir Bryan Carsberg, secretary general of the IASB (Cited in: Berton 2000) is not just optimistic about world harmonization, he is sure that all countries will move to IASB or the international accounting standards. Despite what Sir Bryan Carsberg believes, in the current situation it is very difficult to judge the future of international accounting standards but one can say that slowly but steadily countries are moving to the harmonization of international accounting standards.