

International Financial Accounting and Policy

International Convergence of Financial Reporting



Dinuka Perera

ACA, ACMA (UK), CGMA, ACMA (SL), MBA (PIM - Sri Lanka)



Harmonization

- **What is harmonization?**
 - The process of increasing the level of agreement in accounting standards and practices between countries.
- **The two "levels" of Harmonization**
 - Harmonization in accounting standards, which is increased the agreement in accounting rules.
 - Harmonization in practice, which is increased agreement in actual accounting practices.
 - Harmonization in standards may or may not result in harmonization in practice.
 - Harmonization is different from Standardization.
 - Harmonization allows for different standards in different countries as long as there are not logical conflicts.
 - Standardization involves using the same standards in different countries.



The Pros and Cons of Harmonization

Pros

- Expedite the integration of global capital markets and make easier the cross-listing of securities.
- Facilitate international mergers and acquisitions.
- Reduce investor uncertainty and the cost of capital.
- Reduce financial reporting costs.
- Allow for easy adoption of high-quality standards by developing countries.

Cons

- Significant differences in standards currently exist.
- The political cost of eliminating differences.
- Overcoming "Nationalism" and traditions.
- Will cause "Standards Overload" for some firms at the transition.
- Diverse standards for diverse places is acceptable.



Harmonization Efforts

International Organization of Securities Commissions (IOSCO)


- Works to achieve improved market regulation internationally.
- Works to facilitate cross-border listings.
- Advocates for the development and adoption of a single-set of high quality accounting standards.

International Federation of Accountants (IFAC)

- Works to develop international standards of auditing, ethics, and education.
- Began International Forum on Accountancy Development (IFAD) to enhance the accounting profession in emerging countries.
- Started the Forum of Firms to raise global standards of accounting and auditing.

United Nations (UN) / European Union (EU)


- Has worked to harmonize accounting standards, primarily by way of two directives.
- Fourth Directive - comprehensive accounting rules on the principle of a "true and fair view."
- Seventh Directive - requires consolidated financial statements for company groups of a certain size.



Harmonization Efforts - IASB

IASB

- Preceded by the IASC (International Accounting Standards Committee) - IASC was established in 1973.
- Works toward harmonization of international accounting standards.
- Comprised of 14 members (12 full, 2 part-time).
- Standard development process is open. - Standards are principles-based.
- Since establishment of IASB, focus is on global standard-setting rather than harmonization per se.
- Comprehensive review of existing IAS (International Accounting Standards). - Begun in 1989. - In order to increase consistency of IAS.
- IASB attempts to follow a Principles-Based approach to standard setting.
- As such accounting standards are grounded in the the IASB Framework.




Principles-Based Approach to Accounting Standard Setting

A Principles-Based approach

- Represents a contrast to a Rules-Based Approach.
- Attempts to limit additional accounting guidance (e.g., FASB UITFs, FASB Interpretations).
- Is designed to encourage professional judgment and discourage over-reliance on detailed rules.

Support for a Principles-Based Approach from outside the IASB


- FASB - has published a supportive proposal entitled, "Principles-Based Approach to U.S. Standard Setting"
- SEC - has recommended adoption of this approach



IASB Framework and IFRSs

IASB Framework

- Provides the basis for financial statements presented in accordance with IFRS
- Similar to the relationship between U.S. GAAP financial statements and the FASB Conceptual Framework.
- Include the objective and underlying assumptions of financial statements.
- Qualitative characteristics of information.
- Definition, recognition, and measurement of elements in financial statements.
- Possesses objective and underlying assumptions of financial statements.
- Primary objective is to provide information useful to decision making.
- Underlying assumptions include accrual-basis and going concern.




IASB Framework

Qualitative characteristics of information

- **Understandability** - should be understandable to people with reasonable financial knowledge.
- **Comparability** - allows for meaningful comparisons to financial statements of previous periods and other companies.
- **Relevance** - useful for making predictions and confirming existing expectations.
- **Reliability** - free from bias (neutral) and represents that which it claims to represent (representational faithfulness).

Elements of Financial Statements


- **Definition** - assets, liabilities, and other financial statement elements are defined.
- **Recognition** - guidelines as to when to recognize revenues and expenses.
- **Measurement** - various bases are allowed, historical cost, current cost, realizable value, and present value.



Presentation of Financial Statements (IAS 1)

This standard provides guidance in the following areas

- **Purpose of financial statements** - to provide decision-useful information.
- **Components of financial statements** - balance sheet, statements of income, cash flows, changes in equity, and notes to the financial statements.
- **Fair presentation** - the overriding principle of financial statement presentation.
- **Accounting policies** - Should be consistent with all IASB standards. When specific guidance is lacking, use standards on similar issues, and definitions of the financial statement elements.
- **Basic principles and assumptions** - Reiteration of underlying assumptions - Accrual basis/going concern/comparability.
- **Structure and Content of Financial Statements** - Provides information on presentation format as Current/noncurrent.



First Time Adoptions of IFRSs (IFRS 1)

IFRS 1

- Provides guidance for first time adoption - Much used, particularly in EU.
- Requires compliance with all effective IFRSs.
- Allows exemptions when costs deemed to outweigh benefits.

Evidence of support for IFRSs

- Adoption by the EU - public companies in the EU were required to begin using IFRSs in 2010.
- IOSCO has endorsed IFRSs for cross-listings.
- Many developing nations have adopted IFRSs.
- Some countries disallow IFRSs for domestic firms but allow foreign companies to use them.
- U.S. is a major exception, does not allow use of IFRSs.



IASB/FASB Convergence

The Norwalk Agreement

- Between the IASB and FASB.
- To work toward accounting standards convergence.

FASB's key initiatives in the Norwalk Agreement

- Joint projects - boards will work together to address some issues
- Short-term convergence - to remove differences between IFRSs and U.S. GAAP for issues where convergence is deemed most likely.
- IASB liaison - IASB member in residence at FASB.
- Monitoring IASB projects - FASB monitors IASB projects of most interest.
- Convergence research project - identification of all major differences between IFRSs and U.S. GAAP.
- Convergence potential - FASB assesses agenda items for possible cooperation with IASB.

