Chapter 8—International Accounting
Harmonization

Accounting Harmonization has four essential aspects:

1—accounting standards, which deal with measurement and disclosure
2—disclosures made by publicly traded companies in connection with securities offerings and stock exchange listings
3—auditing standards
4—offering and listing requirements, auditor education, and immediate public disclosure of material information

Rationale for Harmonization

If the accounting practices between countries are different to the point of imposing unreasonable burdens on capital providers, then they may direct their investment to less efficient and productive companies in certain countries simply because they understand the financial statements and thus regard them as less risky.
Opponents also cite differences in the economic, political, legal and cultural environment in countries as a justification for financial reporting differences. Imposing Western accounting practices on developing non-Western countries is likely to do more harm than good.

Pressures for Harmonization

Current pressures to harmonize are driven by investor groups who use financial statements, MNCs which prepare financial statements, regulators who monitor capital markets, the securities industry which views itself as being significantly impacted by the global diversity in financial reporting requirements and developing countries that often lack the resources to develop indigenous accounting standards.
Investors

Since accounting standards are still determined on a nation-by-nation basis, users such as investors and financial analysts are concerned about the reliability and comparability of financial statements prepared in countries other than their own. They favor harmonization because they perceive that it will help lower the cost of investing abroad and enhance their ability to make effective investment decisions across borders.

Regulators

Critics argue that the high costs of financial reporting and other regulatory compliance thereby imposed on foreign firms cause them to stay away. Empirical evidence exists to support this assertion.
Obstacles to Harmonization

On the economic front, harmonization is often opposed due to its economic impact on countries or segments of society within countries. To the extent that economic consequences of accounting practices vary by country and to the extent that they are considered in the standard-setting process, this acts as an important obstacle to harmonization.

Another political obstacle to harmonization is the absence of strong professional accounting bodies in a number of countries. This means that an organization such as the IASB, will not be effective in a number of countries.

Measuring Harmonization

Accounting scholars draw a distinction between harmonization of accounting
practices (de facto harmonization) and harmonization of accounting regulations (de jure harmonization). In addition, they draw a second distinction dealing with measurement and disclosure issues. Harmonization of both accounting practices and accounting regulations can focus either on measurement issues such as methods of recognition, valuation, and estimation or on disclosure issues such as the level of transparency provided by entities.

Supranational Organizations Engaged in Accounting Harmonization

In 1987, the IASC responded to this criticism by initiating the Comparability Project, which was aimed at enhancing comparability of financial statements by reducing alternative treatments available under IASC standards.

International Federation of Accountants

IFAC issues International Standards on Auditing (ISA) that are aimed at harmonizing
auditing practices globally. It also works toward reducing differences in the requirements to qualify as a professional accountant in its member countries.

In 1992, IOSCO voted to accept ISA for cross-border filings with securities regulators.

IFAC is also examining how accountants can play a role in reducing corruption.

Recent Efforts Toward Harmonization

The SEC has made a number of concessions to foreign issuers. For example, since 1994, it has permitted foreign issuers to use the following IAS treatments without reconciliation to US GAAP:

--a cash flow statement prepared in accordance with IAS 7—Cash Flow Statements
--IAS 22—Business Combinations insofar as it deals with the determination of the period of amortization of goodwill

--IAS 21—The Effects of Changes in Foreign Exchange Rates insofar as it deals with the translation of amounts stated in a currency of a hyperinflationary economy.

The concept release suggests that the SEC could take one of several actions;

--maintain the current reconciliation requirements in all respects
--remove the current reconciliation requirements for selected IASs, extending the exemption to additional IASs based on future reviews of those standards—when IASs permit alternative treatments, the SEC could specify one treatment as acceptable
--rely on IASs for recognition and measurement principles but require US GAAP and SEC rules for disclosures and the level of detail for the line items or
The primary elements required for an infrastructure for IASs includes:

1—the standards should include a core set of accounting pronouncements that constitute a comprehensive, generally accepted basis of accounting
2—the standards must be of high quality—they must result in comparability and transparency and they must provide for full disclosure
3—the standards must be rigorously interpreted and applied.

The IASB does not have the enforcement capabilities possessed by a national regulatory agency such as the SEC. The IASB is an international organization with a limited budget and virtually no enforcement powers.
Harmonization Scenarios

The MDS was created to reduce multiple registration, listing, and reporting requirements for Canadian firms that dual-list in Canada and the US, primarily to make access to the US market less costly for Canadian firms. Under the MDS, eligible Canadian firms may satisfy most SEC requirements by filing documents prepared for Canadian regulators.

World Class Issuer

They would provide the SEC with a written explanation of any material differences from US GAAP.

There are a number of problems with this approach that make it unlikely it will be adopted in the near future. The SEC has not been impressed by this proposal and has been openly critical of it. It considers the world class issuer approach as a dilution of the quality and extent of disclosure.
requirements in the US. There are also possible legal problems that could arise as a result of discriminating between companies on the basis of size.

Current Evidence on Harmonization

It appears that auditors assert that financial statements are in compliance with IASs or IFRSs even though the accounting policies footnotes and other notes indicate otherwise.

The IASC reviewed its current standards and eliminated a significant number of options or showed its preference for a benchmark treatment.
In the US, there has been some discussion about introducing competition into the accounting standard setting process by allowing individual corporations to issue financial reports prepared in accordance with either IASB or FASB rules. The reasons for supporting the status quo are:

1—the FASB’s experience and world leadership in making accounting rules
2—the increased risk of a “race to the bottom” under regulatory competition
3—the inability of most users to understand the complex technical issues underlying accounting standards
4—the possibility that IFRS will be diluted to gain international acceptance, allowing more opportunities for earnings management
5—the risks of the IASB being deadlocked or captured by interests hostile to business
6—the costs of experimentation in standard setting
7—economies from network externalities

Arguments in favor of competition between the two sets of standards are:
1—competition will help meet the needs of globalized business
2—increase the likelihood that accounting standards will be efficient
3—help protect standard setters from undue pressure from interest groups
4—allow different standards to develop for different corporate clienteles
5—allow corporations to send more informative signals by their choice of accounting standards
6—protect corporations against capture of regulatory bodies by narrow interests