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A Survey of Accounting Educators Regarding Convergence of Financial Reporting Standards

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Abstract

Generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS) are becoming more and more similar. Though their sources are different and though GAAP has the force of the authority in the United States, the two sets of standards are reaching a greater level of convergence. In some cases, GAAP has been altered in order to align with the position of IFRS. Similarly, some IFRS have been altered in order to converge with GAAP. The motivation for these changes is to improve financial reporting standards across political borders by creating a common set of standards. In the process, global markets will benefit from having standards that are comparable worldwide. The purpose of this paper is to summarize the progress made toward convergence and report the results of a survey of accounting educators regarding their opinions of the current progress and future potential for convergence of financial accounting standards.

Financial reporting standards in the United States and internationally have different origins. Standard-setting in the United States began in 1939 with the formation of the Committee on Accounting Procedure, which was replaced in 1959 by the Accounting Principles Board, which also was replaced by the current standard-setting body, the Financial Accounting Standards Board (FASB), in 1973. Internationally, the International Accounting Standards Committee (IASC) was founded in June 1973 as a result of an agreement by accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States. The IASC had full autonomy in setting international accounting standards and in publishing discussion documents on international accounting issues. The International Accounting Standards Board (IASB), which issues international accounting standards today, was formed as the successor to the IASC in 2001 (IASB, History).

Historically, standards issued in the United States and those issued internationally have not been coordinated. Although the IASB has existed since 2001, only recently have its standards had a significant impact on U.S. generally accepted accounting principles (GAAP). After a joint meeting in September 2002, the FASB and the IASB issued their Norwalk agreement in which they each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the two boards pledged their best effort to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate their future work to ensure that once achieved, compatibility would be maintained (IASB, 2006). Some have suggested that international financial reporting standards (IFRS) that are issued by the IASB could eventually replace GAAP in the United States as well as standards issued in other countries. In fact, approximately 100 countries require, allow, or plan to converge with IFRS (McGill, 2007).

GAAP and IFRS are becoming more and more similar. In some cases, the FASB has altered its standards to align its position with IFRS. Similarly, some IFRS have been issued that converge with U.S. GAAP. The motivation for these changes is to improve financial reporting standards across political borders by creating a common set of standards. In the process, global markets will benefit from having standards that are comparable worldwide. The purpose of this paper is to summarize the progress made toward convergence and report the results of a survey of accounting educators regarding their opinions regarding the current progress and future potential for convergence of financial accounting standards.

Background

In assessing the progress and future of the convergence movement in the United States, a working definition of convergence must first be established. The dictionary definition of convergence is, "moving toward union or uniformity, as an end in itself". *(Oxford Dictionary, 2005)* However, such dictionary definitions have repeatedly been rejected by both the FASB and IASB, who instead, have agreed to focus on convergence as described in the 2002 Norwalk Agreement as: "the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting". *(Norwalk Agreement, 2002)* In that definition, convergence is a change to either IASB or GAAP which not only converges the two sets of standards, but also improves financial reporting. Therefore, projects geared toward producing the same standard without discernible improvement in financial reporting either in the United States or internationally are not satisfactory. As a result, the task of convergence for the FASB is indeed challenging.

The IFRS are widely accepted as a set of high quality accounting standards that are intended to converge the world's varying accounting standards into a compatible and reliable set of reporting standards. Although the movement toward convergence with IFRS began slowly, acceptance of these standards has increased significantly in recent years. In 1999, a global committee was formed, which significantly increased the push to spread IFRS around the globe. Although third world countries were first to support IFRS, these standards are now being accepted by global financial powers. The momentum toward convergence with IFRS increased with action taken in the European Union (EU). In June of 2000, the European Commission for Securities issued a proposal requiring all listed companies in the EU to prepare their consolidated statements using IFRS by January 2005. This proposal was an important milestone for international convergence since the EU's support effectively reduces the number of parties that have to agree. Robin Murray, CFO of iPin, acknowledged the importance of the EU's step towards harmonization by stating that,

"Once the EU and the U.S. agree [to confirm with IFRS] the rest of the world is extremely likely to follow". (Hansen, F, 2000)

U.S. support for international convergence has not always been as strong, but significant steps have been taken. In September 2002, the FASB and the IASB met and confirmed their commitment toward international convergence. These groups laid out broad tactics for achieving convergence between GAAP and IFRS (FASB and IASB, 2002). Their plan, known as the Norwalk Agreement, was issued following that meeting. The two groups broadened the scope of their joint activities by including some major projects. Joint activities in the last few years include: a project to improve, complete and converge their conceptual frameworks; a statement from the SEC outlining a process to eliminate its requirement that foreign private issuers reconcile statements with U.S. GAAP; and a consultative document from the Committee of European Securities that promoted convergence of GAAP and IFRS disclosures (FASAC, 2005).

Other major powers have also taken steps towards convergence with IFRS. Japan has taken on a plan to reform and merge its current standards into closer agreement with IFRS. In an IASB Press release on October 12, 2004, the Japanese Accounting Board and the IASB agreement to promote further international convergence will contribute to the development of global capital markets (IASB, 2004). Japan's agreement is complemented by China's implementation of a five-year plan to bring their standards into line with the IFRS (IASB, 2006). Singapore has also begun an accelerated program to converge their standards with IFRS, and Russia outlined a reform plan in spring 2000 to bring their current standards into line with the IFRS in the following one to two years (Hansen, 2000) Cyprus and Kenya have mandated the use of IFRS by 2002 (Street, 2002. Australia has moved towards IFRS announcing a strategic direction in July 2002 which included implementing IFRS in Australia by January 2005. The International Organization of Securities Commissions has also endorsed IFRS for cross-border listings. Consequently, numerous multinational organizations are moving to produce reports and records based on IFRS (IASB, 2004).

Following the Norwalk Agreement, the FASB and IASB agreed on several joint short-term and long-term projects as the best approach for achieving convergence. The first major project taken on by the boards produced two new standards for Business Combinations (FASAC, 2005). In June 2005, the boards released exposure drafts:

1) A statement on the appropriate accounting for the purchase method intended to replace FASB Statement No. 141, *Business Combinations*.
2) The accounting and reporting for non-controlling interests in a consolidated Financial Statements, which would replace Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. *(FASAC, 2005)*

Based on comments to the exposure drafts and re-deliberations, the issues of greatest concern faced by the boards are: classification of non-controlling interests as equity, attribution of consolidated net income or loss, components of other comprehensive income to controlling and non-controlling interests, and the necessity and usefulness of disclosure requirements (FASB, 2006). The IASB and FASB have also made progress on another long-term project focusing on revenue recognition. The FASB has stated that its major objective from the project is to achieve one, comprehensive accounting standard on revenue recognition. Problems with the current standards on revenue recognition include discrepancies between authoritative statements themselves and between authoritative statements and accepted practices.

A fundamental discrepancy between authoritative statements is the definition of revenue recognition. Currently, FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, and No. 6, *Elements of Financial Statements*, differ in their definition of revenue recognition. Concept No. 5 uses criteria based on notions of realization and the completion of an earnings process to define revenue recognition, whereas Concepts No.6 defines revenue in terms of changes in assets and liabilities. The Board has indicated that its definition of revenue based on changes in assets and liabilities in Concept No. 6 will be retained. The Board believes that the use of realization and completion of an earnings process is too difficult to define precisely or in a way that can be applied across a range of different transactions and industries. Currently, IFRS fills approximately 2,000 pages of accounting regulations. On the other hand, GAAP comprises over 2,000 separate pronouncements, many of which are several hundred pages long. The difference in volume alone suggests that the IASB and the FASB are fundamentally different in their standard-setting philosophy. GAAP has been historically rules-based, and IFRS have been historically principles-based. Their systems of standards differ conceptually on a number of points (McGill, 2007). However, because of ongoing convergence projects, the extent of differences is shrinking.

Methodology

A survey was designed to gather the opinions of accounting professors in the United States regarding convergence of GAAP and IFRS. Subjects were selected based on their interest in financial and/or international accounting in the Accounting Faculty Directory. Participating professors completed the survey and returned it via email for evaluation and analysis. The survey was divided into two parts: questions about convergence and demographic information. The survey provided a definition of rules-based and principle-based accounting standards and first asked subjects to characterize the level to which both IFRS and GAAP are rules or principle based. Second, subjects were asked their opinion of both the current and optimal proportion of rules-based and principle-based accounting standards and what length of time they believed it would take to achieve the optimal proportion. Specifically, subjects were asked to establish the optimal level of convergence that would allow the United States to compete best in global capital markets; the length of time they estimate it would take to reach this level of convergence; and their opinions regarding the impact that the optimal level of convergence would have on the efficiency of audits, the volume of standards that auditors must know, and the level of confusion with transnational audits. **Subjects were asked which set of standards produced the more appropriate accounting standards.** The subjects were asked to place a marker on a scale at the percentage (ranging from 0 percent to 100 percent) of convergence that best represented their answer to the question. Subjects were also asked how IFRS were addressed at their university and to identify any new courses or subject matter that had been implemented regarding convergence. Finally, the survey contained demographic questions. Two rounds of responses were gathered in the survey. After all responses were received, early and late responses were compared to assess whether a nonresponse bias existed.

Results

Five hundred surveys were emailed to a random sample of accounting faculty throughout the United States. A total of 86 responses were received. A comparison of early and late respondents showed no material difference between the two groups of respondents. In an effort to assess the future of convergence, survey respondents were asked to indicate whether they believed GAAP or IFRS presented the more appropriate accounting standard for several accounting topics that have been identified by the FASB or by practicing CPA’s as key topics to be addressed. Revenue recognition and business combinations were included in the group of topics in order to assess the impact of current joint projects. Table 1 presents subjects’ responses to this question. A large majority of subjects (79 percent) believe that GAAP presents the more appropriate standard for insurance contracts. By contrast, 64 percent of survey respondents state that IFRS is the more appropriate standard for leases. This finding is consistent with the 2005 Financial Accounting Standards Advisory Council (FASAC, 2005) plans that were announced at its meeting held on “International Convergence - Status and Plans.”

The FASAC listed "leases" first on its list of possible topics to approach next in a joint long-term project. (FASAC, 2005) Table 1 also shows relatively even responses for revenue recognition and Business Combinations.

How Far is far enough?

Responses regarding the proportion of convergence with IFRS that would allow the U.S. to perform best in global capital markets are shown in Table 2. Notably, not one survey respondent advocated 'complete convergence.' Responses varied from 10 percent stating 25 percent convergence would be best, to 5 percent of respondents indicating a level of convergence of 95 percent would be the most beneficial. A clear majority (78 percent) believed that 75 percent convergence as the optimal proportion of convergence for the U.S. When asked how long they estimate it would take to reach the "optimal" proportion of convergence, 49 percent of respondents said within 2-5 years.

The optimal level of convergence reported in Table 2 correlates well with results shown in Table 3 regarding rules-based versus principle-based based accounting standards. The optimal proportion of rules vs. principle-based standards was around 75 percent. Tables 2 and 3 display subjects' responses regarding::

1. The extent to which GAAP are currently principle or rules-based standards (Table 2)
2. The extent to which rules or principle-based standards would make GAAP more effective in the future (Table 3).

On the x-axis, 0 percent represents purely Rules-based standards, while 100 percent represents purely Principle-based Standards. In the survey, respondents positioned their marker on the line scale somewhere in between the two extremes. A large majority of survey respondents believed that GAAP would be more effective if the standards were between 51-75 percent principle-based (see Table 3). This is interesting as 80 percent of survey respondents believe 70 percent or more of U. S GAAP is currently rules-based. The majority (67 percent) believes it would take 2-5 yrs to achieve their optimal proportion of rules-based and principle-based accounting standards, while 11 percent believe that the optimal level of convergence will never be reached.

Survey respondents were asked a number of questions regarding courses and curriculum implemented in their respective universities to address the issues of: convergence; IFRS; and the global market they affect. Notably, 61 percent of survey respondents stated that no new courses for International Accounting have been implemented. However, of those who have, 82 percent have implemented a course specifically named, International Accounting. Other courses introduced for international accounting include: Accounting Theory and a Seminar in International Accounting. 88 percent of these classes are at the Graduate level, with 12 percent (Largely the seminar class) being made available to both seniors and Graduate students. In place of introducing an entire course devoted to International Accounting, many colleges (63 percent) have integrated International Accounting curriculum into current Accounting courses. This is an important step, as many find it difficult to fit an entire course on International Accounting into the already, full, and demanding accounting programs. Of the universities that have included IFRS curriculum into current courses, 65 percent say that international accounting was included into the curriculum since, or as a result of, the establishment of IFRS.

The number of students expressing an interest in learning about International Accounting has also increased. Although 70 percent of those surveyed said their students have not expressed significant interest in the topic, the remaining schools have recorded numbers from 25 percent student interest, to as high as 75 percent of the student population expressing an interest in International Accounting. This is a large increase in interest for these schools, especially when compared to the largely non-existent course work, or student interest in international accounting seen five to ten years ago. Therefore, as the push for convergence continues, the need for International Accounting in the classroom is increasing. Although, students may need a larger International Accounting content in future programs, the current concern is to provide graduating students with current knowledge of global issues and the effects of IFRS. This is something which, for now, can generally be covered through inclusions in current subjects.

Conclusion

The question of "how far is far enough" with regard to convergence is very difficult for anyone to answer. Despite support for the idea that capital markets benefit from using comparable accounting standards, the survey findings did not indicate support for 100 percent convergence of GAAP and IRFS. Perhaps convergence to the point that differences may be covered in the notes will be the best option. Research in Europe is being conducted to establish whether this could ever be a realistic option. Inevitably, as nations face different issues, their position on convergence may differ. Therefore, there may never be an end of the road for convergence.

Though reaching a desirable level of convergence may be reached, maintaining that level will be a challenge. Why is complete convergence not supported? The impact of political influences and protests from industries that are affected by new and possibly unfavorable standards is one explanation. In addition, economic conditions worldwide may vary. Thus, the desirability of complete convergence may be incompatible with economic differences. The alternative to complete convergence is to allow different standards but require disclosure of differences. The possibility that these differences may increase over time may return the respective boards to a situation where divergence rather than convergence may recur. Thus, maintaining convergence between GAAP and IFRS could prove to be the greatest challenge of all.

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Table : 1

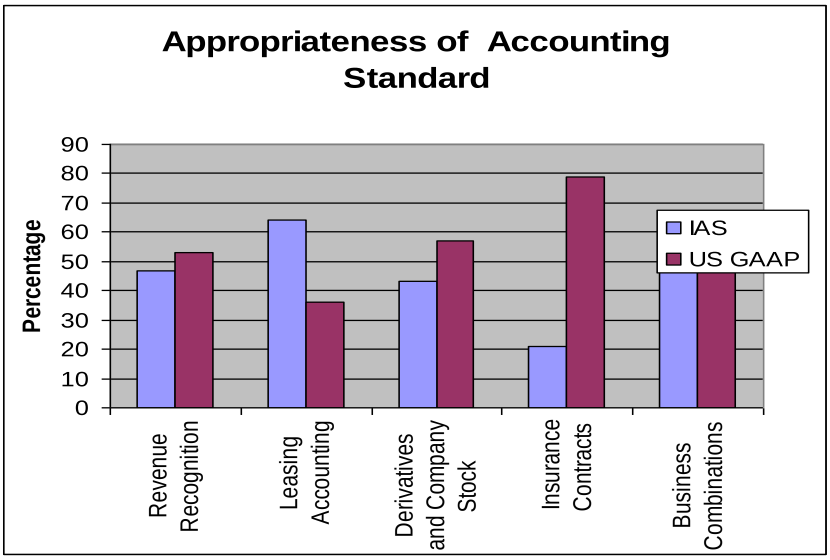

Table 2: Current Status

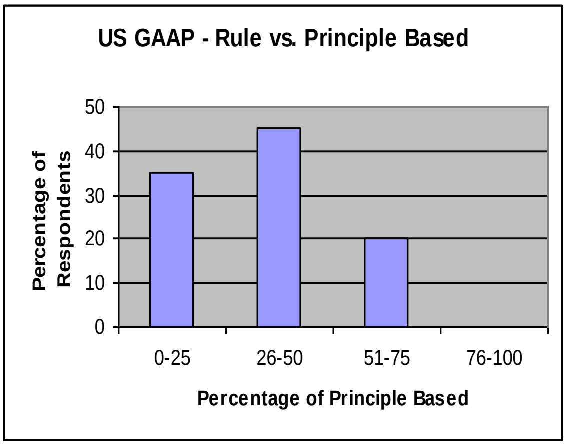

Table 3: Optimal Level