Accounting & Finance - Financial Accounting Report

Structural features

Communication features

1. Introduction

Standard essay style introduction (see Ch1, Getting started on your essay)

In today's international business environment, multinational companies have to prepare more than one financial report based on different accounting standards to satisfy the needs of investors from different countries. To avoid the costs and inconvenience as well as improve the efficiency of information exchange, many countries are now in the process of adopting an accounting policy in convergence with International Financial Reporting Standard (IFRS). Convergence means to assimilate two accounting standards; it is a concept brought about by International Accounting Standard Board (IASB) in 2001. Japan, Canada and the US have already launched programmes to promote convergence. In China, it is a basic benchmark to have accounting standards convergence with IFRS. Since the European Union (EU) Parliament passed a regulation requiring a mandatory adoption of IFRS for all the companies listed in EU after 1st January, 2005, it seems that the global trend of convergence has become more prevalent.

This paper will firstly present the convergence process in the US and China in detail; then critically discuss the pros and cons of adopting one set of accounting standards all over the world. Finally, the study will provide a prediction regards to convergence process and any resulting consequences.

2. A review of convergence of accounting standards to IFRS in the US and China

2.1 Convergence of US GAAP

Compared to the early mandatory adoption of IFRS in EU, convergence began relatively late in the US. In 2002, IASB and Financial Accounting Standard Board (FASB) in America signed the **Norwalk Agreement**, which is a notable event in the initial period of convergence. In this agreement, the two boards issued initiatives to eliminate differences between IFRS and US Generally Accepted Accounting Principles (GAAP) (Tyson, 2011).

In 2006, the two boards then issued **memorandum of understanding (MOU)**, which changes the purpose of "eliminate differences" in Norwalk Agreement to "improve current standards together" (Gill, 2007).

From 2007, US Securities and Exchange Commission (SEC) has undertaken a series of action to encourage convergence. In 2007, SEC removed the requirement of reconciliation for statements based on IFRS to US GAAP and published the **"roadmap"** for convergence in 2008; it also announced the decision on whether to proceed mandatory adoption of IFRS would be made in 2011. Since 2008, SEC encouraged related parties to provide comment letters on the conversion of GAAP to IFRS (Tyson, 2011). On 24 February 2010, SEC approved a **commission statement** of an overview of activities related to IFRS, summarising feedbacks received and outlining approaches going forward (Deloitte, 2015).

From then on, several push-back actions have been taken by SEC. From October 2010 to 2011, FASB and IASB twice postponed the deadline announced for complete convergence. In December 2010, the concept of condorsement was put forward and was introduced by the Staff Paper issued in 2011 as a new method of incorporating IFRS in the US. In 2013, SEC issued its Final Report on the Work Plan, which is the final push back, emphasising that the commission has not made any policy or recommendation that IFRS should be incorporated into US financial reporting system (Yallapragada, 2014).

Formal style, using business-like language such as push-back

2.2 Convergence of China's GAAP

Rather than converging gradually by eliminating differences, China's set-up of **the New Accounting Standard** was initially based on the IFRS model. In 2006, China released 39 new accounting standards, which were then adopted by over 1400 business enterprises in China in 2007. During the process of setting the standards, Chinese Finance Ministry maintained frequent contact with IASB. Before the introduction of the new standards, China used its own version of GAAP, which relies on historical accounting (Outa, 2013).

After the releasing of new accounting standards, IASB and Chinese Accounting Standard Commission (CASC) signed a joint announcement, which confirmed that Chinese accounting system was already in the process of convergence to IFRS.

In 2008 after the mandatory adoption of IFRS in EU, European Commission (EC) assessed the convergence process in China, confirming that Chinese accounting standards have equivalent effect to those adopted in EU.

In 2009, China issued the **roadmap** regards to continuous convergence of China's GAAP to IFRS. In October of the same year, the World Bank issued an assessment on the status of convergence, pointing out that the strategy of improving accounting standards in China had become a good example and could be learned by other countries (China's GAAP Convergence Roadmap, 2009).

2.3 Pros and Cons of Adopting a Single Set of Accounting Standards

There are several reasons why convergence of accounting standards has become a preferred and prevalent system around the world.

First of all, specifying accounting treatments by one set of standard reduces information asymmetry between investors and the company by making accounting information comparable (Ball, 2006). For example, to clarify accounting items included in debts will provide certainty to both lenders and borrowers when looking at gearing required by leverage covenant. The cost of processing financial information could be lower for investors, thus improving efficiency of the whole capital market.

Analysis supported by sources

Since financial information of companies is presented in "the same language", which means that investors are able to compare different investing opportunities. Thus they will be willing to make investment, increase supply of capital in the market, and therefore reduce cost of capital for companies (Ray, 2011). According to Barth (2008), the cost incurred for companies to prepare financial statements as well as to audit them will also be reduced with a global financial reporting system. This is the so-called economies of scale for public goods as economic consequences of implementing a uniform standard. The improvements of transparency and investor confidence are supported by empirical studies of Leuz and Verrecchia (2000), who contended that a transition from German GAAP to IAS or US GAAP represents a better disclosure; and Pae et al's long-window test (2006) over the period after the adoption of IFRS in EU, suggesting a reduction in agency costs and other associated benefits.

Another advantage of uniform accounting standards is the protection for auditors. If the adoption of one single set of accounting system becomes mandatory, intimidation and ethical threats will be lowered. Managers are no longer able to coerce auditors to give an unqualified opinion based on a more favourable set of accounting rules. This advantage is mentioned by Ball (2006) as the protection against managers playing an "opinion shopping" game.

Although the benefits seem to be attractive in terms of improving transparency of information and efficiency of capital market, adopting one set of accounting standards also goes with numerous disadvantages.

Use of concluding sentence to link theme to the next paragraph

One of the main critiques is the significant transition cost incurred for companies. It is necessary to prepare financial reports based on a new and completely different set of standards, and as a consequence, an organisation needs to invest in training their employees. They **may** also be required to update their computer-based accounting system. For a small company, these costs **might** be relatively low. But for a large company, especially those in the US where GAAP has been adopted for a long time and with substantial investment by US regulators, transition costs **could be** enormous. SEC has predicted that "early adopters of IFRS would each incur about $32 million" (Johnson and Leone, 2009, cited in Outa, 2013, p 234) in US.

In some types of reports, short paragraphs are acceptable.
Check with your tutor.

Use of cautious language to interpret possible implications

Compared to these high one-off costs, benefit is quite uncertain from the results of empirical investigations. Some studies show a positive economic result as discussed above, while some show a neutral or even negative result. For example, Cuijpers and Buijink (2005) failed to find a decrease in cost of capital after studying non-GAAP adopters in EU. By studying companies adopted non-GAAP in the period of 1993-2003, Daske (2006) found that the cost of capital appeared to increase.

Sources used to support argument

A second challenge for a single set of standards is that it may not be suitable for all companies in different situations. Feedback received by SEC from members of US congress expressed concerns among small business owners for the unnecessary hardship and expenditure they will face in the conversion (Tyson, 2011). For those local businesses only local markets are paramount and the adoption of international standards may not be needed. Another example of unsuitability can be found in Egypt where related party transactions are private, and therefore a full disclosure requirement in IFRS is not realisable since such disclosures are considered taboo. (Outa, 2013).

Use of (sourced) examples to support and illustrate analysis

Finally, adopting uniform accounting standard could slow the process of improving standards, because it will be impossible to conduct comparative studies based on the results of applications using different standards (Sunder, 2009). Countries with their own GAAP are able to make adjustments based on their own particular domestic situation. For China, this means that special accounting problems occurred under the particular economic environment, and this in turn provides a different perspective for accounting transactions, which in turn could then impact and influence the standard, forcing further amendments. For example, the revision of IAS 24 in 2009 regards to disclosure of related parties' transactions was a convergence towards Chinese standards (China's GAAP convergence roadmap, 2009).

2.4 Interpretation of Findings

Overall, it has taken approximately twenty five years, to implement a standard accounting system, from the issue of EC directives aimed at making accounting information more comparable for the first time in 1980s, to the mandatory adoption of IFRS among EU countires in 2005. However, global capital market is more complicated than capital market in EU: the development statuses of financial markets and users' focus of accounting information vary greatly all over the world. This means that quick convergence is highly problematic and may come with high costs and uncertain benefits as discussed above. Therefore, to reach full convergence in the next decade **may not be entirely realistic**.

Detailed evaluation of findings, based on evidence provided

Use of cautious language to indicate the writer's view

Thus, attitudes of different countries towards full convergence seem to be conservative. Although China has always aimed towards a full convergence with IFRS, its Ministry of Finance still remain the power to revise Chinese GAAP based on its own conditions. As for the US, it was not until it signed the Norwalk Agreement in 2002 that it has taken an active part in convergence. After 2010, SEC began its process of full convergence. In 2011 it put forward the concept of condorsement, making it clear that the country will not require mandatory adoption IFRS in the foreseeable future but choose to lead a gradual transfer to IFRS through further US GAAP settings to eliminate the differences between those two standards (Yallapragada, 2014). In India, the deadline of 2012 has passed, but full adoption of IFRS has still not been achieved (Outa, 2013). This accumulated evidence shows that there is still a long way to go to finally reach full convergence globally.

3. Conclusion

Clear, succinct conclusion that follows a standard essay style structure (see Ch 1, Getting started on your essay)

To analyse the global trend of convergence of accounting standards, this paper provided detailed reviews on the harmonisation processes of US GAAP and China's GAAP towards IFRS. A critical analysis on the advantages and disadvantages of adopting a single set of accounting standards was then provided. Whether the full convergence of standards will be achieved depends on whether its advantages overweigh disadvantages under current circumstances. The paper concludes that because of the complication of global economic environment as well as the existence of different situations in different countries, it seems unlikely that the full convergence of accounting standards will be achieved in the next decade.

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Harvard Referencing System (see Ch 8, Referencing with Accuracy)

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Diana and Tom's Comment

While there is no clear position evident in the thesis statement, the writer has produced a thorough analysis and evaluation of a key issue. The report has been well-researched and sources are used effectively to present various positions and arguments. There is a clear sense of purpose and direction throughout. The structure is clear with good use of sub-headings that help guide the reader. Final evaluations and conclusions are insightful, original and justified in the context of the findings and analysis presented.