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IFRS: A Solution for Variations of Accounting Standards

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Abstract:

Accounting, as a language of business, has a historical connection with the dynamic economic growth and development and its principles, rules and procedures change over time in parallel with the changes in business activities accordingly. This paper deliberates an overview of the historical development of accounting standards and the necessity for having a single accounting standard across the globe through reviewing previous literatures and it totally deals with the theoretical concepts of Accounting Standards to provide an insight to professionals and practitioners in countries that is moving toward adapting or adopting IFRS for the first time to enhance their understanding of accounting standards and give an overview of their historical launch along with the progress made toward converging into a single international accounting Standard - IFRS.

Keywords: Accounting, accounting professional organizations, accounting standards, GAAP, IFRS

1. Introduction

Financial decision (both investment and financing), inter alia, depends on the quality of the financial information it relies on. The quality of financial information also in turn depends on the quality of accounting standards used in measuring, recognizing, presenting and disclosing this information. In cognizant of this fact, according to UNCTAD ISAR (2008), the need for a global set of high-quality financial reporting standards goes back to the early 1970s when efforts were made to have a single global benchmark that enables direct comparison of corporate financial reports between jurisdictions as such high-quality standards enhance investor's confidence by allowing economic transactions of a similar nature to be treated, presented and reported in the same manner around the globe which is an essence of accounting.

Large numbers of accounting professional organizations, authors, academics and researchers have defined the term "accounting" from different perspectives. For instance, according to AICPA "Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of financial character, and interpreting the results thereof". Investopedia defines Accounting as the systematic and comprehensive recording of financial transactions pertaining to a business; the process of summarizing, analyzing and reporting these transactions; and producing financial statements that summarize a large company's operations, financial position and cash flows over a particular period which are a concise summary of hundreds of thousands of financial transactions it may have entered into over this period (<http://www.investopedia.com>). Encyclopedia, likewise, defines Accounting as the language of business as it is the basic means of keeping economic histories of a business's activity in monetary terms and that helps an organization to record, report, and evaluate economic events and transactions that affect the business entity (<http://www.inc.com/encyclopedia/>). To capture each and every economic event and transactions of a business entity which is going to be organized, summarized and reported to the users, an accounting system is designed and implemented. According to encyclopedia, accounting system is "a management information system responsible for the collection and processing of data useful to decision-makers in planning and controlling the activities of a business organization and the data processing cycle of an accounting system encompasses the total structure of five activities associated with tracking financial information: collection or recording of data; classification of data; processing (including calculating and summarizing) of data; maintenance or storage of results; and reporting of results" (<http://www.inc.com/encyclopedia/>).

2. Accounting, Professional organizations and Accounting Standards: History

Accounting has evolved through different stage of development at different parts of the world and at different periods of time depending on the economic development of the society. The gradual increase in production and economic transactions from time to time has, depending on technological enhancement, created difficulty to memorize and manage all these economical events and compel people to record. According to Alexander (2002), people started recording economic transactions for the first time on clay in Mesopotamia and then advanced to record on Papyrus in Egypt. Alexander (2002) described the historical development of accounting concisely as under:

“The history of accounting is that of human commerce, and even more fundamentally, of writing and the use of numbers and counting. Five thousand years before the appearance of double entry, the Assyrian, Chaldaean-Babylonian and Sumerian civilizations were flourishing in the Mesopotamian Valley, producing some of the oldest known records of commerce. Governmental accounting in ancient Egypt developed in a fashion similar to the Mesopotamians and extensive records were kept, particularly for the network of royal storehouses within which the "in kind" tax payments were kept. Pre-Christian China also used accounting chiefly as a means of evaluating the efficiency of governmental programs and the civil servants who administered them but a level of sophistication was achieved during the Chao Dynasty (1122 - 256 B.C.) which was not surpassed in China until after the introduction of double entry processes in the 19 century. In the 5th century B.C., Greece used "public accountants" to allow its citizenry to maintain real authority and control over their government's finances. Perhaps the most important Greek contribution to accountancy was its introduction of coined money about 600 B.C. Government and banking accounts in ancient Rome evolved from records traditionally kept by the heads of families, wherein daily entry of household receipts and payments were kept in an *adversaria* or daybook, and monthly postings were made to a cashbook known as a *codex accepti et expensi*. [...] Public accounts were regularly examined by an audit staff, and *quaestors* were required to account to their successors and the Roman senate upon leaving office. The innovative Italians of the Renaissance (14th -16th century) are widely acknowledged to be the fathers of modern accounting. Luca Pacioli was a true Renaissance man, with knowledge of literature, art, mathematics, business and the sciences, at a time when few could even read and invented the double-entry system and published in book entitled *Summa de arithmetica, geometria, Proportioni et proportionalita* in 1494.”

In the history of professional accounting Associations, the first national accounting society, the American Association of Public Accountant was launched in 1887, later named the American Institute of Certified Public Accountants (AICPA) in 1957. In the 1940s, the accounting profession increasingly used the funds statement to measure the actual flow of monies, rather than simply the sum of working capital changes between balance sheet dates. The funds statement increasingly became a staple for the financial statement and, in 1971, the American Institute of Certified Public Accountants began requiring its inclusion in stockholders' annual reports (Alexander, 2002).

According to Stephen Zeff in *The CPA Journal*, the term Generally Accepted Accounting Principles (GAAP) was used for the first time in 1936 by the American Institute of Accountants (known as the AICPA since 1957). Federal endorsement of GAAP began with legislation like the Securities Act of 1933 and the Securities Exchange Act of 1934, laws enforced by the U.S. Securities and Exchange Commission (SEC) that target public companies (<http://www.accounting.com/resources/gaap/>). In 1973, Financial Accounting Standard Board (FASB) became the designated organization in the private sector for setting standards that govern the preparation of corporate financial reports along with not-for-profit organizations. In 1984, the Government Accounting Standards Board (GASB) was formed under the Financial Accounting Foundation (FAF) umbrella to issue standards and other communications that result in decision-useful information for users of government financial reports. (<http://www.accountingfoundation.org>).

3. Accounting Standards

Accounting standard is a written statement or document issued from time to time by institutions of the accounting profession or institutions in which it has sufficient involvement (Lal, 2009; Rawat, 2013). Das and Pramanik (2009, p194) also defined Accounting Standards as “the authoritative statements of best accounting practices issued by recognized expert accountancy bodies relating to various aspects of measurements, treatments and disclosures of accounting transactions and events, as related to the codification of Generally Accepted Accounting Principles (GAAP).” These are, according to Das and Pramanik (2009), stated to be the norms of accounting policies and practices by way of codes or guidelines to direct as to how the items, which make up the financial statements, should be dealt with in accounts and presented in the annual accounts. Accounting methods thus are an integral component of the contracting between firms and other parties, including lenders, shareholders, managers, suppliers and customers (Ball, 2006, p7).

4. Objective of Accounting Standards

The basic objective of accounting standards is to standardize the diverse accounting policies and practices with a view to eliminate to the extent possible the non-comparability of financial statements and add the reliability of the financial statements (Rawat, 2013, p1). This comparability should not be limited within a given country and comparison of the financial statements prepared in different countries of the globe should be possible to provide useful information to interested users in any country. In this regard, Hail et al (2010) argued that accounting standards play a key role by minimizing the economy-wide transaction costs of communicating information among various stakeholders, allowing them to make more efficient real decisions and undertake transactions within, outside, and between firms and offer competitive advantage by enhancing regulatory and compliance costs, and could increase the barriers to entry into public capital markets.

However, Skinner (1972) argued that following the World War II, each country had its own Generally Accepted Accounting Principles resulting in significant difference even among the GAAPs in countries with active equity capital markets on which listed companies depended heavily for finance—the United States, Canada, the United Kingdom, Australia, and New Zealand stating that, for example, in the U.K., Australia, and New Zealand, companies could revalue their property, plant, and equipment (PPE), including investment property.

Zeff (2012, Pp808-809) discussed concisely that:

“There had been even greater gulf existed between the GAAPs in these Anglo-American countries and those in countries on the European continent and in Japan, where income taxation drove accounting practice, where reported profit determined by law, the dividend to be declared, and where financial results could be manipulated by secret reserves. In most developing countries, financial

disclosure was minimal and there was little that could be called GAAP beyond what they might have inherited from former colonial masters, such as the U.K. or France. In sum, worldwide accounting practice was highly diverse and meaningfully comparing financial statements from one country to the next was very difficult" (Zeff, 2012).

International differences in accounting standards create problems by resulting in different financial reporting because many users (e.g. investment analysts acting for investors in equity or debt) assess companies on a comparative basis internationally (ACCA, 2011).

To overcome these problems and enhance the comparability of financial statements across different nations in the world, efforts have been exerted to produce uniform single language accounting standards that are applicable in different legal and regulatory environments. Among those efforts, according to Zeff (2012, Pp808-809), France established in 1947 the Plan comptablegénéral, or National Accounting Plan, a detailed, codified regulation of company accounting, which France then exported to Belgium and Spain and eventually to Portugal, Morocco, Tunisia, Algeria, and Peru. The next effort has been made since inception of International Accounting Standard Committee (IASC) in 1973 to develop quality accounting standards whose objective is, as Rawat (2013) stated, to standardize the diverse accounting policies and practices with a view to eliminate to the extent possible the non-comparability of financial statements and add the reliability to the financial statements.

A lot of previous literatures (e.g. Ball, 2006; Jeanjean and Stolowy (2008); Ramanna and Sletter, 2009; Li, 2010; Shabana and Samant, 2011; Outa, 2011; UNCTAD, 2012, and Rawat, 2013) argued for the necessity of single accounting standard for the globe. For instance, among these literatures, Ball(2006) identified three basic advantages which can be realized from using uniform accounting standards voluntarily and explained each of them as follows:

"I am aware of at least three major advantages of uniform (here interpreted as applying equally to all public companies) standards that would cause them to emerge voluntarily (i.e., without state fiat). The first advantage – scale economies – underlies all forms of uniform contracting: uniform rules need only be invented once. They are a type of 'public good', in that the marginal cost of an additional user adopting them is zero. The second advantage of uniform standards is the protection they give auditors against managers playing an 'opinion shopping' game. If all auditors are required to enforce the same rules, managers cannot threaten to shop for an auditor who will give an unqualified opinion on a more favourable rule. The third advantage is eliminating informational externalities arising from lack of comparability. If firms and/or countries use different accounting techniques – even if unambiguously disclosed to all users – they can impose costs on others (in the language of economics, create negative externalities) due to lack of comparability. To the extent that firms internalize these effects, it will be advantageous for them to use the same standards as others."

UNCTAD ISAR (2012, p4) also pointed out that "a strong and internationally comparable reporting system facilitates the international flows of financial resources, while at the same time helping to reduce corruption and mismanagement of resources and it also strengthens the international competitiveness of enterprises by attracting external financing and benefiting from international market opportunities."

Shabana and Samant (2011,p46-47) also argued in favor ofthe global convergence of accounting standards asserting that convergence in accounting standard is a very positive development as it: (i) contributes to the free flow of global investment and achieve substantial benefits for all capital markets stakeholders; (ii) improves the ability of investors to compare investments on a global basis and thus lower their risk of errors of judgment; (iii) has the potential to create a new standard of accountability and greater transparency, which are values of importance to all market participants including regulators and (iv) creates an unprecedented opportunity for standard setters and other stakeholders to improve the reporting model. In backing of this view, Jeanjean and Stolowy (2008) indicated that with the globalization of international financial markets across the globe, the idea of adopting a common language for financial reporting to enhance international comparability has become widespread.Li (2010) also observed and explained that many international countries have recently permitted their domestic companies to use International Financial Reporting Standards (IFRS), an international reporting language, to reduce the problems. Therefore, IFRS is, as a solution, converging the various local Accounting standards in various states across the world into single international accounting standards.

5. International Financial Reporting Standards (IFRS)

International Financial Reporting standards are accounting standards that two bodies: International Accounting Standard Committee (IASC) from 1973 to 2001 and International Accounting Standard Board (IASB) since 2001. Accounting standards developed by IASC are called International Accounting Standards (IASs)while those developed by IASB are called International Financial Reporting Standards (IFRS). IASB adopted the IAS developed by IASC and continued developing other standards, and, currently, both IAS and IFRS are termed as IFRS. In its guide through IFRS, IFRS Foundation (2015, pA8) stated that "when IFRS is used, it includes standards and Interpretations approved by IASB, and International Accounting Standards (IASs), Standards Interpretation Committee (SIC) Interpretations issued by ISAC" (IFRS Foundation, 2015, pA8). IFRS are single high quality global accounting standards that require for measurement, recognition, presentation and disclosure of information in the general purpose financial statements of a reporting entity. In collaboration with World Bank, IMF, and other international organizations, IASB is working toward inviting countries to use its standards.

5.1. Progress of IFRS Conversion in the International Level

The profiles of 140 jurisdictions (see table 1 below) which covers 97 per cent of the global Gross Domestic Product (GDP) of the world was compiled from different sources revealed that Today, more than 120 countries require the use of IFRS by public companies, while most other 40 jurisdictions permit the use of IFRS in at least some circumstances (IFRAS, 2015):

Region	Number of jurisdictions	Percent of Total
Europe	43	31%
Africa	19	14%
Middle East	9	6%
Asia and Oceania	32	23%
Americas	37	26%
Total	140	100%

Table 1: Profile of Jurisdictions toward IFRS conversion
Source: www.ifrs.org (accessed on 14/10/2015)

The data summarized in table 1 above shows that the most countries in adopting IFRS are from Europe (31%) while the least are from Middle East (6%). Africa's performance toward adopting IFRS is almost half of Americas.

5.2. IASB's Standard Setting Processes

According to the information from IFRS website (www.ifrs.org), the due process of standard setting process of IASB comprises six stages, with the Trustees of the IFRS Foundation having the opportunity to ensure compliance at various points throughout: (1) Setting the agenda; (2) Planning the project; (3) Developing and publishing the Discussion Paper, including public consultation; (4) Developing and publishing the Exposure Draft, including public consultation; (5) Developing and publishing the Standard; and (6) Procedures after an IFRS is issued and summarized and depicted as follows:

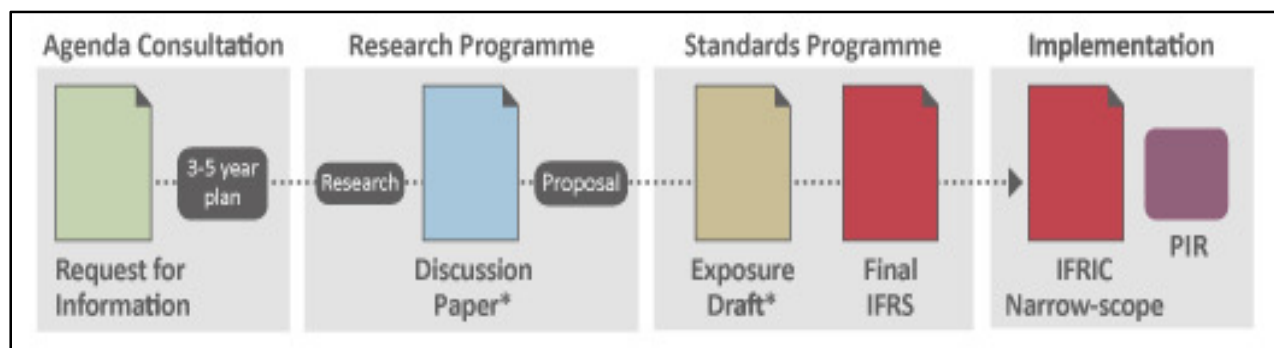


Figure 1: IFRS Standards Setting Due Process

Source: <http://www.ifrs.org/How-we-develop-standards/Pages/How-we-develop-standards.aspx>

5.3. IFRS Transition Date, Adoption Date of and Reporting Date

The date identified as the beginning of the earliest period for which full comparative figures are presented in accordance with IFRS is known as Transition date. Accordingly, companies who present one-year comparative figure and two years' comparative figures have different transition date. To illustrate, if a given entity prepares its first IFRS financial statements for the year ending December 31, 2015, with one year of comparative figures, its transition date is January 1, 2014 and the opening IFRS balance sheet but entity that prepares two years' comparative figures has a transition date of January 1, 2013 and prepares its opening IFRS balance sheet at that date

Date of Adoption is the beginning of the fiscal year for which the reporting entity prepares the IFRS financial statements for the first time. Accordingly, for an entity that prepares its first IFRS based financial statements for the year ended December 31, 2015, its date of adoption is January 1, 2015 whereas reporting date is the closing balance sheet date for the first IFRS financial statements. Hence, for the above illustrated entity that prepares financial statements for fiscal year ended December 31, 2015 has a reporting date of December 31, 2015 (PricewaterhouseCoopers LLP, 2009).

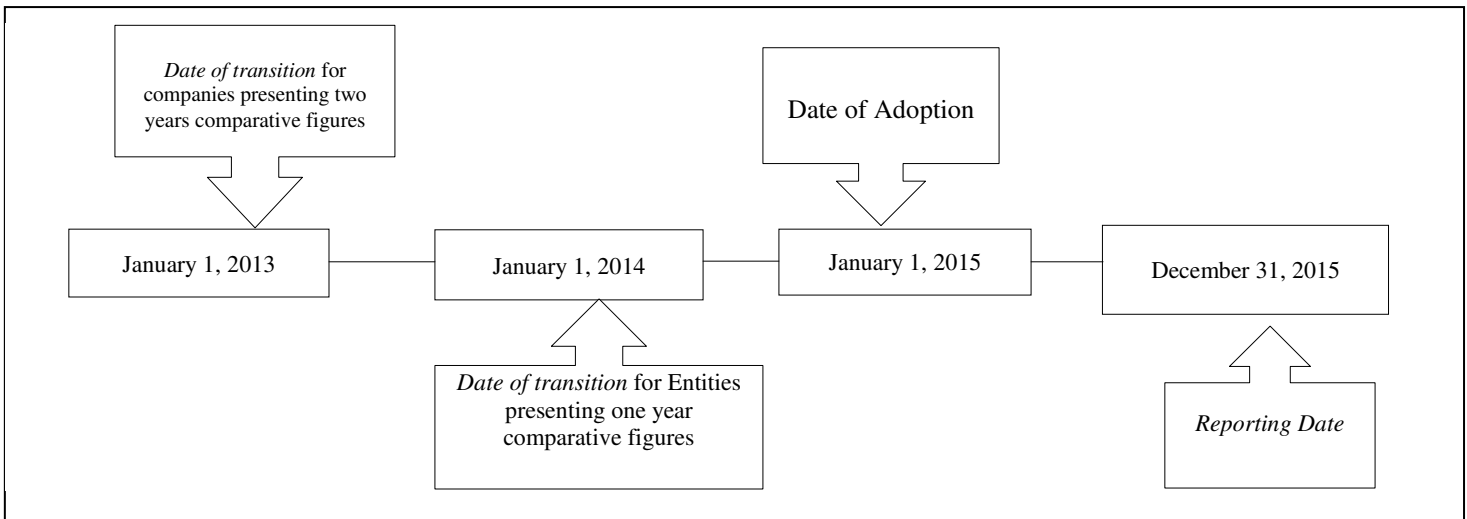


Figure 2

6. Conclusions

Financial decisions are made based on the financial information produced by accountants. Accountants produce this financial information based the requirements required by accounting standards which describes the measurement, recognition, presentation and disclosure of financial economic events. The requirements of these standards were vary from country to country and hampering the comparability of accounting information. Accounting Standards; however, have passed through various life cycle and reached an era of having a single high quality global accounting standards which are known as International Financial Reporting Standards (IFRSs) which are being used in more than 100 countries across the globe even though still variation is expected as neither the IFRS setting body- IASB nor IASB overseeing body- IFRS Foundation empowered to enforce their implementation and follow up.

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