

Convergence of Accounting Standards

Topic Gateway Series No. 4



About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

About the Technical Information Service

CIMA supports its members and students with its Technical Information Service (TIS) for their work and CPD needs.

Our information specialists and accounting specialists work closely together to identify or create authoritative resources to help members resolve their work related information needs. Additionally, our accounting specialists can help CIMA members and students with the interpretation of guidance on financial reporting, financial management and performance management, as defined in the *CIMA Official Terminology* 2005 edition.

CIMA members and students should sign into My CIMA to access these services and resources.

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Convergence of Accounting Standards

Definition and concept

In a financial reporting context, convergence is the process of harmonising accounting standards issued by different regulatory bodies. One example might be the convergence of International Accounting Standards (IAS) and US Standards.

The objective is to produce a common set of high quality accounting standards to enhance the consistency, comparability and efficiency of financial statements.

Context

In the current syllabus, CIMA students will learn and may be examined on this topic in Paper P7 Financial Accounting and Tax Principles. Study Systems for these papers are available from CIMA Publishing.

Overview

There are two aspects to the current convergence debate.

- International Convergence – the process within which the International Accounting Standards Board (IASB) and National Standard-Setters (NSS) are converging their respective financial reporting standards into one global set of accounting regulations.
- National GAAP Convergence – the adoption of International Standards as national GAAP. For example, the Accounting Standards Board (ASB) in the UK is working to converge its own financial reporting standards with those of the IASB.

The two aspects are clearly intertwined: the IASB works with the NSS in one country to converge IAS and local Generally Accepted Accounting Practice (GAAP), which has implications for the convergence of local GAAP in another country with IAS.

Convergence in practice

An international perspective

A single global comprehensive set of accounting standards is a conceptual ideal.

- It would help to ensure the comparability of financial statements
- It would allow companies to enjoy a lower cost of capital as a result of their financial statements being more readily understood. A single set of accounting standards would ensure lower barriers to the free movement of accountants in business across jurisdictions.

Significant events on the road to international convergence have been:

- March 2002 - EU Decision to adopt IAS for the consolidated accounts of its listed companies
- September 2002 - the Norwalk Agreement in which IASB and FASB each acknowledged their commitment to develop high quality, compatible accounting standards for both domestic and cross-border financial reporting
- October 2004 - the IASB and the Accounting Standards Board of Japan agreed to discuss a joint project to minimise differences between IFRS and Japanese accounting standards, with a final goal of convergence of their standards
- January 2006 - Canada's Accounting Standards Board approved a plan for convergence with IFRS
- February 2006 - the Chinese Ministry of Finance announced the adoption of a new Chinese accounting standards system to bring about substantial convergence with IFRS
- November 2007 – the US SEC announce that convergence has progressed sufficiently for them to remove the requirement for overseas companies to file a reconciliation to US GAAP with their IFRS financial statements
- February 2008 – the US SEC announced that their 2008 agenda would include a continuation of the progress being made in the US towards acceptance of IFRS for domestic filers.

There are now over 100 countries worldwide that either require or allow the use of IAS for financial statements. This figure is expected to grow to 150 countries by 2011.

Key to this continued movement towards the use of international standards is the acceptance of IAS in the US. Although international standards and US GAAP are not identical, there is a general acceptance by the SEC that convergence has progressed sufficiently well to date and there is a programme in place to bring them even closer together. The IASB agenda still contains a number of convergence projects, including:

- joint ventures
- impairment
- income tax
- research and development
- consolidation
- financial statement presentation
- fair value measurement
- revenue recognition
- pensions.

The European perspective

The EU is one of the major users of IAS in terms of market capitalisation. Approximately 8,000 European companies report their consolidated accounts using IAS. As such, the European Commission (EC) is particularly interested in the consequences of pace of convergence between US GAAP and IAS. The US accounting system is generally recognised to be more rules-based than its international counterpart, which is known to be principles-based.

Supporters of a principles-based regime argue that a rules-based system is easier to circumvent. This issue has particularly concerned European regulators and resolution of this tension is crucial to continued international convergence.

The removal of the reconciliation requirement by the SEC referred to above is of particular interest to Europe. There are approximately 400 EU companies which are listed in both the EU and on a US stock market. The accounts of these companies are prepared using IAS and they need to file a reconciliation of their results to US GAAP. It is estimated that reconciliation work (including audit assurance) costs the largest companies up to ten million Euros.

Once International Financial Reporting Standards have been issued by the IASB, they need to be endorsed by the EC before they can be used in Europe. At the present time, there are certain sections of IAS 39 Financial Instruments that have not been approved for use by European companies. This so-called 'carve-out' has the potential to delay the benefits of convergence for European companies filing their financial statements in the US.

The original relaxation of the requirement to include a US GAAP reconciliation was for those companies preparing their accounts using IFRS 'as published by the IASB', not 'as endorsed by the EC'. As a result of representations by the EC, the SEC agreed to a two-year exemption for European companies, but after that either the 'carve-out' must be removed or a US GAAP reconciliation must be included.

National GAAP convergence in practice: a UK perspective

Along with its European partners, the UK requires listed groups to prepare their consolidated accounts using IAS. Unlisted groups, subsidiaries of listed groups and other companies are not required to use IAS but may do so. Those that do not use IAS need to apply the principles of UK GAAP.

Consistency between UK standards and IAS is important:

- for the credibility and understanding of financial reporting
- for companies choosing to continue preparing their financial statements under UK standards, but who also wish to ensure consistency with IAS in their financial statements
- in facilitating the movement of business accountants between organisations using either UK GAAP or IAS.

In March 2004, the ASB issued a discussion paper *Strategy for Convergence of UK GAAP with IAS*. Here the ASB proposals were to adopt UK standards based upon the principles of IAS. There would be a phased approach to convergence rather than the 'big bang' approach as adopted by the EU in respect to the introduction of IAS. CIMA supported this strategy, along with many others.

The next step in the ASB's due process was to issue an exposure draft in March 2005. The draft 'Accounting Standard-Setting in a Changing Environment: the Role of the ASB' reiterated the ASB's view to converge with IAS, using a phased approach. The aim would be to bring UK standards fully in line within a period of three to four years.

The impact of the first joint IASB/ FASB consultation

During the consultation period, the IASB issued an exposure draft on business combinations. This document was a result of a joint project with the FASB. Commentators felt that it contained some quite fundamental changes to the principles of IAS and also highlighted the complexity of trying to converge a rules-based system with a principles-based system. Most respondents to the IASB's exposure draft felt that the correct balance had not been struck and rejected the joint IASB/ FASB proposals.

Many respondents to the ASB exposure draft felt the time was right for the ASB to reconsider its phased approach to convergence. They favoured a pause in convergence efforts before a 'big bang' implementation. The ASB listened to the views of its constituents and now proposes to issue new IAS-based UK accounting standards that will not be mandatory before a specific date. This was originally expected to be financial years beginning on or after 1 January 2009 but is now expected to be later.

The ASB website lists the following convergence projects as current workload:

- business combinations
- inventories: construction and service contracts (FRED 28)
- property, plant and equipment: borrowing costs (FRED 29)
- disposal of non-current assets and presentation of discontinued operations.

The IASB are developing an accounting standard for small and medium sized companies (IFRS for SMEs). This is causing an interesting debate within the UK. At present, listed UK companies must report using IFRS, while unlisted or private companies are subject to a two-tier GAAP system. The UK's financial reporting standard for small entities (FRSSE) is available for SMEs to use, whereas full UK GAAP applies elsewhere.

There are two schools of thought in the UK at the moment regarding the IASB's IFRS for SMEs. The first believes that the SME standard, when published, would be applicable for all companies in the UK other than those that apply full IFRS. The second school would retain the FRSSE for our smallest companies.

The ASB held a public round-table discussion in January 2006 to address this subject. However, no consensus was reached. To date, the ASB has produced no guidance as to who would have to apply the proposed SME standard.

CIMA believes that the SME standard should not be applicable to our smallest

companies, which should continue to use the FRSSE. The requirement to use full IFRS should be extended to include larger unlisted public interest entities. The SME standard would apply for those companies falling between these two categories.

After a period of 'watching and waiting', it is anticipated that the ASB will start to move the convergence debate forward again in the UK in 2008.

Further information

Articles

Full text available from Business Source Corporate through My CIMA.

www.cimaglobal.com/mycima

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Fontes, A., Rodrigues, L. L. and Craig, R. *Measuring convergence of National
Accounting Standards with International Financial Reporting Standards*.
Accounting Forum (Elsevier), December 2005, Volume 29, Issue 4, pp 415-436

FASB and IASB reaffirm commitment on accounting convergence. *AFP Exchange*,
April 2006, Volume 26, Issue 3, pp 15-16

Books

Kirk, R. (2005). *International financial reporting standards in depth*. London:
CIMA Publishing

Kirk, R. (2004). *UK accounting standards*. London: CIMA Publishing

CIMA Mastercourses

Company accounting in the USA. To book via CIMA Mastercourses
www.cimamastercourses.com please go to Find and key in the course code
CUSA.

International financial reporting standards: core standards and update. To book
via CIMA Mastercourses www.cimamastercourses.com please go to Find and
key in the course code INAS.

Financial reporting in France and Germany: European financial reporting practices
in detail. To book via CIMA Mastercourses www.cimamastercourses.com
please go to Find and key in the course code FRFR.

The accounting standards masterclass. To book via CIMA Mastercourses www.cimamastercourses.com please go to Find and key in the course code ASMC.

Websites

The Accounting Standards Board
Available from: www.frc.org.uk/asb
[Accessed 5 March 2008]

The International Accounting Standards Board
Available from: www.iasb.org/Home.htm
[Accessed 5 March 2008]

The Financial Accounting Standards Board
Available from: www.fasb.org
[Accessed 5 March 2008]

The Federation of European Accountants
Available from: www.fee.be
[Accessed 5 March 2008]

The European Financial Reporting Advisory Group (EFRAG)
Available from: www.efrag.org/homepage.asp
[Accessed 5 March 2008]

EU Financial Reporting News
Available from: <http://digbig.com/4xxag>
[Accessed 5 March 2008]

Deloitte have a website dedicated to developments in International Accounting Standards and Convergence projects of national standards-setting bodies.
Available from: www.iasplus.com/index.htm
[Accessed 5 March 2008]

Further information

Stay up-to-date with developments in the field of financial reporting by reading the Financial Reporting News section of CIMA's electronic newsletter Insight published monthly.

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Community of practice

Registered community members

If you have received confirmation from CIMA that you are a registered member of the Financial Reporting Community of Practice you can access the online discussion forum through My CIMA.

Available from: www.cimaglobal.com/mycima [Accessed 5 March 2008]

Purpose

The Financial Reporting Community of Practice has been set up for members who are directly affected by financial reporting issues and developments. Community discussions will be focused on, but not limited to, public consultations on financial reporting for which CIMA is developing a response. In addition, news items and other sources of information that community members may not be aware of will be highlighted.

Further information on purpose and discussion topics.

Benefits of participating

Members currently involved in financial reporting, will find that active participation in community discussions is a convenient, cost-effective way of helping to meet their CPD needs. This will be especially useful for experienced practitioners who may find it difficult to identify challenging CPD opportunities in this area.

Community members will be able to readily access each other's expertise, share good practice, and benefit from networking and benchmarking opportunities.

An overview of the benefits of participating.

Opportunity to join

A number of members have been invited to join the financial reporting

community of practice. They were selected because their employment details indicate that they will be able to provide useful practical insight and experience, and are likely to benefit the most from participation.

If your current professional role and expertise in this area would enable you to contribute to forum discussions, and you would like to join this community please email tis@cimaglobal.com or phone Bill Haskins on +44 (0)20 8849 2385.

Further information

Topazio, N. *Financial reporting. Financial Management*, February 2007, p. 30. Available from: www.cimaglobal.com/financialmanagement [Accessed 5 March 2008]

Topazio, N. *IFRS: is the worst still to come? CIMA Insight*, February 2007. Available from: www.cimaglobal.com/insight [Accessed 5 March 2008]

Communities of Practice topic gateway through My CIMA
www.cimaglobal.com/mycima
[Accessed 5 March 2008]

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First published in 2006 by:

The Chartered Institute of
Management Accountants
26 Chapter Street
London SW1P 4NP
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Printed in Great Britain

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