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The Emergence of Harmonization in Accounting Standards: A brief analysis

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Abstract

This study considers the emergence of harmonization in accounting standards by justifying the needs and rationale for the harmonization process. An attempt has been made to find out the various institutional efforts behind the harmonization process. This article is purely based on secondary data. Overall the study indicates the necessity for harmonization of accounting standards, its benefits and impediments. The article also depicts the results or the outcome of harmonisation that is the introduction of international financial reporting standards which is the single set of accounting standards introduced in 2001.

Keywords

Harmonization, accounting standards, financial statements, IFRS.

1.Introduction:

Harmonization of accounting practices aims at bringing down the disparities that exist in the financial reporting system practiced by different countries owing to their own sets of socio economic political, cultural and legal systems. The purpose of harmonization is to increase the comparability of accounting practices as followed by different nations across the globe. Standardization often used as synonymous to harmonisation, too aims at reducing disparities in accounting practices, but not without a set of rigid rules and policies guidelines as compared to the harmonization. It is the process of harmonization which is preferred to standardization, as harmonization still allows nations to enjoy certain degrees of freedom while preparing the financial reports than under the standardization. Nevertheless, it is mostly through standardization that harmonisation of accounting policies is achieved.

2.Objectives of the study:

- to understand the concept of harmonization and its needs.
- to describe the process of harmonization.
- to discuss the various institutional efforts to achieve harmonization.
- to trace out the impediments to harmonization.

3.Review of literature:

Wiley (2005), “Even if the harmonization is achieved, this will not be fully as there still will be differences in preparation and presentation of financial statements due to reasons such as taxation, culture and the political factors that shape up the accounting standards in any country.”

Garrido, Leon and Zorio (2002), stated that “the globalization has been one of the main drivers of moving towards harmonization by eliminating differences. This has been increasingly important in the case of multinational companies when operating internationally and using different sets of reporting standards which made is less efficient to compare the financial statements.”

Kirk (2005), states that “the trends towards greater globalization, the motivation of companies for seeking a uniform accounting system are strong.”

4.Research methodology:

This article is based on secondary data collected from the various textbooks journals and websites related to Commerce.

5.Meaning of Harmonization:

Harmonization is the process by which differences in financial reporting practices among countries are reduced, with a view to make them comparable and decision- useful across the globe. It is a process of increasing the comparability of accounting practices by setting bounds to their degree of variation. In the accounting context, harmonization is the process aimed at enhancing the comparability of financial statements produced in the different countries.

In a simplest way, harmonization means not only bringing out uniformity by reducing alternatives and differences in procedures by setting specific bounds but embraces a blending and combining the elements of accounting practices of various countries into an orderly structure. There is pressure for harmonization of divergent accounting practices not only from the users of financial statements but also from those who regulate and prepare them. Pressures came from investors and financial analyst to facilitate investment and credit decisions. The financial analysis are of the view that international diversity in accounting practices has enough potentiality to destroy the international flow of capital. The investors are also putting pressure for harmonization as they desires that financial information's should not only be intelligible but comparable also. Increased number of MNCs on global arena also calls for increased harmonization. Lack of harmonization in different accounting standards developed by different countries also imposes financial burden on MNCs.

6.Need for Harmonization:

The important reasons which necessitate harmonisation of accounting practices are well contained in the observation made by Saudagaram, “While the initial efforts at harmonization were mainly campaigned by political bodies and professional accounting organizations, current pressures to harmonise are driven by investor groups who use financial statements, multinational companies which prepare financial statements, regulators who monitor capital market, the securities(including Stock Exchange) 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”.

7. Reasons for Harmonization:

- Diversities in measurement of business income

Diversities exist in the measurement of business income due to the differences in accounting practices across nations.

Example, for the same set of business transactions the profit as per Indian GAAP will be different from that calculated under US GAAP. By virtue of harmonisation of accounting practices, this difference in profit determination is likely to get substantially reduced.

- Administrative requirements

Each and every country has its own administrative requirements which differs from each other as regards financial reporting of MNCs. For instance, in the US, foreign firms are required to furnish financial information in line with the domestic firms and in accordance with the US GAAP. Consequently, non-US firms will have to translate and reconcile their financial reports as per the US accounting principles. But for the harmonization of accounting practices so that not only such translations would be avoided but also government and regulatory authorities would be in a better position to understand the financial reports of MNCs and control their operations.

- Internationalization of accounting profession

Harmonisation of accounting practices will help in internationalising the accounting profession. As harmonization aims at reducing the disparities in accounting practices across nations, accounting professionals operating in one nation will find it easy to operate in other nation as well.

- Emergence of MNCs

Harmonisation of accounting practices would greatly reduce the efforts, energy and money that are otherwise required by MNCs to put in for presenting financial reports as per country specific requirements.

In other words, different countries follow different set of accounting rules for preparation of financial reports and as such MNCs operating in different countries will have to prepare multiple sets of financial reports to meet the legal requirements of each individual country in which they operate thus incurring additional expenses. Through harmonization of accounting practices, however these expenses can be reduced as then only, one set of reports maybe just enough to meet the requirements of every country in which MNCs have presence.

- Global flow of capital

The harmonisation of accounting standards is needed to help international investors to get comparable financial information of the financial statements. The greater benefit that would flow from harmonization would be the comparability of international financial information. Such comparability would eliminate the current misunderstanding about the reliability of foreign financial statements and remove one of the most important impediments to the follow of international investment, observe turnover and harmonization would result in a more uniform financial reporting across globe, global investors will find it easy to understand the financial data and decide about their financial decisions and also it is helpful for inflow of foreign currencies results in development of economy of the nation.

8.Rationale for harmonization:

- The primary economic rationale in favour of harmonization is that major differences in accounting practices act as a barrier for flow of capital to the most efficient users.
- Investors would ideally like to direct their capital to the most efficient and productive companies globally, **provided they are able to understand accounting statements.**
- Accounting is a language of business, it is easily understood when there's consistency in this language
- Harmonization enhances comparability of financial statements, thus making them easier to use across the globe.
- Harmonization is necessary to produce comparable and credible financial information for use across borders.
- Harmonization is necessary in view of the rapid growth of international capital, capital markets and increased cross border financing.

9.Process of Harmonization:

Nor withstanding the fact that harmonization of accounting practices has many advantages as stated above, a complete harmonization would be difficult to achieve due to the socio-economic, political, legal, environmental and cultural diversities that exists in different countries. However, in endeavours have been made in past and efforts are still on both at international and national levels to minimize the deviations in accounting practices across the globe by formulating, adopting and implementing standardised accounting procedures in the form of proclaimed policy guide lines called accounting standards.

9.1 Accounting standards

Accounting standards are 'policy documents' issued by professional accountancy bodies at national and international levels, in relation to different aspects of measurement, treatment, disclosure and presentation of accounting information. The basic purpose behind issuance of accounting standards from time to time is to minimize the effects on financial statements of the diversities in accounting practices that exist between nations due to their own socio- economic, political, legal, cultural, technological and environmental setup. Thus, by providing standardised accounting policies, accounting standards help in achieving international harmony in the preparation and presentation of accounting information for use by various stakeholders at the international level, 41 accounting standards called IAS and 8 international financial reporting standards popularly called IFRS have been issued till date. Of the 41 IAS, 34 are in use now. The remaining 7

standards have been either merged with these 34 or done away with as per the changing environment similarly at the national level, i.e., in India, 32 accounting standards have been issued till date.

10.Arguments:

10.1 For

- a. Diversity in accounting standards and practices act as a barrier to capital flow across borders.
- b. Investors invest their capital in most efficient and productive companies globally provided they are able to understand the financial positions.
- c. It is the set of knowledge which made the investors to invest their capital on foreign companies which resulted in the development of the economy.

10.2 Against

- a. Complete harmonization is not practical and not viable, where the harmonization does not have the practical experimentation, where it just combines the system it is difficult to predict the future uncertainties.
- b. Harmonization is unnecessary: where this process does not suites to the under developed nations. Where most of the people are not aware of this concept and also it is difficult to adopt at initial stage.
- c. Opponents cite differs in the economic, political, legal and cultural differences to oppose harmonization.

11.Harmonisation of what?

11.1Harmonisation of

- Accounting regulation

It consists of legal framework, standards, education and licensor. A legal framework is fundamental to accounting regulation. It determines the types of entities available under the law

- Accounting practices

It is the process of recording of day today financial operations of the business entity necessary to produce the legally required financial statements. Public companies in the US must follow GAAP in their accounting practices. Two methods are followed - cash accounting and accrual accounting

11.2 Harmonization to

- Recognition issues

Revenue recognition is a generally accepted accounting principle (GAAP). That identifies the specific conditions in which revenue is recognize and determines how to account for it. Typically, revenue is recognized when a critical event has occurred and the dollar amount is easily measurable to the company.

- Measurement issues

There are specific problems that affects the different basis of accounting available to financial recording: historical cost, values to the firm, fair value, realizable value and value in use.

- Disclosure issues

There is a confusion that how to measure and identify all of the revenues, expenses, assets, liabilities and owners equity and disclose in the financial records.

12. Impediments to Harmonization:

- a. Absence of professional accounting bodies

This is because IASC operates and implement its standards through professional accounting bodies of the nations as its members and in the absence of such accounting bodies implementation of IAS in such countries becomes difficult for implementation of these standards would require necessary amendments to the exciting laws of the land to be made by the government of the respective countries which may not do it by themselves without being lobbied or persuaded by such professional bodies.

b. Economic considerations

Empirical evidences have shown that harmonization is opposed by nations due to its impact on countries economy or the specific segment of country.

An aspect of economic consideration that affects harmonization of accounting practices is the economic gap between developed and developing countries.

Given the fact accounting is the language of business, if the business itself is less developed; accounting is bound to be less developed as well.

c. Nationalisation

National pride prevent an accountant from willingly accepting the idea that his accounting principles are “inferior” to those another country, even though the accountant maybe strong proponent of harmonization. Nationalism represents political obstacles to harmonization.

13.Organizations that involved in global accounting harmonisation are as follows:

13.1 IASB – International Accounting Standards Board:

- IASB was started in 1973 as IASC.
- Over past 40 years IASB has evolved into the most prominent international accounting standard-setting organization.
- 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.
- The IASB is the independent standard-setting body of the IFRS Foundation. Its members (currently 14 full-time members) are responsible for the development and publication of IFRSs, including the IFRS for SMEs and for approving Interpretations of IFRSs as developed by the IFRS Interpretations Committee (formerly called the IFRIC).
- The IASB engages closely with stakeholders around the world, including investors, analysts, regulators, business leaders, accounting standard-setters and the accountancy profession.

13.2 IASC - INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE:

- IASC is an Independent private body.
- Formed in 1973, in the 10th International Congress of Accountants held at St. Louis by leading Accounting bodies of ten nation’s viz., Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, UK and USA.
- The IASB (International Accounting Standards Board) is the independent standard-setting body of the IFRS Foundation.
- IASC has been restructured and renamed as IASB – International Accounting Standards Board with effect from 2001.

13.2.1 Objectives of IASC were:

- 1) To formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their world wide acceptance and observance.
- 2) To work generally for the improvement and harmonization of regulations, Accounting standards and procedures relating to the presentation of financial statements.
- 3) It is important to note that nations are not members of IASC, instead accounting bodies within nations are members.
- 4) For Ex: In the US the AICPA, the main professional Accounting group is a member of IASC not FASB.

13.3 IFAC – INTERNATIONAL FEDERATION OF ACCOUNTANTS:

- Formed in the year 1977
- Body of National, Professional Accounting Organizations, represented by Accountants employed in Public, Private and Government institutions including educational to frequently interface with the profession.
- IFAC is comprised of over 175 members and associates in more than 130 countries and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry, and commerce.
- Early (IFAC has over two million Accountants from as many as 150 members organizations in over 100 countries).

13.3.1 ADDITIONAL ACTIVITIES

- 1) It works towards reducing differences to qualify a professional Accountant in the member countries.
- 2) It issues code of ethics for professional Accountants.

3) Works for providing the Government's worldwide International Public Sector standards for improving their financial Management and reporting practices.

13.4 IOSCO – International Organization of Securities Commission:

- INTERNATIONAL ORGANISATION FOR SECURITIES COMMISSION was formed in 1983.
- The International Organization of Securities Commissions (IOSCO) is the international body that brings together the world's securities regulators and is recognized as the global standard setter for the securities sector.
- In 1983, International Organization of Securities Commission was formed.
- IOSCO is comprised of Securities Regulators from more than 115 countries representing coverage of 85% of the World's Capital markets.

13.5 UN – United Nations:

1) The United Nations role in harmonization of Accounting practices has been rather limited.
 2) The list of disclosures which is suggested like Transfer Pricing, Segment Performance, R&D, employment, etc., was not well accepted by most of the industrialized nations.
 3) However, UN's recent effort in bringing harmony in International Accounting practices in the line of IASC and Environmental reporting has been a success.

- The UN's involvement in harmonization is mainly restricted to
 – Disclosure of Accounting and Non-Accounting Information by MNCs/TNCs.

The UN Security Council established the "Centre on TNCs" in 1974 to assist the various groups working on the projects of the commission.

- In 1976, the Group of Experts on ISAR- International Standards of Accounting and Reporting was created.
- In 1977, the Group of Experts on ISAR submitted its report to the UN Security Council.

13.6 OECD – Organization for Economic Cooperation and Development:

- OECD comprises of 29 member countries which produce 2/3rd of the world's goods and services.
- OECD was formed in 1960 consists of 24 developed countries.
- To meet and discuss problems of mutual interest and harmonize their policies in important International Issues.
- OECD is often called RICHMAN's CLUB
- All member countries of OECD have committed to

a. market economy; and
 b. pluralistic democracy.

- OECD's efforts on accounting harmonization includes 'ad hoc Working Group on Accounting Standards' which (or) Activities:

– Supports current efforts by international, regional and national bodies to promote accounting harmonization.
 – Functions as a Forum for the exchanges of views on UN efforts on International Accounting and Reporting Standards.
 – Provide technical clarification to the terms used in Disclosure guidelines.

- In 1976, the OECD issued a Code of Conduct for MNCs that include recommendations for Annual Report Disclosures.
- In 1976, OECD had issued a 'Code of Conduct' entitled "Declaration on International Investment and Multinational Enterprises" for Financial reporting by MNCs.

13.7 EU – European Union:

THE EU has its origins in 3 pans – European treaties from the 1950s

1. The European Coal & Steel Community
2. The European Atomic Energy Community
3. The European Economic Community.

– Aims:

1. Harmonize Accounting principles and thereby
2. Enhance comparability by
3. Laying down minimum standards of "presentation, publication and Audit. "Fourth Directive was implemented in the year 1978 after almost 15 years of negotiation, revision and debate.

14. Outcome:

Recognizing the need to harmonize diverse accounting policies and practices prevalent in all the countries of the world, various organizations such as IASB, IFAC, IOSCO, OECD and UN worked for the enforcement of international financial reporting standards in 2001. IFRS is a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements. This single set of accounting standards would enable internationally too standardised and assure better quality on a global screen.

15. Conclusion:

Harmonization is aimed at reducing differences in financial reporting practices around the world. The goal is to achieve some level of compatibility in the way financial statements are prepared and practiced. When international harmonization occurs the difficulties for companies and individuals considerably decrease in presenting the financial statements and their interpretations. If international harmonization is achieved many countries would benefit from it as it would improve the access to the international financial markets and improve the confidence and knowledge of investors which may earn trigger and increase in future investments.

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