# The Possibility of International Financial Reporting Standards to be Accepted as International Accounting Standards

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**Abstract:**

In recent years, globalization of the economy has revealed the necessity for international accounting standards. Since accounting is a language of business, financial statements (F/S) prepared by each company play a very important role as a resourcein evaluatinga company's financial position and operational results. Since companies have become more and more internationally active, it is beneficial for companies to use worldwide accounting standards.Generally, each country has its own accounting standards. When companies have international operations, they prepare their F/S by using their own accounting standards; at the same time, a second F/S is generated by using internationally accepted accounting standards. U.S. GAAP, which is the accounting standard in the United States, has been used when preparing F/S for international purposes since a majority of business transactions are with the U.S. However, International Financial Reporting Standards (IFRS) prepared by the International Accounting Standards Board (IASB) are currently accepted and now over 100 countries have adoptedthem as their accounting standards. Since the European Union (EU) adopted IFRS, European companies are required to use IFRS. In 2002, the number of countries that switched their accounting standards to IFRS increased, and it has been increasingsince then.

Under such circumstances, the U.S. had an agreement with IASB to reduce the differences between IFRS and U.S. GAAP. It is not a simple task but they have been working on the project since 2002. In 2007 the Securities and Exchange Commission (SEC) dropped the reconciliation requirements that applied to foreign companies. This means that the U.S. accepts financial reports prepared under IFRS.This change brought

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some unfairness toward the U.S. domestic companies which are also internationally active. These domestic companies expect the SEC to open this rule to them soon. However, progress has been slowing down.
Another economically strong country, Japan, also has difficultywith this issue. Japanese accounting standards have been well-organized. However, they must be revised to accommodate more foreign investors after the collapse of the "Bubble Economy." Now Japanese accounting standards needrevision to make them equivalent to IFRS. It will be a big issue for the Japanese government to keep making revisions whenever IFRS are updated, or tochoose convergence or adoption of IFRS. Under the current shadow of economic crisis in the EU and worldwide political issues, the kind of attention IFRS will receivewill be a very interesting topic of research in the near future.

## 1. Introduction:

International Financial Reporting Standards (IFRS) arecurrently a big issue in the business field. IFRS are Accounting Standardsthat have been accepted by over one hundred countriesto date. The expansion of IFRShasoccurred during the past ten years or so. The number of countrieswhich accept IFRS hasbeenincreasing. In the past, accounting standards weredeveloped in each country for its own use. They were developed domestically and had no need to consider other countries.Financial statements (F/S) prepared by companies play a very important rolein making operational decisions.Theyare the sourcesfor analysis of the companies and their financial affairs; therefore, they must provide relevant and reliableinformation.In the recent globalization of the economy,Financial Statements prepared according to each country's standards were nolonger effective. However, having common standards to prepare F/S solves this problem.Having IFRS as a common language of business is onesolution, and it will make F/S useful and valuable for users at an international level. However, it is not an easy task to change standardswhich have been used for many years.

It is said that the United States (U.S.) and Japan are the key to the situation because they are strong economic countries and they have not yet accepted IFRS. International accounting standards cannot be discussed without considering some political issues and power struggles among countries. Research on the issue of international accounting standards and what kind of role they play has been conducted. First, the roles of accounting standards in the business field and the needs of domestic and international accounting standards werestudied. Second, research was done to understandIFRSspecifically, andthe relationship between globalization and increasing number of countries incorporating IFRS. Finally, how the U.S. and Japan have been handling the situation was researched. These findings will bring some answers to the above questions related to IFRS.

## 2. The Importance of Accounting Standards

### 2.1. The Role of the Accounting System:

All companies must keep records of their daily financial activity and report their financial results as F/S at the end of thefiscal year. These statements tell the companies' financial position, operating resultsand cash flow within a year and/or at the end of fiscal year. F/S are utilized by investors, bankers, government agenciesand managers as a resource to understand operations of a company. Company outsiders read F/S to evaluate each company's operational condition, financial position for future investment, lending money, orother purposes. For managers, F/S reveal results of actions and decisions they made during the year; at the same time, they assist in making necessary adjustments for future operation in order to achieve the companies' goals.

### 2.2. Needs of Accounting Standards:

F/S play important roles among these users; especially, investors and bankers, because they compare and analyzefinancial position and operational results among companies in the same industries within a certain year; at the same time, different years under one company in order to evaluate and forecast its future condition.Therefore, F/S must be useful, valuable, and effective for users.Each country has its own accounting standards in order to prepare useful and comparative F/S.When business entities expand their operations into more than one office,facility and/or factory in other countries, they are required to prepare more than one F/S under different accounting standardsbecause they are operating in differentcountries, which have different accounting standards.

### 2.3. Role of Accounting Standards Among International Businesses:

Therole of F/S is the same under any standard in the world, and they provide very important financial information for international business. However, each company has its own accounting standards to control itsdomestic companies. For international business, F/S prepared by different rules and regulations are unable to provideas much useful information as they should. For example, Japanese companies' F/S are prepared in Japanese language, following Japanese accounting standards. These statements must be translated intoEnglish andreconciled under the accounting standards requested by their overseas business partners.U.S.Generally Accepted Accounting Principles (GAAP), which is the accounting standards ofthe U.S., has been utilized to prepare financial statements for international businesses. When companies have no international activity, companies and users of F/S do not experience any need forinternational accounting standards. Since many international operations and/or transactions occurwithin the U.S., U.S. GAAP has been fulfilling itsrole effectively. However, economic globalization has changed this situation rapidly, and the need for one international accounting standard has increased since the late 1900s.

## 3. Understanding IFRS

### 3.1. What are IFRS:

"IFRS are a set of standards promulgated by International Accounting Standards Boards (IASB)" (Nandakumar 2010, p.2)[1] .IFRS are the standard stated principles and require interpretation by each business entity. This is referred to as *principles-based standards*. On the contrary, U.S. GAAP containa significant number ofapplication guidance. These standards are referred to as rules-based standards.Nandakumar (2010) stated that "the IFRS approach focuses more on the business or the economic purpose of a transaction and the underlying rights and obligations instead of providing prescriptive rules (or guidance). IFRS providesguidancein the form of principles" (P.2).[2] It can be said that IFRS area capital market-oriented system of financial reporting rules.

IFRS represent international standards collectively and they "include International Accounting Standards (IAS), the Standing Interpretations Committee (SIC) Interpretations, IFRS, and IFRIC Interpretations" (Nandakumar 2010, p.2).[3] This IFRS is also known as iGAAP. According to Kieso (2010), "iGAAP includes the standards,referred to as International FinancialReporting Standards (IFRS), developedby the IASB. The predecessor to theIASB issued International AccountingStandards (IAS). Both IFRS and IASare considered iGAAP." (p.18)[4]

### 3.2. History of IFRS:

In 1973 the International Accounting Standards Committee (IASC), organized with accounting professionals from nine countries, and was found as the original international standards setter. The objective of this setting was to develop accounting standards that would be acceptable around the world in order to improvefinancial reporting internationally; especially, in the public interest. IASC issued 41 standards, known as IAS, and SIC issued by the IASC's interpretive body. Some of them were withdrawn or superseded but IAS and SIC are still in force. However, the IASC has experienced some difficulty in truly being an international standards setter due to various political struggles among countries.

In 2001 "fundamental changeswere made tostrengthen the independence, legitimacy, and quality of the international accounting standard-setting process" (Nandakumar 2010, p.4).[5] The IASB became the body of setting international accounting and financial reporting standards, replacing the IASC. New standards issued by IASB are called IFRS, and new interpretations issued by the International Financial Reporting Interpretation Committee (IFRIC) are IFRIC Interpretations.

In 2002 the EU adopted legislation that required listed companies in Europe to apply IFRS to their consolidated financial statements. This requirement brought tremendous expansion of IFRS all over the world. Also, in 2002 the Norwalk Agreement was concluded between the IASB and FASB, which is the U.S. standards setter. Under this agreement, a number of revisions for either U.S. GAAP or IFRS have already been implemented.

The year 2005 marked "the beginning of a new era in global conduct of business, and the fulfillment of a thirty-year effort to create thefinancialreporting rules for a worldwide capital market" (Epstain, 2010, p.1).[6] Many countries adopted IFRS by 2005 because the EU's requirement to prepare F/S with IFRS was launched that same year.

In 2007 the SEC"dropped the reconciliation(to US GAAP) requirement that had formerly applied to foreign private registrants" (Epstain, 2010, p.2).[7]

In 2008 the SEC went a step forward with its acceptance of IFRS and proposed to permit the use of IFRS by domestic companies in the U.S.; however, the new chairman of the SEC held back this rapid movement to accept IFRS in the U.S. in 2009.

**3.3. Current Situation:**

"The IASB places emphasis on developingstandards based on sound, clearly stated principles, from which interpretation is necessary" (Nandakumaer, 2010, p.2).[8] Due to such needs, IFRS have been incorporated rapidly all over the world. Epstain (2010) stated the following:

> Since there are about 15,000 SEC-registered companies in the USA that prepare financial statements in accordance with US GAAP (plus countless non-publicly heldcompanies also reporting under GAAP), the vast majority of the world's large businesses arenow reporting under one or the other of these two comprehensive systems of accounting andfinancial reporting rules.[9]

It has been said that over 100 countrieshaveadopted IFRS as their national accounting standards. However, some people still believe that the global acceptance of IFRS is not complete yet because some important jurisdictions in the financial world such asthe U.S., which has heldthe largest economic power ofthe world for years,has not fully accepted

IFRS for financial reporting of their domestic companies. Unless the U.S. accepts IFRS as its national accounting standard, it maybe difficult to call IFRS the world's standard. Currently, the SEC has been working on convergence with IFRS by the year 2016. IFRS would be the world accounting standards then if this convergence would be completed as the original plan.

## 4. What Caused theInternational Rapid Expansion of IFRS

### 4.1. Globalization of the Economy:

Nandakumar (2010) stated:

> With such a robust wave of globalization surging through the world, businesses acrossthe globe cannot remain unaffected by it no matter how hard they try. With the advent of theWorld Wide Web and the knocking down of trade barriers across national boundariesthrough global initiatives such as the setting up of the World Trade Organization (WTO), interactional trade between businesses across the globe has become quite simple and attractive.[10]

Business enterprises move their production facilities to countries which are able to provide work force at low cost because it keeps the cost of operation to a minimum. At the same time, many publicly-listed companies expect to receive more fundsfromoverseas investors. Various changes in the existing rules and regulationsallow investors to invest easily in foreign entities, and the number of securities trading has increased. Under this globalization, entities have to deal with different accounting standards and prepare their F/S. For example, when companies have activities outside their own countries, they often prepare more than one F/S; one utilizedby their own countries'standards and others with the other countries'standards. This situation is common among companies which have international business. As a result, this requires additional costs for companies to prepare multiple F/S every time. In addition, they have to understand each accounting standard thoroughly. The globalization of companies' operations and securities tradingrequireaccounting standards which can be accepted internationally.

### 4.2. Requirements by the EU:

The major breakthrough came in 2002 when the EU adopted and required application of IFRSfor listed companies in Europe. This legislation came into effect in 2005 as briefly explained in the section on 3.3 Current Situation. Since then, "more than 8,000 companies in30 countries, including countries such as France, Germany, Italy, Spain, and the UnitedKingdom adopted IFRS" (Nandakumar, 2010, p.8).[11] This adoption of IFRS in Europe leads the idea that IFRS has replaced national accounting standards and requirements as the basis for preparing and presenting group financialstatements for listed companies in Europe. Therefore,it can be said that the decision made by the EU is a major milestonein the history of international accounting.This caused many other countries outside of the EU to adopt IFRS.

### 4.3. Adoptions by Developing Countries:

Many other countries outside Europe have been moving towards IFRS since 2005. Because each country has its own accounting standards, each country has a choice of "Convergence" or "Adoption" when they consider incorporating IFRS. "Convergence" is the way to make their own standards similar and equivalent to IFRS by revising their standards. "Adoption" is the way to change theiraccounting standards into IFRS. One reason of increasing adoption of IFRS among the developing countries is that the countries that do not have well-organized accounting standards. Also, countries that have their own accounting standards find it easy for them adopt IFRS as long as they have businessin the EU. They may choose convergence and modify their own standards, but it seems that more countries tend to choose "Adoption."Thomatsu stated the following as the reason for this tendency:

> In order to convergence to IFRS, they have to check the differences between IFRS and own standards constantly. If necessary, they have to revise all the time. This checking the differences between two standards and revising them is a time consuming task; at the same time, this task is very costly. (p.32)[12]

Also, countries'equivalence between IFRS and their ownstandardsmust be approved in order to be accepted in the securities market in the EU.Until its government chooses an adoption or a convergence of IFRS, business entities have to keep preparing more than one financial report by usingits own standards and IFRS. It is costly and time-consuming. Therefore, more countries are adopting IFRS even though they must spend a lot of hours and cost for this adoption.

## 5. How to Deal With IFRS in the U.S.

### 5.1. Past Actions by the U.S.:

As discussed in the section on 3.2 History of IFRS, the FASB, which is the U.S. accounting standards setter, and the IASB, the standards setter of IFRS, had one agreement, the Norwalk Agreement, and called for convergence of the respective set of standards, and "indeed a number of revision of either US GAAP or IFRS have already taken place to implement this commitment, with more changes expected in the immediate future" (Epstein, 2010, p.3).[13] Under this Memorandum of Understanding

(MoU), the FASB and the IASB spent years to "make their existing financial reporting standards fully compatible as soon as practicable, andcoordinate their future work programs to ensure that once achieved, compatibilityis maintained" (Kieso, 2010, p.18).[14] Since these two standards have been developed for the different ideas; one is Principle-Based Standards, which is IFRS, and the other is Rules-Based Standards, which is the U.S. GAAP. Because of these differences, IFRS tend to be simpler and less stringent in its accounting and disclosure requirements. On the contrary, U.S. GAAP is more detailed.

In 2007 the SEC dropped the reconciliation requirement that had formerly applied to foreign private registrants. This means foreign business entities are able to file their report prepared by IFRS, with no need to prepare U.S.GAAP any longer. This is one result of the agreement, which made the IASB and the FASB work hard to eliminate their major differences in order to develop common standards. By late 2008 the SEC had begun the process of acceptance of IFRS; first forthe largest companies in the industries having (worldwide) preponderance of IFRSadopters, and later for all publicly held companies. However, in 2009the new chairman of the SEC showed his concern that "the move to IFRS should move more slowly than had previously been indicated" (Epstein, 2010, p.2).[15]

**5.2. Future Actions by the U.S.:**

The SEC's action in 2007 was to droprequirements, which previously was for all F/S to reconcile to U.S. GAAP.This decision assisted foreign entities by reducing cost andoperating complexity. Since many countries incorporate IFRS, most of foreign entities prepare their F/S only by IFRS. However, the U.S. companies that have international operations have to prepare their F/S by U.S. GAAP domestically and IFRS internationally. This causes extra cost and timefor these companies. Therefore, some ideas have been discussed among CPAs. Due to this special treatment for foreign entities and "fairness and free market competition, all domestic companies should have theoption to apply IFRS" (Anderson, 2010, p.34).[16] Also, AICPA recommends that "whether or not the SEC decides to incorporate IFRS into the U.S. financial reportingsystem through an endorsement/convergence approach, we believe U.S. issuers shouldbe given the option to adopt IFRS as issued by the IASB" (PR News, 2011, p.1)[17]
In 2011 the SEC issued a staff paper entitled "Work Plan for the Consideration of Incorporating International Financial Reporting System for the U.S. Issuers-Exploring a Possible Method of Incorporation on May 26."In this paper a new plan of adoption of IFRS in the U.S. was discussed. Forgeas (2011) explainedin this paper that it was "addressed preparers' issues and acknowledges the possibility of seeing a"U.S.-flavored IFRS" being developed."[18] Foreges (2011) concluded the following:

We strongly believe that IFRSshould be adopted in the U.S., but the recent transition plan presents significant riskthat could with the U.S. FRS instead of IFRS. Unfortunately, this would lead to countries developing the samenational flavored deviations and in a near future we would be back to square one: domestic standards.[19]

By reviewing what has been happeningconcerning the workbetween the IASB and the FASB, Brice (2011) also concluded:

An awareness of the delays and the changes to the timetable is essential for preparers and users of financialinformation in ensuring that they are ready for the conversion to IFRS and that appropriate accounting policy andfirst-time adoption choices are made when that day finally happens.[20]

The working together in order to reduce the differences between IFRS and U.S. GAAP seems to bring the modified IFRS and U.S. GAAP. They could be the similar one soon or later. It can be "U.S.-favored IFRS" or "U.S. FRS" as a result. However, if it takes too long, their efforts would be worthless under the current rapid globalization of economy. Since the U.S. is one of big country holding back the situation, how the U.S. is going to deal with this issue will bring a very interesting result.

## 6. How to Deal with IFRS in Japan

### 6.1. Past Actions by Japan:

From the end of 1900s to the early 2000s Japan needed to reviseitsfinancial system after the collapse of the "Bubble Economy." In order to collectmaximumfundsfor operations, companieshad to expect funding from foreign investors. Therefore, Japan had to have an acceptable accounting system and standards for them. It was not a simple task butJapan gradually began to modify the accounting system year by year. In those days the EU requestedthe Japanese business entities, which were listed in the EU, to prepare their F/S by the standards equivalent to IFRS. This caused Japan to make revisions resulting in the Japanese GAAP. In late 2008 Japanese GAAP was approved, its equivalency to IFRS recognized. However, the fast expansion of globalization pushed Japan to consider "Convergence" or "Adoption" of IFRS. In 2009 the Financial Service Agency (FSA) in Japan announced the possible conversion of IFRS by the year of 2016. Many business entities which would be affected by this situation started to prepare for the coming changebecause they had no choicebut to startgetting readyfor it. However, it is said that thedeadline has been postponed due to the huge disaster in 2011.

### 6.2. Future Actions by Japan:

The Japanese government made a decision toauthorize convergence with IFRS, saying that this convergence will be completed in 2016 if everything is performed as planned. This change will take time and cost for companies in Japan. Some large international companies, originally Japanese companies, have been preparing their F/S by U.S. GAAP and/or IFRSdue to requirements by the U.S. and/or the EU. Even so, change of accounting standards is a hugeproject for any company. Itcausesnot only accounting results but various modificationswithin the companies; such as IT systems, personnel, product handling, sales forceandmuchmore. The staffmust understand how important and complicated it is to change accounting standards. In addition, the outcome of the upcoming convergence to IFRS will bring very different operational results from the F/S prepared under Japanese GAAP.How companiesshould deal with such a situation has to be discussed by professionals and responsible personnel.This modification willtake years before completion; therefore, these companies need to know the final decision of the Japanese government. Some might expect this movement will fade out due to the financial crisis in the EU and other problems the EU has been experiencing in recent times.

## 7. Conclusion

Accounting Standards are very importantin preparingfinancial statements for all companies. Investors, creditors, bankers, government agencies, managersand owners evaluate companies by analyzingfinancial statements. The finalized F/S have to be useful and efficient for the users. Therefore, having well-organized accounting standards is very important. Under the current globalized economy,companies that need finance for their operations expect to receiveinvestment funds from all over the world. By preparing their F/S under internationally accepted accounting standards, the companies can expect to have more investment from all over the world. This research revealed that power struggles between the EU and the U.S. have directly affected the process to create one internationallyaccepted accounting standard. The U.S. expects to have U.S.-Favored IFRS by revising U.S. GAAP and IFRS. But the change of the economic situation in the EU in 2011will influence this issue. At the same time, Japan,one of the big economic countries and said to be one of key countries regarding this issue, has no way to appeal their thoughts and ideas.Moreover, Japan is one country caught between the power struggle of the U.S. and the EU. However, current rapid globalization of the economy does not allow much more time before finalizingcommon international accounting standards. This is the urgent issue to be solved. What kind of actions the U.S. and Japan will take and what kind of influence they will have are interesting issues to be studied in the future.

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