What exactly is convergence?

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Abstract: From its inception in 1973, the former International Accounting Standards Committee (IASC) worked towards harmonising global accounting standards by developing standards that could serve as a model on which national standard setters could base their own standards. The IASC was replaced by the International Accounting Standards Board effective in 2001. Its mission became one of convergence of global accounting standards – development of a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent, and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions. This paper examines the ways of achieving such convergence.

Keywords: IASs; IFRSs; IASB; convergence.

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1 Introduction

When the professional accountancy bodies in nine countries agreed, at the 10th World Congress of Accountants in Sydney in 1972, to create the International Accounting Standards Committee (IASC), they all subscribed in writing to a very lofty goal. They committed to use their best efforts to bring about adoption of International Accounting Standards (IASs) as their national generally accepted accounting principles. Twenty-eight years later, in April 2001, when the IASC passed the baton on to the International Accounting Standards Board (IASB), every one of the nine countries still had its own national GAAP. And in only one of them were domestic companies even permitted to use IASs.[1]

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The goal of replacing national GAAPs with a single global set of standards was not just lofty, back in 1973, it was probably unrealistic. This was particularly true in the relatively large economies of nearly all of the IASC's founders, where national standards and national standard setters were well entrenched both professionally and politically. In at least a majority of the founding countries, relatively robust bodies of accounting standards were already in place, while the IASC was in the position of having to play catch-up.

Exhibit 1

IAS 1 Disclosure of Accounting Policies (1974), Paragraph 14

The following are examples of areas in which differing accounting policies exist and which therefore require disclosure of the treatment selected:

General
Consolidation policy;
Conversion or translation of foreign currencies including the disposition of exchange gains and losses;
Overall valuation policy (e.g. historical cost, general purchasing power, replacement value);
Events subsequent to the balance sheet date;
Leases, hire purchase, or instalment transactions and related interest;
Taxes;
Long-term contracts;
Franchises;

Assets
Receivables;
Inventories (stock and work in progress) and related cost of goods sold;
Depreciable assets and depreciation;
Growing crops;
Land held for development and related development costs;
Investments: subsidiary companies, associated companies, and other investments;
Research and development;
Patent and trademarks;
Goodwill;

Liabilities and provisions
Warranties;
Commitments and contingencies;
Pension costs and retirement plans;
Severance and redundancy payments;

Profit and losses
Method of revenue recognition;
Maintenance, repairs and improvements;
Gains and losses on disposals of property;
Reserve accounting, statutory or otherwise, including direct charges and credits to surplus accounts.

The daunting task that confronted the new IASC is evident from paragraph 14 of its very first pronouncement, IAS 1, Disclosure of Accounting Policies, which was approved in 1974 and effective in 1975. That lengthy paragraph is presented in Exhibit 1. It lists 'examples of areas in which difference accounting policies exist' in the nine founding countries. There were differences among the nine IASC founding countries on how to account for almost every major accounting question confronting business entities.

2 Harmonising national GAAPs

When the new IASC hung out its shingle in London in 1973, it faced reality by embarking on a programme of setting standards with the goal of harmonising national GAAPs. Harmonising meant:

- developing IASC standards that could serve as a model on which national standard setters could base their own standards
- narrowing but not necessarily eliminating the range of acceptable methods of accounting for particular types of transactions
- developing standards that set out broad principles but did not include the degree of detail that would almost surely put them in conflict with most of the existing national standards
- Writing standards that were more descriptive of acceptable practices than prescriptive. For example, the IASC's first segment reporting standard said:

> "Some consider it appropriate to provide guidelines on how material a segment should be before it is reported separately and to limit the segments to a reasonable number so as to avoid unnecessary complexity. Such guidelines may be 10% of consolidated revenue, or operating profit or total assets."

One of the pluses of this approach is that it led to what have lately been described as principles-based standards that required judgement in application and that contained relatively fewer exceptions and bright lines than might be found in the US GAAP and the GAAPs of some of the other founding countries.

Another plus is that by not being as overwhelming as, say, the US GAAP, while at the same time providing a reasonable level of guidance, the IASC's approach encouraged countries to use the standards in various ways. During the 1980s and 1990s, some countries – mostly smaller ones – simply got out of the standard-setting business altogether and adopted IASs as their national GAAP. Other countries either required or permitted IASs for some but not all companies, generally listed companies but in some cases all banks or all regulated financial institutions. Some countries went ahead and adopted selected standards individually, though not the entire package of IASs. Some countries required IASs as a fallback in the absence of a national standard dealing with a particular issue. And many countries looked to IASs in developing their national standards.

There were a number of minuses, of course. One was that national standard setters in the larger countries almost never adopted an IAS word for word. The differences were often quite substantive, not just wording. Standard setters in many countries that looked to IASs could not resist the temptation to make changes. Unfortunately, because the IASs

were generally modified at the national level, national standard setters' claims that their standards were 'consistent with', 'harmonised with', or 'equivalent to' IASs were often somewhat exaggerated. For example, as recently as July 2004, the accounting standards board in one of the most developed countries in Asia had been saying publicly:

> "Accounting standards in [our country] have been IAS compliant since 1972".
>
> I wrote and enquired as follows:
>
> "How is it possible that accounting standards in [your country] have been IAS compliant since 1972, when IASC was not formed until 1973 and did not issue its first standard until 1975?"

Their reply was that the date should be changed to 1978. Because that country has yet to adopt a number of IFRSs, including IAS 39 Financial Instruments: Recognition and Measurement, its standards cannot yet be described as collectively IAS compliant, though certainly some individual ones are.

As a part-time body, the IASC used steering committees not only to manage its projects but actually also to develop exposure drafts for consideration by the IASC Board. This tended to result in ad hocism in developing standards, particularly because it was not until 1989 that the IASC adopted its conceptual framework (patterned on FASB's conceptual framework). It is understandable that teams comprising representatives of different countries, working somewhat independently without the guidance that a conceptual framework provides, are likely to reach different decisions on which assets, liabilities, income, and expenses should be recognised and how they should be measured. Even to this day, the IASB *Framework for the Preparation and Presentation of Financial Statements* includes just three paragraphs on measurement concepts, and all those do is point out that historical cost, current cost, realisable or settlement value, and present value are all "employed to different degrees and in varying combinations in financial statements" without guidance on when each might be appropriate. This is another vestige of the early descriptive, rather than prescriptive, approach of some IASC pronouncements.

An obvious consequence is the mixed-attribute measurement model that pervades International Financial Reporting Standards – though the IASB has taken a number of steps in the direction of greater use of fair value measurements and standardising the definitions of fair value across standards.

Moreover, the IASC sometimes found it difficult to outlaw practices even though they were supported in only a relative handful of the IASC member countries. Examples included the following:

- reinsertion of LIFO in the IASC's final inventory standard (1975) when it had not been proposed in the exposure draft
- retention of pooling of interests accounting in both the original (1983) and revised (1998) IASC standards on business combinations
- allowing capitalisation of interest as an alternative in the IASC standard on borrowing costs (1984)
- a range of acceptable methods of reporting accounting policy changes and error corrections (standard originally issued in 1978, revised in 1993)

- allowing both the cost-depreciation-impairment model and the revaluation-to-equity model for accounting for property, plant, and equipment (standard originally issued in 1982, revised several times including 2003)
- adoption and retention of the corridor approach in the IASB's pension accounting standard (1998)
- acceptability of both the equity method and proportionate consolidation in accounting for interests in joint ventures (1990)
- the somewhat fuzzy guidance on derecognition of financial instruments in the original IAS 39 (1998) to accommodate the only two countries that had standards on the subject.

3 From harmonisation towards convergence

When the old IASC was restructured in the International Accounting Standards Board effective in 2001, the mission of the standard setter changed importantly to one of convergence of global accounting standards. The IASC Foundation is the oversight body for the IASB. Its constitution sets out the following objectives for the Board:

- to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements, and other financial reporting to help participants in the world's capital markets and other users make economic decisions
- to promote the use and rigorous application of those standards
- to bring about convergence of national accounting standards and International Accounting Standards to high quality solutions.

Objective (a) is quite a clear goal: a single set of global accounting standards.[2] Ultimately, 'single set' must mean standards that are word-for-word identical across borders – and rigorously translated from the IASB's official language, English, into other languages so that differences do not creep in via the translation process.

National accounting standards that differed across political boundaries may have made sense when companies raised money in, and investors and lenders looked for investment opportunities in, their home country. The world's capital markets began to globalise over 30 years ago, and are now so globalised that only a single set of global accounting standards can serve those who use financial statements to make investment, credit, and other decisions.

A few facts to demonstrate globalisation of the US securities markets:

- On the New York Stock Exchange, 459 non-US companies from 47 countries are listed – roughly 20% of the total listings and 33% of total market capitalisation.
- On the NASDAQ, the comparable figures are 338 companies from 35 countries – 10% of the total.

- In 1981 (just a bit more than 20 years ago) only 173 non-US companies were registered with the Securities and Exchange Commission (SEC). In 1991, there were 439 foreign registrants. By the end of 2003, there were 1,232 foreign registrants from 57 countries. Foreign securities issuers are permitted to provide US investors with financial statements in US GAAP, IFRSs, or their national GAAP. In fact, around 50 national GAAPs are submitted to the SEC. When IFRSs or a national GAAP is used, the company must present a reconciliation of income and net assets to US GAAP. But the reconciliation amounts only to a few selected financial figures on two or three pages. All of the monetary amounts in the financial statements and footnotes themselves, and all of the other financial data in the annual and quarterly reports and in filings with the US Securities and Exchange Commission, are prepared using the company's national GAAP or IFRSs. Those who use financial statements to make capital allocation and pricing decisions are not well served when presented with figures that are not comparable from one country to the next.

Globalisation is by no means restricted to the US securities markets. Here are the percentages of foreign listed companies on selected stock exchanges around the world. In most of these countries, the foreign company may submit its financial statements in its national GAAP without even a reconciliation to the GAAP in the country in which the market is located:

- London: 17% of listed companies are foreign (over 60% of market capitalisation)
- Euronext (amalgamation of the exchanges in France, Belgium, Portugal, the Netherlands): 25% foreign
- Switzerland: 31% foreign
- Germany: 21% foreign
- Australia: 4% foreign
- New Zealand: 21% foreign
- Singapore: 14% foreign.

In addition to these cross-border listings, there are cross-border markets. Often, by contractual arrangements, securities listed on one exchange also can be purchased on exchanges in other countries. And, of course, investing via the internet has made the world one giant global securities market. How to regulate such a market, and who should do it, are questions in search of answers at the moment.[3] But the case for global financial reporting standards is strong.

4 Convergence of IFRSs and US GAAP

In October 2002, following a joint meeting at the offices of the FASB in Norwalk, Connecticut, the FASB and the IASB formalised their commitment to the convergence of US GAAP and International Financial Reporting Standards by issuing a memorandum of understanding (sometimes called 'the Norwalk agreement'). The two boards pledged to use their best efforts to:

- make their existing financial reporting standards fully compatible as soon as is practicable
- to coordinate their future work programmes to ensure that once achieved, compatibility is maintained.

Compatible means the two sets of standards do not contain conflicts. Compatible does not mean word-for-word identical standards, for many reasons. The existing standards in the USA are much more detailed than IFRSs, and the USA is unlikely simply to discard all of that guidance. Moreover, each set of standards is an integrated body with numerous cross-references, links to other bodies of literature such as interpretive guidance and, in the case of the USA, links to auditing and other professional literature. Further, the FASB's scope of responsibility includes not-for-profit entities, and some of its standards are written with those entities in mind. The IASB, at least for now, is focusing on business entities. So compatible, rather than identical, standards is a more achievable goal.

The Sarbanes-Oxley Act of 2002 provided some impetus and support for the Norwalk agreement. Section 108 of the Act permits the SEC to recognise standards established by a private-sector accounting standard-setter (i.e., FASB) provided that the standard-setter considers "the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors". Section 109 of the Act provides US Government funding to the SEC-recognised standard setter.

4.1 Why the emphasis on convergence of IFRS and US GAAP?

To a large extent, national standards in most countries of the world have been based either on IFRSs or US GAAP. Despite the tendencies of national standard setters to make small or large changes to those standards, they cannot and do not ignore those two substantial and advanced bodies of literature in developing their own national standards. Therefore, a sensible way to achieve a single set of global accounting standards in a reasonable time span is to work towards convergence of IFRSs and US GAAP – in turn causing a 'trickle down effect' in those countries that continue to maintain their national GAAPs. And that is the approach that the IASB has adopted.

4.2 The IASB-FASB convergence process

The IASB and the FASB have various joint initiatives to accomplish the goal of convergence, including:

- Twice-yearly joint board meetings.
- Aligned agendas, including explicit consideration of convergence potential in all agenda decisions.
- Joint staffing of major projects.
- Short-term projects to revise their individual standards to eliminate as many inconsistencies as possible.

- A convergence research project seeking to inventory all of the substantive differences between US GAAP and IFRSs and to develop strategies for resolving them. Any recognition, measurement, presentation, or disclosure topic in which a specific accounting treatment would be permissible under one basis of accounting but would not be permissible under the other basis of accounting is included in the project scope.
- Coordination between their respective interpretive bodies (FASB's Emerging Issues Task Force and the IASB's International Financial Reporting Interpretations Committee).

In December 2003 through March 2004, the IASB amended the majority of the standards that it inherited from its predecessor, and it issued several new standards as well. Many of those changes were in the interest of convergence. The new international standards on business combinations and goodwill, for instance, are virtually identical to FASB's recent standards. Likewise for the IASB's new standard on assets held for disposal.

Specific short-term convergence projects currently under way include:

- *IASB*. provisions, segment reporting, government grants
- *FASB*. accounting changes, error corrections, exchanges of productive assets, earnings per share, inventory costs, fair value option for financial instruments, and research and development
- *Both boards*. income taxes.

Joint major projects include business combinations phase II, revenue recognition, performance reporting, and the conceptual framework.

FASB standards may soon even take on an IASB 'look and feel'. The FASB has recently announced that it will adopt the IASB's black letter-grey letter approach in its upcoming business combinations phase II exposure draft and will consider that approach for all future standards.[4]

4.3 IASB partner standard setters

The IASB works within a partnership of national standard-setters. Its constitution requires that seven IASB members have formal liaison responsibility with national standard setters in Australia-New Zealand, Canada, France, Germany, Japan, the UK, and the USA. There are regular joint meetings of the chairs of those standard setters and the IASB. A large percentage of the IASB's current active and research agenda projects are actually being managed by partner standard setters. Examples include:

Active agenda

- business combinations phase II: the USA
- convergence: the USA
- reporting comprehensive income: the UK and the USA
- revenue recognition: the USA

Research agenda

- measurement: Canada
- leases: the UK
- joint ventures: Australia, China/Hong Kong, Malaysia, New Zealand
- extractive industries: Australia, Canada, Norway, South Africa
- management's discussion and analysis: Canada, Germany, New Zealand, and the UK
- hyperinflation: Argentina and Mexico
- intangibles: Australia
- concessions: Australia, France, Spain, and the UK.

5 European Union and European economic area (28 countries)

5.1 Listed companies

In the European Union (EU), for listed companies, convergence has simply been bypassed in favour of adoption of IFRSs. In June 2002, the Council of the EU approved an Accounting Regulation requiring all European companies listed on a stock exchange in the EU to follow IASB standards in their consolidated financial statements starting in 2005. The European Parliament ratified the regulation into law in September 2002. The goal of the Regulation is to eliminate barriers to cross-border trading in securities by ensuring that company accounts throughout the EU are reliable, transparent, and comparable.

In addition to the 25 Member States of the EU, three countries are members of the European Economic Area, though not of the EU. Like the 25 members, they are committed to follow EU Directives, including the Accounting Directives. Consequently, IFRSs will be the basis for financial reporting by the 9,000 largest companies in the following 28 countries starting in 2005.

Austria	Belgium	Cyprus	Czech Republic	Denmark
Estonia	Finland	France	Germany	Greece
Hungary	Iceland	Ireland	Italy	Latvia
Liechtenstein	Lithuania	Luxembourg	Malta	Norway
Poland	Portugal	Slovakia	Slovenia	Spain
Sweden	The Netherlands	UK		

The basis of presentation notes to the financial statements of these 9,000 listed companies will refer to conformity with IFRSs. And the auditors' reports will similarly express opinions on conformity with IFRSs.

5.2 Non-listed companies

The Accounting Regulation authorises EU Member States to extend the IFRS requirement to the consolidated financial statements of non-listed companies. While there are roughly 9,000 companies currently listed for trading in European securities markets, there are an estimated 3,000,000 non-listed European companies that, by national law, have an obligation to prepare GAAP financial statements. Here is the information as of September 2004 regarding which countries are expected to do that.

- *Require non-listed companies to use IFRSs*: Cyprus, Malta, Slovakia. Several other countries may require banks and financial institutions (but not other entities) to follow IFRSs: Belgium, Estonia, Italy, Sweden, Slovenia, and Lithuania.
- *Permit non-listed companies to use IFRSs*: Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Netherlands, Portugal, Norway, Slovenia, Spain, Sweden, the UK.
- *Permit non-listed companies only to use national GAAP and prohibit them from using IFRSs*: Lithuania, Latvia, and Poland.

To the extent that these 3,000,000 unlisted companies continue to use their national GAAP by choice or by national requirement, convergence will continue to be an issue in Europe. Most of those 3,000,000 companies have a statutory (legal) obligation to prepare GAAP financial statements and, usually, to submit them to the government. Because listed companies in Europe will all use IFRSs, many of the European national accounting standard setters have indicated that they intend to base their national standards applicable to non-listed companies on IFRSs. That process has just begun.

Meanwhile, the IASB itself has embarked on a project to develop accounting standards suitable for non-listed entities (small and medium-sized entities, or SMEs). Those standards will:

- be consistent with the IASB's *Framework* and with its IFRSs
- address the needs of external users of financial statements
- be comparable across national boundaries and within a country
- allow for an easy transition to full IFRSs for entities that wish to enter the public capital markets.

The European Accounting Regulation does not apply to IASB Standards for SMEs. Unless the Regulation is broadened, each individual country within the European Union will have to decide whether to adopt those standards as its national standards for unlisted entities or whether to base its national GAAP for unlisted entities on those standards. It is not yet clear exactly what convergence will mean in Europe with respect to unlisted companies.

Parent-company statements

EU Member States are also authorised to extend the IFRS requirement to the separate-company ('parent company') financial statements of both listed and unlisted companies. Eleven of those 28 European countries are expected to permit or require

IFRSs in parent company statements. Those countries that do not require IFRSs for the separate-company statements of all companies will have to maintain their national GAAPs for that purpose. While it is likely that they will work towards converging their national GAAPs with IFRSs, it is not yet clear exactly what that will mean.

Special deferrals to 2007

Member States may defer application until 2007 for those companies that are listed both in the EU and elsewhere and that currently use US GAAP (or other GAAP) as their primary basis of accounting, as well as for companies that have only publicly traded debt securities. Information available in September 2004 indicates that:

- five of the 28 EU/EEA countries are likely to allow deferral of IFRSs to 2007 for companies listed both in the EU and elsewhere and currently use US or other GAAP as their primary basis of accounting
- twelve of the 28 countries are likely to allow deferral of IFRSs to 2007 for companies that have only debt securities listed for public trading (not equity).

6 Some hiccups in European 'convergence'

IAS 39

Several political issues have arisen in connection with the adoption of IFRSs for listed companies in Europe. One concerns the adoption of IAS 39 *Financial Instruments: Recognition and Measurement*, which is being resisted by some, particularly banks, in Europe. Although the European Accounting Regulation requires listed companies to use IFRSs starting in 2005, a 'technicality' requires that those IFRSs be individually or collective 'endorsed' for use in Europe. While most of the IASs have been endorsed, the EU 'carved out' two parts IAS 39 of IAS 39 two sections – the prohibition on hedge accounting for a bank's core deposits and the option to measure any financial asset or financial liability at fair value option with value changes recognised in profit or loss. The remainder of IAS 39 has been adopted.

An interesting but, as yet, unresolved audit reporting issue arises if a bank chooses to apply hedge accounting to its core deposits, thereby following IAS 39 as endorsed in Europe but not IAS 39 as adopted by the IASB. What does the auditor's report say?

- 'presents fairly in conformity with IFRSs'?
- 'presents fairly in conformity with IFRSs as adopted for use in Europe?'
- 'presents fairly in conformity with EU accounting standards' (no reference to IFRSs)?

Non-European companies listed in EU markets

Another political issue concerns non-European companies listed in EU securities markets. The Accounting Regulation adopted by the European Union requires that European companies listed in a regulated European securities market must prepare their financial statements in conformity with International Financial Reporting Standards starting in 2005. Subsequent legislation provides that non-European companies whose securities are listed in a regulated European securities market must also follow IFRSs

starting in 2007 unless the Commission has agreed, prior to 1 January 2007, to recognise financial statements prepared in accordance with 'third country GAAP' (a non-European national GAAP) as being equivalent to those prepared in accordance with IFRSs.

The European Commission has asked the Committee of European Securities Regulators to assess the IFRS equivalence of the following GAAPs by June 2005: US-GAAP, Japanese GAAP, and Canadian GAAP. The Japanese Government and business sector have been urging 'mutual acceptance' by the EC and Japan of each other's standards. Currently, around 250 Japanese companies list their shares or bonds on EU exchanges. Most prepare their financial statements under Japanese accounting rules. Around ten companies from IFRS countries are listed in Japan. Of the 442 non-British companies listed on the London Stock Exchange, 309 come from outside Europe and therefore would not be required to use IFRSs.

Switzerland

Many large companies in Switzerland (which is not an EU or EEA member) have long used IFRSs. Starting in 2005, the Swiss Exchange will require IFRSs for all listed companies that have international operations.

7 Prospects for use of IFRSs in the USA

There will be several ways in which Europe's adoption of IFRSs will have an immediate impact in the USA. First of all, approximately 350 European companies are registered with the SEC. Most of them had been submitting financial statements to the SEC using their national GAAP, with reconciliation to US GAAP. A few had followed US GAAP. The great majority of these are expected to switch to IFRSs for US filings in 2005. The SEC is busily preparing to receive and review these IFRS financial statements. Actually, the work of the SEC staff is likely to be made easier because instead of having to review financial statements using 20 or more different European GAAPs, they will consistently be reviewing IFRS statements.

In addition, European companies that have the US subsidiaries, equity method associates, and joint ventures may well ask those the US entities to produce IFRS financial statements for the purpose of preparing group (consolidated) IFRS financial statements.

It is also likely that the US parent companies, equity method investors, and joint venturers with European holdings will begin to receive IFRS financial statements from their investees.

And, of course, the US institutional investors, financial analysts, and individual investors do not confine their investment research to US companies. For companies in the 28 EU/EEA countries, those investors and investment advisors will begin seeing IFRS financial statements in place of national GAAP statements.

Beyond the immediate impact, there remains the issue of whether the Securities and Exchange Commission will accept IFRS financial statements from foreign issuers without the reconciliations of earnings and shareholders' equity to US GAAP. In February 2000, the SEC issued a *Concept Release on International Accounting Standards*. A key issue for the SEC identified in that Concept Release is to determine under what conditions the Commission should "accept financial statements of foreign private issuers that are prepared using the standards promulgated by the International

Accounting Standards Committee". That study was put on the back burner by the accounting problems that surfaced at Enron, World Com, and nearly 1,000 other listed companies. The Chief Accountant of the Commission has indicated that the Commission will undertake a study of the reconciliations submitted for 2005 and, based on the findings, will determine whether to eliminate the reconciliation. Speaking at the American Accounting Association Annual Meeting in August 2004, the Chief Accountant indicated his hope that the reconciliation could be eliminated by the end of the current decade.

In August 2004, the SEC published its *Strategic Plan for 2004–2009*. The plan identifies the "vision, mission, values, and goals that will shape the agency's activities during the next five years" and details the initiatives being undertaken to achieve the SEC's goals. Regarding the Commission's efforts in support of international convergence of accounting standards, the plan notes:

> "Companies and investors benefit when financial statements, accounting standards, and auditing procedures mean the same thing from country to country. When one set of high-quality standards is applied anywhere in the world, the cost of accessing capital markets is likely to be reduced, and information disclosed to investors in one country can be as relevant and meaningful to investors in other countries."

Canada

Domestic Canadian companies are not currently permitted to use IFRSs in place of Canadian GAAP. Foreign securities issuers in Canada were permitted, starting in 2004, to use IFRS without reconciliation to Canadian GAAP. This amounts to only a handful of companies.

The Accounting Standards Board of Canada is in the midst of developing a five-year plan for the period 2005–2010. The possibility of adopting IFRSs in Canada is one possible outcome. The invitation to comment states:

Four key issues, which need to be addressed sequentially, are whether Canada should:

- maintain its own standard-setting capability
- maintain its own GAAP or adopt either US GAAP or International Financial Reporting Standards (IFRS), the standards of the International Accounting Standards Board (IASB)
- maintain the current strategy of working to support the international convergence of accounting standards while harmonising with US GAAP
- consider modifying current GAAP requirements to provide better information to the users of financial statements of various different types of entities through, for example, a wider application of differential reporting.

Asia

Here is a summary of convergence in Asia as of September 2004.

Hong Kong

Hong Kong Financial Reporting Standards are developed by the Financial Accounting Standards Committee (FASC) of the Hong Kong Institute of CPAs (HKICPA) and must be approved by the Council of the Institute before they become effective. The Council has mandated that the FASC develop accounting standards to achieve convergence with the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

Therefore, every agenda project of the IASB automatically becomes an agenda project of the FASC and becomes the groundwork for a new or revised Hong Kong Financial Reporting Standard. While there is necessarily a slight time lag between issue of an IFRS and issuance of its word-for-word Hong Kong equivalent, the standards are identical. Hong Kong had resisted adopting several of the more contentious IASB standards, particularly IAS 32 and IAS 39 on financial instruments and IAS 40 on investment property. However, these have now been adopted effective 2005.

There is a relatively small issue in Hong Kong regarding the definition of a subsidiary. An untested interpretation of Hong Kong company law restricts consolidated financial statements to those of a parent and its subsidiaries in which it has majority voting control. The consolidation principle in IAS 27 is just control, which means that some IAS 27 subsidiaries may not be allowed to be consolidated in Hong Kong.

One observation that might be made about the Hong Kong circumstance – which is true in some other countries as well – is that the Hong Kong companies are subjected to all of the 'pain' of adopting IFRSs but are not getting the full 'gain'. Why? Because the basis of presentation notes and auditor's reports will continue to refer to conformity with Hong Kong Financial Reporting Standards, not IFRSs. Investors, money managers, and financial analysts who are not familiar with Hong Kong GAAP – which really means most investors, money managers, and financial analysts throughout the world – will be unaware that Hong Kong GAAP is identical to IFRS. This may be a factor in making investment decisions or in pricing deals.

Australia

Australia's case is similar to that of Hong Kong. The Australian Accounting Standards Board (a governmental agency) is adopting Australian equivalents (nearly word-for-word) of IFRSs, effective in 2005 for all listed companies in Australia and all except very small unlisted. A difference from Hong Kong is that the AASB on occasion will eliminate an alternative permitted by an IFRS, add disclosures, and add requirements appropriate for not-for-profit or governmental entities (since Australia has a single body of accounting standards applicable to commercial and non-commercial entities). Assuming that the basis of presentation notes and auditors' reports will refer to Australian GAAP rather than to IFRSs, Australian entities may have the same 'pain without the full gain' problem that Hong Kong companies will likely have.

New Zealand

The situation in New Zealand is essentially identical to that of Australia except that the effective date of the New Zealand equivalents of IFRSs will be 2007, with implementation starting in 2005 permitted but not required. New Zealand is considering whether the basis of presentation note and auditor's report should refer to New Zealand GAAP or IFRSs.

Singapore

Since 2003, all Singapore-incorporated companies have been required to follow Singapore Financial Reporting Standards (FRSs) approved by the Council on Corporate Disclosure and Governance (CCDG), a body established by the government. The stated policy of the CCDG is that FRSs will be "closely modelled after the International Accounting Standards and International financial Reporting Standards issued by the International Accounting Standards Board". With a few exceptions, the CCDG has adopted IFRSs as Singapore FRSs word for word. However, there are some exceptions. The Singapore equivalents of IAS 16 (property, plant, and equipment), IAS 17 (leases), IAS 27 (consolidation), IAS 28 (equity method), and IAS 31 (joint ventures) all contain modifications from the IASs. Moreover, IAS 40 Investment Property has not yet been adopted in Singapore. The basis for presentation note and the auditor's report refer to conformity with Singapore GAAP, not conformity with IFRSs.

Philippines

Like Hong Kong, the Philippines has adopted all IFRSs word for word as national GAAP.

Elsewhere in Asia

- *Asian countries that are adopting many IFRSs word for word, but not (yet) the entire current suite*. India, Malaysia, Pakistan, and Thailand.
- *Asian countries whose national GAAP is different from IFRSs.* China, Indonesia, Japan, Korea, Taiwan, and Vietnam.
- *Asian countries where IFRSs are already permitted or required for some (but not all) domestic listed companies*. In Bangladesh, IFRSs are required for all listed companies. In Hong Kong, IFRSs are permitted for Hong Kong-based companies that are incorporated in another country, as well as for companies from mainland China that are listed on the Stock Exchange of Hong Kong. In China, IFRS financial statements must be published by Chinese companies listed on the two Chinese stock exchanges if those companies have issued 'B' Shares (shares that trade in US dollars and are intended for purchase by non-Chinese investors). There are about 110 such companies. Currently, the 1,100 or so 'A' Share companies (shares that trade in Chinese currency and are intended for purchase by Chinese investors) report using Chinese Accounting Standards.

8 Convergence will not work without enforcement

Like the FASB in the USA, the IASB does not have any direct power to enforce the application of its standards. In an international environment with national capital markets in various stages of development and maturity, enforcement of IASB standards seems to be more challenging than in the US environment – though the US accounting scandals in the first few years of this decade may prove that statement false. The fact is that now matter how closely different sets of standards are converged on paper, the real test of convergence is in rigorous and consistent application from country to country.

Europe has recognised the need for consistent and coordinated enforcement of IFRSs throughout the 28 EU and EEA countries. To that end, the European Commission has formed the Committee of European Securities Regulators and charged that body will develop enforcement standards that the Commission would adopt for use across Europe.

In 2004, the International Organisation of Securities Commissions (the consortium of securities market regulators from around 100 countries) began two projects relating to the enforcement of IFRSs globally:

- The IOSCO Technical Committee initiated a project called Regulatory Interpretations of International Financial Reporting Standards to address communications among IOSCO members 'to promote the consistent application and enforcement of IFRSs'. The major outputs of this project are expected to be a central database of regulatory decisions and a process for facilitating communications and cooperation among regulators and other enforcers relating to IFRSs. The Technical Committee will also seek to coordinate its work on this project with a comparable project being undertaken by the Committee of European Securities Regulators.
- The IOSCO Technical Committee also initiated project called Review and Enforcement of Application of Financial Reporting Standards. It will look at the range of activities and powers that relate to reviews of public company financial statements by securities regulators and others. This project will focus on the powers and activities of a review process, and criteria and actions needed, regardless of the accounting standards in use. The major output of this project is expected to be an IOSCO statement of principles, best practices, and/or descriptions of effective models in use for such review functions.

9 Conclusion

In a statement before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the US House of Representatives in Washington in June 2001, Paul Volcker, former Chairman of the US Federal Reserve Board and current Chairman of the IASC Foundation Board of Trustees, summed up the case for global convergence of financial reporting standards:

> "If markets are to function properly and capital is to be allocated efficiently, investors require transparency and must have confidence that financial information accurately reflects economic performance. Investors should be able to make comparisons among companies in order to make rational investment decisions. In a rapidly globalising world, it only makes sense that the same economic transactions are accounted for in the same manner across various jurisdictions."

Slowly, that goal is being achieved.

Notes

[1]The nine countries were Australia, Canada, France, Germany, Japan, the Netherlands, Mexico, the UK/Ireland, and the USA. The commitment of the American Institute of Certified Public Accountants, in particular, might be described as oddly timed, since it came at virtually the same moment as the AICPA was supporting the creation of the Financial Accounting Standards Board to set accounting standards in the USA.

[2]The standards issued by the IASC from 1973–2000 were known as International Accounting Standards (IAS 1, IAS 2, and so on). The IASC's interpretive body, the Standing Interpretations Committee (SIC), issued interpretations that are labelled SIC 1, SIC 2, and so on. The new standards issued by the IASB are known as International Financial Reporting Standards (IFRS 1, and so on). In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains. The IASB's interpretive body is the International Financial Reporting Interpretations Committee (IFRIC), and its interpretations are known as IFRIC 1, IFRIC 2, and so on. The IASB has adopted all of the old IASs and SICs with equal authority to the new IFRSs and IFRICs unless and until replaced. The IASB also uses the term IFRSs collectively to include the IASs and IFRSs as well as the interpretations issued by the SIC and the IFRIC. In the remainder of this paper, IFRSs will be used collectively to include the pronouncements of both the predecessor and current bodies.

[3]In Europe, the European Commission has recognised this problem and, as part of its 'single market initiative', has taken various steps toward integrating the European securities markets, including formation of a pan-Europe regulatory group, adoption of a single prospectus, and of course adoption of a single body of accounting standards for all European listed companies – International Financial Reporting Standards. Globally, the International Organisation of Securities Commissions has various projects to develop minimum standards for national securities markets, including IFRSs as the basic accounting standards

[4]IASB standards include paragraphs in bold type and plain type. All have equal authority. Paragraphs in bold type indicate the main principles.

Appendix: Websites of organisations mentioned

Accounting Standards Board of Canada:	www.acsbcanada.org.
Australian Accounting Standards Board:	www.aasb.com.au.
Committee of European Securities Regulators:	www.cesr-eu.org.
European Union accounting:	europa.eu.int/comm/internal_market/accounting/index_en.htm.
Financial Accounting Standards Board:	www.fasb.org.
International Accounting Standards Board:	www.iasb.org.
International Organization of Securities Commissions:	www.iosco.org.
Securities and Exchange Commission:	www.sec.gov.