INTERNATIONAL ACCOUNTING FRAMEWORKS: THE CONVERGENCE OF CORPORATE FINANCIAL STATEMENTS

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Abstract

Globalization and the gradual opening of financial frontiers have acted as an imperative in having homogeneity in the reporting frameworks and the financial statements of the entities in public and private sectors both nationally and internationally. The on-going global financial crisis, as well as the lack of investors' confidence in stock markets, has increased the necessity of a common approach in accounting standards. Certified Public Accountants (CPA's) from 7 different European countries took part in the present study, whose purpose was to identify the main differences between the two most used accounting standards, the IFRS and the US GAAP. Quantitative research revealed that there are differences in both the balance sheet presentation of debt and classification of D. Tax assets/liabilities, as well as the presentation of extraordinary items in the income statements. The research concludes the developments and the governance of existing reporting frameworks over the last decade, from which conclusions are drawn, and future studies towards the convergence are suggested.

Keywords: International Accounting Standards, IFRS, US GAAP, Europe

1. INTRODUCTION

In the Norwalk Agreement (2002), the two main Councils (FASB and IASB) have publicly stated their commitment to the convergence of IFRS with American Standards, and since then, both sides have made significant movements in this direction. In 2007 the IASB President predicted that between 2011 and 2012 the United States Accounting, and International Accounting Standards would be almost the same (Tweedie, 2007). Despite the significant progress in converging the two standards, however, the FASB chairman stressed the same year that the result is incomplete and that further improvements are needed (Herz, 2007). Although convergence is a goal with many advantages, especially for businesses operating in many countries, it is also an objective that can be achieved easily or quickly. The question arises about the current progress on the road to convergence, which has been investigated in the past with different results (Larson & Street, 2004; Street & Linthicum, 2007; Blanco & Osma, 2004).

The main differences between American and International Accounting Standards have been a field of research for many scholars (Leuz, 2003; Ng et al., 2002; Street et al., 2000). However, these standards seem to have more similarities than differences. They have similarities in their conceptual framework, the handling of transactions between affiliated members, the handling of events that took place after the balance sheet date, and the forecasts. In addition, the ratios used to analyze the financial statements have also significant similarities according to the two different sets of standards.

Sawabe (2002) noted a specific difference between countries in Japan's banking industry. Japanese Regulatory Accounting Principles (RAP) are in line with the Generally Accepted Accounting Principles for the valuation of inventories. However, managers have the option of choosing either the lowest cost-to-purchase price or the historical cost method for corporate accounting principles. Another example is the case of German banks. SFAS 131 and IAS 14R describe "Segment Financial Information". Homolle (2003) notes that there are significant differences between these two models when applied to the German banking industry. Studies (Ng et al., 2002; Sleigh-Johnson, 2002, Larson & Street, 2004), the Securities and Exchange Commission (SEC) 20-F adjustment form, which adapts IAS to American Standards, have pointed out the differences of the two approaches.

Thus, the main purpose of this study is the investigation of the differences between the two accounting frameworks (IFRS and US GAAP), as seen by Certified Public Accountants, and how results vary across European countries. The literature review will give more insight into the basic differences between the frameworks. The methodology will present how the research for the present study will take place in order for the main research question to be answered. Results will be analyzed and discussed, and finally, conclusions will be drawn and suggestions for future studies will be made.

2. LITERATURE REVIEW

2.1. Presentation of financial statements – terminology

The accounting terminology used by US Standards and International Accounting Standards is not always the same, although the terms may be used interchangeably. Differences also exist between the UK and American English. Accounts in the Statement of Balance Sheet according to US GAAP are often presented according to their liquidity rather than the opposite. For example, according to US GAAP, the current assets accounts can be presented where the fund receivables accounts and inventories are presented in a liquidity order. Under IAS, the current assets accounts are presented after the fixed assets accounts in a reverse order of liquidity. The rationale behind the liquidity presentation used under American Standards results from the relative commerciality of the assets or the preferential payment of liabilities in cases of liquidation or bankruptcy of the company (Kieso and Weygandt, 2001). The rationale behind IAS is the assumption that the company will continue to operate in the near future. Both approaches to the presentation of financial statements are fully valid and useful to the users of the financial statements.

2.2. Basic differences in terminology

As far as leases are concerned, according to U.S. GAAP and in particular FAS 13 "Accounting for Leases", FAS 28 "Accounting for Sales with Leasebacks" and FAS 98 "Accounting for Leases: Sale-Leaseback transactions involving Real Estate, Lease of Real Estate, definition of Lease term and Initial direct costs of direct financing Leases, the lease accounting is only applicable to tangible assets. In addition, for the purposes of classifying the lease, the International Accounting Standard will deal separately with the elements of "land" and "buildings" in a lease of land and buildings. This means that all leases, including land and buildings, are divided into two separate items, which get different treatment with respect to accounting. The American Standards agree with this directive that a lease of land and buildings can be treated as two separate leases, provided, however, that the fair value of "land" is 25% of the fair value of the lease. It is then necessary to distinguish these elements more frequently when using IAS. This may result in differences in the classification and accounting of land and buildings leases (Caretta & Nicolini, 2009).

Table 1. Differences between US GAAP and IRFS

US GAAP	*IFRS*
Income Statement	Profit and Loss Account
Account Receivable	Debtors
Accounts Payable	Creditors
Capital Lease	Finance Lease
Allowance for uncollectible accounts	Provision for bad debts
Inventory	Stock
Common Stock	Ordinary Shares
Statement of Cash Flows	Cash Flow Statement
Accounts Receivable Confirmation	Debtors Circularization

Moreover, attention has been given to the differences between the Accounting Standards Earnings per Share which are presented in both accounts by companies, whose ordinary shares or potential ordinary shares are publicly traded, as well as by companies that are in the process of issuing ordinary shares, or securities convertible into ordinary shares in the public securities markets (Steinbach et al., 2014). International Accounting Standard 33 "Earnings per Share" and the corresponding American FAS 128 "Earnings per Share" use similar methods of calculating earnings per share, while there are differences in the details of the applications.

For IAS the notion of Extraordinary Items does not exist and according to U.S. GAAP is described as rare. The "negative reputation and clientele" that occurs in business is deleted from earnings as Extraordinary Item and presented separately in the Income Statement (Rezaee, et al., 2010; Garefalakis et al., 2015a,b). The tax effect is presented either on the Results Statement page or on the Attachment. According to IAS when the firm enters into a contract that can be settled in ordinary shares or in cash, at its option it will assume that the contract will be settled in ordinary shares and the resulting ordinary shares will be included in the diluted earnings per share if the effect is earnings per share (Bartov et al., 2005). Under the SFAS 128, it will apply the same unless the firm has an existing practice or disclosure policy that provides a reasonable basis under which the contract can be settled partially or wholly in cash (Atwood et al., 2012; Clacher et al., 2013; Gordon & Hsu, 2018). Furthermore, according to IAS 33, if an enterprise discloses, additionally to basic and diluted earnings per share, the amounts per share using an item of Statement of Income is not required by this Standard. The basic and diluted earnings per share associated with such item shall be disclosed in a similar manner and presented in the notes of the financial statements. In contrast, the American Standard does not require the presentation of adjusted basic and diluted earnings per share based on alternative methods of measuring earnings (Grant Thornton India LLP, 2016). Such differences in the two accounting frameworks could lead to the use of different denominators in the calculations of impaired earnings per share (Smith et al., 2008).

3. RESEARCH METHODOLOGY

This chapter explains the methodological approach used. More specifically, the Main study was designed to successfully address the aims of this study: to test for differences between the two accounting frameworks. All questionnaires were designed and administered electronically. E-mail or telephone contact was made prior to the distribution of the questionnaires to increase the response rate.

Taking into account the characteristics of quantitative and qualitative research methodology, the use of quantitative research in this research was the most appropriate in this case. The online questionnaire was administered to 150 Certified Public Accountants (CPA's) highly skilled professionals, using homogeneous sampling. Electronic and telephone communication prior to completion, and a follow-up (Saunders et al., 2016, p. 475) had an impact on the period given to complete this study. Four weeks (14 May – 8 June 2018) were needed in order to receive a satisfactory amount of responses. From the initial 150 companies that the questionnaire was administered to, only 93 responded. The number of responses and the corresponding response rate is satisfactory (62%), as it exceeds the >40% response rate of professionals indicated by Dillman (2015). Replies are considered to be reliable and representative of the perception of international markets regarding the factors and conditions of various accounting frameworks, since the questioned are distinguished members of economic society, with a high level of experience and economic and accounting knowledge(Garefalakis & Dimitras, 2016).

This main study focuses on convergence among the 2 main reporting frameworks which is US GAAP and IFRS. This study is conducted to explore the professionals (CPA's) perception and beliefs of which are the most significant differences and the potential convergence of the 2 reporting frameworks. The questionnaire comprised of two main sections focusing on "Reporting Framework convergence", where the potential of the convergence was rated on a 7-point Likert scale, in terms of the likeliness. Following the aforementioned question, the most significant differences among 2 reporting frameworks were placed for selection among existing differences was again rated on a 7-point Likert frequency scale. However, due to time constraints and to free the participants from similar and long questions, only one item from each scale was used to establish the expectancy for convergence.

Table 2 presents the demographic details of the sample. The total number of professionals that responded to the questionnaire was split into 2 main categories, high and low perceived reporting framework convergence, based on the mean scores of their experience.

Table 2. Summary of main study sample (N=93)

Gender:	*Age:*	*Education:*	*Years at current position:*	*Years of accounting experience:*	*Company's number of employees:*	*Country (Frequency)*
73.1% male 26.8% female	37.2 years mean age 27 years min 58 years max	44.2% undergraduate degree 53.8% postgraduate degree 2% PhD.	37.6% 0 – 2 years 45.2% 2 – 5 years 17.2% 5 – 10 years	20.4% 0 – 5 years 38.7% 5 – 10 years 30.1% 10-15 years 10.8% 15+	25.8% 20-50 45.1 50 – 100 19.4% 100 – 250 9.7% 250 – 500	14 Austria 10 France 12 Germany 15 Greece 14 Italy 13 Switzerland 15 U.K.

4. RESULTS

After analyzing the data received from the questionnaires, the differences between various reporting frameworks, essentially reflect the diversity of societies and nations, reflecting differences in the political, economic, social, cultural, technological, legal and business environment (Palea & Scangelli, 2016). And while developing nations have and can operate on less comprehensive accounting standards like IAS, as they have a unique business environment, developed nations such as the United States in which are undertaken complex business and need complex accounting standards to regulate specific issues.

The convergence between various reporting frameworks presents a lengthy and prolonged process (Larson & Street, 2006; Ampofo & Sellani, 2005). It is certain that this convergence will demand high monetary and non-monetary costs associated with this change, and the various states may need to sacrifice some political power in terms of formal regulation so that other countries can agree on a convergent system. There are many differences between the two sets of standards, including inventory valuation, impairments, leases and presentation of financial statements (among others). However, recently, both sides have agreed on a largely mathematical model dealing with revenue recognition (KPMG, 2014) and thus, it is expected with interest in the future the further developments and probable convergence of various reporting frameworks(Garefalakis et al., 2016).

Furthermore, even though there was no hypothesis for the specific data collected, as it was just an informative item, most significant differences were further analyzed. It is apparent that Balance sheet presentation of debt as current vs.

noncurrent is generally more significant, while Balance sheet classification of D. Tax assets/ liabilities (Hong et al., 2018) is considered to be as of an average significance, while differences in Income statement existence of extraordinary items are considered to have as a considerable lower significance. Further explanations over the aforementioned differences among 2 reporting frameworks are provided below:

– Balance sheet presentation of debt as current vs. non-current

IFRS: Debt associated with debt covenant violation must be presented as current unless the lender agreement was reached prior to B/S date.

US GAAP: Debt associated with debt covenant violation may be presented as noncurrent if a lender agreement to waive exist before issuance of financial statements.

– Balance sheet classification of D.Tax assets/liabilities

IFRS: All amounts are classified as non-current in BS.

US GAAP: Current and noncurrent classification generally required based on the nature of the related asset or liability.

– Income statement existence of extraordinary items

IFRS: Prohibited.

US GAAP: Restricted to items that are both unusual and infrequent.

Moreover, over the initial question of convergence among 2 reporting frameworks, it is expected that in the long-term future further actions will be taken.

5. DISCUSSION

Examination of the Historic Reference of International developments and convergence over the last decade, in combination with the expertise of CPAs, were used to identify the differences between IFRS and US GAAP and how they vary between European countries. Results indicate that the most significant difference among the 2 reporting frameworks is considered to be the balance sheet presentation of debt as current vs. non-current. The expectancy of professional is that there will be apparently a global convergence among all existing reporting frameworks that will support further globalization of the economy.

The first finding of international literature and studies suggest that, as far as their qualities are concerned, the three standards converge to a great extent, with the exception of the level of "reliability" and "comparability". More specifically, the three standards are identical in terms of the following qualitative characteristics: completeness, accuracy, predictability, relativity, objectivity, consistency and neutrality. On the contrary, there is a significant variation in the reliability and comparability of IFRS and US GAAP. Under these circumstances, and taking into account the questionnaire data, we have identified significant differences in the reliability of the two standards. These differences relate to the Balance sheet presentation of debt as current vs. non-current. More specifically: IFRS: Debt associated with debt covenant violation must be presented as current unless the lender agreement was reached prior to B/S date, while according to US GAAP: Debt associated with debt covenant violation may be presented as noncurrent if a lender agreement to waive exist before issuance of financial statements.

In addition, it is considered that for specific industries IFRS could increase comparability with competitors. After examining the qualitative characteristics of the financial statements, issues related to accounting as a science will be examined: standardization rules, valuation rules, disclosures provided, presentation rules and presentation of the balance sheet. To test the possible difference between the views of the three groups, we will re-test two basic assumptions using t-test and Levene test for homogeneity of dispersion with a statistical significance level of 5%. The first findings of international bibliography and articles suggest that, with regard to the above accounting issues, the three standards converge to a large extent, with the exception of "valuation rules". In more detail, the three standards are identified in the following areas: standardization rules, disclosures provided, presentation rules and presentation of the balance sheet. On the contrary, there is a significant difference between the views of accountants and statutory auditors on the valuation rules applied by IFRS and US GAAP. Under these circumstances, two significant differences in the valuation rules of the two standards are identified.

6. CONCLUSION

The main purpose of the present study is the investigation of the differences between the two accounting frameworks (IFRS and US GAAP), as seen by Certified Public Accountants, and through the set rules of each framework. A potential convergence will only be possible when the differences are identified, compared and reviewed so that the necessary adjustments are made to serve corporate interest. Corporations across seven countries in Europe are examined, and CPAs are giving their expert opinion regarding the differences and the difficulties for a potential convergence of the two accounting frameworks. The literature review gives more some basic and "by the book" differences between the frameworks, however, the practical knowledge of CPAs is also needed on such a matter. The methodology used was especially designed to answer the main research question, and after examining the qualitative characteristics of the financial statements, accounting issues, such as standardization rules, valuation rules, disclosures provided, presentation rules and presentation of the balance sheet, certain results were found. The results indicated that there is a significant variation in the reliability and comparability of IFRS and US GAAP. As far as reliability is concerned, differences relating to the Balance Sheet presentation of debt as current vs. non-current were pointed out. We notice that following the IFRS framework, debt associated with debt covenant violation must be presented as current unless the lender agreement was reached prior to BS date, whereas in the US GAAP, debt associated with debt covenant violation can be presented as non-current if a lender agreement to waive exists before issuance of financial statements. Regarding balance sheet classification of D. Tax assets/liabilities in the IFRS framework, all amounts are classified as non-current in BS, while in the US GAAP, both current and non-current classification generally required based on the nature of the related asset or liability. Lastly, when it comes to income statements and the representation of extraordinary items, under the IFRS this is prohibited, whereas, in the US GAAP this is restricted to items that are both unusual and infrequent.

The conclusion of this present research is that for a potential convergence of the two accounting frameworks, many changes need to be made, that will clearly cover all accounting issues. Also, small variation was noticed between the different countries, and what CPAs stated in the questionnaires. Of course, there were limitations on this study. First, due to lack of resources, the hypotheses were tested on a very small sample across 7 European countries, focusing on one small sector of the accounting professional/organizations. This study could be considered as a useful source of information for subsequent studies/essays related to reporting frameworks and to the broader accounting/auditing studies. Generalizations can be made; however, further study could be conducted on more European countries, with larger samples that could enable comparisons to be made. Also, this study could expand to other powerful markets.

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