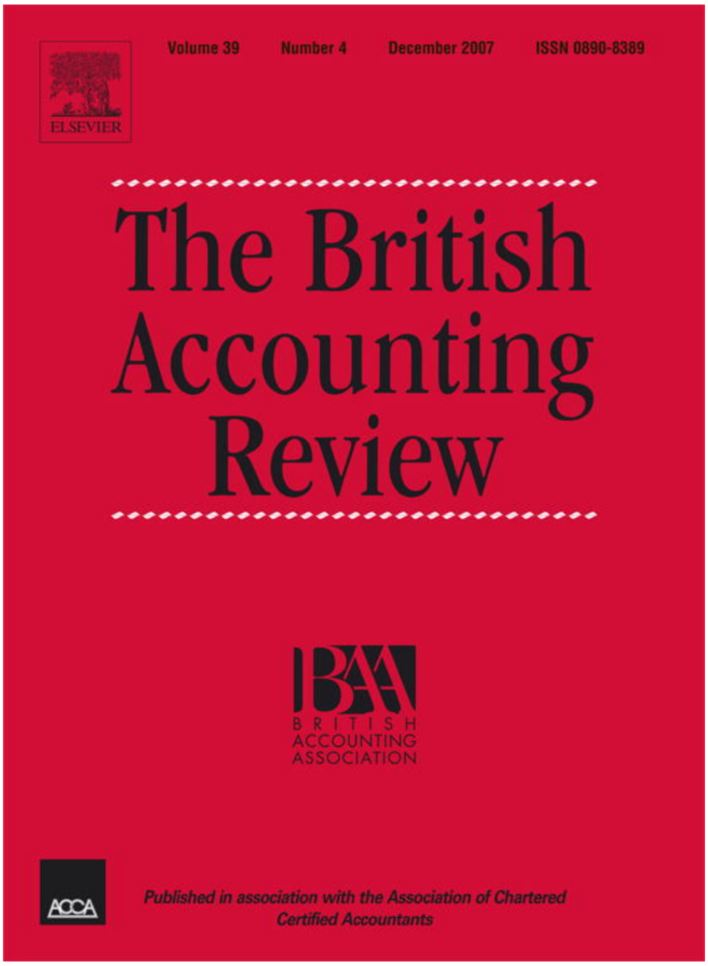
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Commentary

Some obstacles to global financial reporting comparability and convergence at a high level of quality☆

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Now that we are beyond 2005, it is time to take stock of the ongoing efforts of standard setters, companies, auditors, and regulators to promote the continued improvement of worldwide financial reporting and to discuss some of the challenges and obstacles that lie ahead.

The issues I would like to discuss are two: **comparability** and **convergence**.

1. Comparability

'Comparability' is a very difficult notion to understand even within a country, let alone globally. We have not really had much literature that helps us understand what is meant by comparability—when we have it, and when we do not. The view originating in the United States and now cited widely is that comparability is achieved by assuring that 'like things look alike, and unlike things look different' (Trueblood, 1966, p. 189). But in accounting what are 'things'? And how do we perceive and identify 'like' and 'unlike' things? Accounting is an artefact, not articles of furniture or draperies. I will elaborate on this difficulty in the course of my remarks.

Since 2005, when the IAS regulation of 2002 went into effect, some 8000 listed companies in the European Union (EU) are now preparing their consolidated financial statements by the use of International Financial Reporting Standards (IFRS).[1] Scores of other countries around the world have also signed on to IFRS. I think it is a widely shared opinion that there has suddenly been a very great increase in global comparability in relation to what we had before, namely, every country using its own national standards, which differed considerably from country to country. Nevertheless, I would like to strike a note of caution that future progress in enhancing comparability may be difficult to achieve and that one needs to be concerned about the future course of convergence across international borders.

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[1]Some companies have opted out of doing so until 2007 under the special provision in the IAS regulation for companies listed overseas, i.e. mainly in the United States.

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I am going to discuss four cultures in the first part of my presentation, as follows:

- The **business and financial culture**
- The **accounting culture**
- The **auditing culture**
- The **regulatory culture**

These cultures differ from one country to the next, and this is one of the factors that could impede or interfere with promoting genuine worldwide comparability.

1.1. Business and financial culture

First, with respect to the *business and financial culture*, there are certain differences across countries in the way business is conducted and in their supporting financial markets. For example, because of *incentives and disincentives in the income tax law* and other laws, business transactions are often designed differently in different countries. In the USA, partly because of tax benefits, it is commonplace in certain industries to raise financing through long-term leases. Therefore, if you were to board an airliner of a US carrier (e.g. American Airlines, Delta Airlines, Continental Airlines), it is almost 100% certain that the plane would not be owned by the airline company. Instead, it would be owned by financial institutions that lease them to the airline company, and, in the vast majority of cases, the aircraft do not appear on the balance sheet of the operating company. This practice of omitting major tangible operating resources from the balance sheet is also found in a number of other important industries in the USA (see Weil, 2004), and this is one of the reasons for a considerable lack of comparability even within my country, let alone between my country and others.

Further, *executive compensation packages* are composed differently in different countries. In my country, and increasingly in other countries, employee share options and other share plans have become a major part of the compensation packages of executives and of many other employees as well. How we account for these various forms of share compensation compared to how we account for a salary and a cash bonus will determine whether we have comparability across countries because of the different ways in which we compensate executives and other employees. Pension schemes and other retirement plan arrangements are also affected by the way business is done in different countries. In some countries, post-retirement benefits, including those for health care, are administered and paid by the Government, while in others they are the responsibility of the employer.

Then there are *different business customs and corporate structures*. For example, in Japan and Korea, the *keiretsu* and *chaebol*, respectively, represent networks of companies with interlocking relationships, where it is not clear who the holding company is, if indeed there is a holding company. Therefore, one may raise the question whether a standard on consolidated financial statements in its application in Japan and Korea would produce anything like comparability with countries that have a clear hierarchical relationship between subsidiaries and the ultimate parent or holding company. An identical standard in such circumstances would do little more than accentuate the differences between the countries' different way of structuring intercorporate enterprise.

There is also the issue of public vs private ownership of enterprise, including related party transactions. Even today, one reads in the news about EADS producing airliners through its Airbus subsidiary and of the French and German governments' intrusive involvement in their operations compared to Boeing, which manufactures airliners in the USA without any Government involvement in its operations. This can produce accounting non-comparability and, at the same time, present some tricky auditing problems.

We can also mention what might be called *deep* vs *shallow asset pricing markets*. Fair value is becoming more prominent in International Accounting Standards (IAS) and IFRS, raised by the International Accounting Standards Board (IASB), as well as by the Financial Accounting Standards Board (FASB) in its standards, including such accounting issues as measuring impairment losses and revaluing property, plant, and equipment as well as valuing investment properties and biological assets (including forestry, orchards, livestock, and crops). There must be asset pricing markets that provide these values, but it is likely that, in the great majority of countries adopting IFRS, the asset pricing markets are not sufficiently deep to provide the necessary data with which to revalue many of the assets reliably. This means that companies in these countries would have to turn to synthetic approaches, like using fair value models or basing estimates on the prices of similar assets, which may produce results that, some would argue, are not truly comparable to those in other countries, where there are adequate asset pricing markets to value such assets directly.

Moreover, one sees differences among countries in the *vibrancy and centrality of their equity capital markets*. Prior to the middle of the 1990s, in many countries on the European continent and on other continents, large companies did not depend primarily on the equity capital markets for long-term financing. Instead, they relied on banks, on the State, and on family sources; hence, financial reporting did not have to take into account the information needs of equity investors. Beginning in the 1990s and into the current decade, the equity capital markets have begun to expand and become more vital in numerous countries on the European continent and around the world. Yet it is arguable that old habits of reluctant financial disclosure die out slowly.

Numerous other countries have relied for many years on equity capital markets for long-term financing, and they have been well accustomed to providing extensive and candid financial disclosures. This history or tradition of thinking proactively about how much *disclosure* a company must give to equity capital suppliers is relatively young in some countries and relatively older in others. It may take some time before executives in the former change their mentality on such questions as the extent and informativeness of financial disclosure, and there could thus be a disinclination in some countries to disclose information that in other countries has been routinely disclosed. How soon will these executives begin to tailor the candour of their financial disclosures to a regime of active suppliers of equity capital?

With reference to the *degree of sophistication of financial analysts and financial journalists*, in some countries selected newspapers and magazines report companies' financial results credibly and with discernment, and they draw attention to developments at the IASB and the national standard setter. In other countries, it is hard to find any articles in the financial press on these matters at all. The articles in the news media may be brief, and they may not reflect much understanding of the subject. And the financial analysts themselves may not be all that well informed about accounting. This can be a significant variable from country to country. The degree to which potential and actual investors are served well by financial writers and analysts in quite a few countries may be extremely low. All of this bears on how comparably financial statements inform interested parties in some countries in relation to others.

Some examples may be useful here. In a number of Asian and South Pacific countries that have signed on to IFRS, companies and their auditors do not say that IFRS are being used in financial statements. Instead, the companies say they are using national accounting standards, even though they might correspond with IFRS. In the auditor's report, the reference is to the national standards, not to IFRS. Financial analysts and other readers of financial statements, especially from overseas, need to be aware that, in those countries, the national accounting standards are congruent with, or may be nearly the same as, IFRS. Will they know that? The countries to which I refer are Hong Kong, the Philippines, Australia, and New Zealand. So the central issue is whether domestic and foreign financial analysts, as well as the financial journalists, truly understand what is going on in such countries. In other countries, such as India, Pakistan, Malaysia, and Thailand, companies' and auditors' references are also to national accounting standards, but these standards differ significantly from IFRS, or their pace of adoption of IFRS is lagging well behind (Pacter, 2005, pp. 79–81). This diversity in the use of referents to national accounting standards hardly promotes international comparability. I will refer in Section 2.5 to a proposed revision of IAS 1 which is intended to deal with this problem of detecting differences between IFRS and jurisdictional variations of IFRS.

1.2. Accounting culture

Now we turn to the *accounting culture*. The impact on accounting of the *cultural value of fixating on the minimisation of the income tax burden* played a significant role in the choice of financial reporting practices in many continental European countries until recent times, yet it may linger for years to come. A contemporary example is that asset impairment losses are tax deductible in Germany but not in the UK (Nobes, 2006, p. 235). Would that influence a company in the UK not to recognise an impairment loss, using its judgement appropriately, as opposed to a German company that might like the tax deduction and therefore may be willing to show the loss in its financial statements? In this respect, the tax mentality could continue to have an influence.[2] Traditionally in those countries, companies were focused on reducing taxable income and therefore took advantage of options to report a lower accounting income. Such choices leading to a conservative result may still be those that were made when taxation was linked to financial reporting. Yet they are no longer relevant for today's consolidated financial statements.

How long will it be before this mentality changes, when executives come round to believe that the lower accounting income option is not necessarily the best option, that the proper option should be the one that reflects the company's economic reality?

For another example, consider the use of *percentage of completion accounting, or stages of completion accounting, for long-term construction contracts*. Until recent times in some countries, percentage of completion accounting was not used, because no company wanted to be taxed any earlier than it had to be. Therefore, companies would wait until the contract was well along or actually completed before recognising revenue. Now, however, taxes are not an issue in the preparation of the company's primary (i.e. consolidated) statements, but the company's management may still be reluctant to adopt the stages of completion approach because of the traditional way of thinking about financial reporting in its country. This manner of thinking is likely to change gradually with the passage of time.

Then there is the matter of increasing complexity in company financial reporting. In particular, prior to 2005, company financial statements, especially those in Europe, were less detailed and therefore less daunting to read and digest. A recent study by the global firm of Ernst & Young of 65 European companies using IFRS in 2005 reported that there are now some 2000 disclosure requirements, which was about twice the number under UK and Australian GAAP and four times the number under French GAAP (IFRS: Observations on the Implementation of IFRS, 2006, p. 14).

The European companies' financial statements studied by Ernst & Young were 20–30% longer than the financial statements for the same companies in 2004. The standards, too, are growing in length. The textual content of IAS and IFRS in 2006 consumed approximately 2300 pages. In 2000, it extended to only 1200 pages (IFRS: Observations on the Implementation of IFRS, 2006, p. 14). The issue of principles vs rules has been raised as to whether IAS/IFRS are inexorably, inevitably, moving in the direction of more rules and away from a focus mainly on principles, as reflected in the increasing length and greater detail of the IASB's pronouncements, including the basis for conclusions and the implementation guidance which regularly accompany the standards.

1.3. Auditing culture

Then we may enquire into the *auditing culture*.

There is a different auditing culture among countries even though, apart from the USA, auditing and assurance standards are issued by a single body at the international level. In some European countries, for example, there has been an *inclination of the auditor not to issue a qualified report* if the company's financial statements departed from national accounting standards. I saw instances in the 1990s where the external auditor, aware that the company was not following the statutory accounting and disclosure requirements, did not issue a qualification even when the difference was material. In some countries, apparently, the external auditor is more 'flexible' in such matters. Cairns (2001) found that companies and their auditors often did not draw attention to departures from IAS when the company asserted that it was adhering to IAS (chaps. 15–16).

There are, to be sure, countries where auditors have given a qualification because the company was, in one or more material respects, not following national standards or IAS. Yet, in other national settings, no qualification was given because there may have been a sensitivity, or anxiety, over an auditor publicly questioning a major company for its choice of financial reporting methods.

This reflects a different mentality, a different auditing culture, across countries and therefore could lead to a diminution in comparability, especially if a company knows that it can depart from IFRS without having to suffer an auditor's qualification. Because of differences in auditing culture, companies may be more willing to depart from the IASB's standards and interpretations in certain countries than in others.

In some countries, *there may be a deeply held view or value that accounting choice should be responsive to a company's 'circumstances'*. An interesting question is: how does one define 'comparability'? There are those who believe, and many have believed this for a long time, that *comparability* is promoted, or assured, by all

[2] Nobes (2006) writes intriguingly about the 'survival of international differences' notwithstanding the overlay of IFRS.

companies being required to use the same accounting methods, that is to say, 'standardisation' or 'uniformity' of method. On the other hand, there are those who argue that there must be some options available to take into consideration differences in 'circumstances' among companies or among countries.

An anecdote may be instructive. In the 1950s and 1960s, there was a raging debate in the USA about whether uniformity or flexibility of accounting method better promoted comparability (Uniformity in Financial Accounting, 1965). There were major accounting firms, such as Arthur Andersen, which avowed that, without uniform accounting methods across companies, comparability could not be achieved. Other firms, such as Price Waterhouse, now part of PricewaterhouseCoopers, and Haskins & Sells, now part of Deloitte & Touche, disagreed. They insisted that one must take into consideration the individual 'circumstances' of the company when choosing the appropriate accounting method.

Early in the 1960s, I went to an Arthur Andersen partner and asked for his view about companies using either the FIFO or LIFO method for merchandise inventories. He said that it would defeat comparability if one of two companies that were otherwise identical were to use FIFO, while the other used LIFO. Then I asked the same question of a Price Waterhouse partner, after having told him what the Arthur Andersen partner had said, and his reaction was predictable. He replied that there were no two companies that were 'otherwise identical', that differences in 'circumstances' inevitably exist among companies, which necessarily justify the use of different accounting methods to achieve genuine comparability.

The debate in the USA was never resolved: whether uniformity or flexibility, without options or with options, better produces comparability. The Securities and Exchange Commission (SEC), however, has consistently supported uniformity. This is an unsurprising view for a regulator.

Two examples might serve to illustrate the argument advanced by those who prefer an attentiveness to 'circumstances'. Think about a company that owns long-lived depreciable assets, most of whose usefulness and benefit comes in their earlier years of life, and it accordingly uses an accelerated method of depreciation, by which more of the depreciation is recorded in the earlier years and less in the later years, as opposed to the straight-line method. Advocates of an attentiveness to circumstances would argue that the company should not use the straight-line method, because the greater amount of revenue expected from using the depreciable asset is expected in the early years—it will be used more intensively at the onset than at the end. So, allowing companies an option to use either of the two methods makes sense. Yet New Zealand had a requirement in the 1970s that all companies must use the straight-line method, evidently in the belief that the use of one method by all companies would assure comparability.

Suppose, as another example, a company is considering use of the 'average' method of computing inventory cost, as opposed to FIFO. This company, let us say, is in the chemicals industry and receives liquid chemicals that are poured into a vat, a big container, and then would be withdrawn following immersion and mixing. Advocates of flexibility would argue that FIFO does not make much sense for such a company, and perhaps the average method would be more justifiable. On the other hand, if a company manufactures cigarettes and receives tobacco leaf from its suppliers, perhaps FIFO—because of a demonstrable FIFO flow of the raw material—could be more easily defended, and the average method might not make as much sense. Therefore, in the eyes of flexibility advocates, different circumstances, in view of the nature of a company's operations, might justify one option over another. But others would argue that the existence of options impedes the attainment of comparability. This becomes a philosophical question: what fitting of accounting methods to circumstances promotes genuine comparability?

The question is whether the same method to be used by all companies around the world produces *'genuine' comparability or 'superficial' comparability*. This is a debate that has not been adequately taken up in our literature. Referring to the simplistic desideratum that 'like things should look alike, and unlike things should look different' does not address the essence of the conundrum of accounting comparability and how it is to be achieved.

1.4. Regulatory culture

Finally, we can discuss the *regulatory culture*.

There are different traditions across countries as to whether a regulator, either in the private sector or public sector, should take a proactive, that is to say an aggressive, stance when dealing with companies' financial reports destined for the securities markets and also addressed to shareholders.

In the USA, the SEC, which has some 3100 full-time staff and possesses a great deal of statutory authority to regulate the securities market, takes a very strong position on accounting matters. Some would say that the SEC is oppressive, and most countries would probably not accept a body comparable to the SEC as their regulator. Instead, in line with their regulatory tradition, many countries would prefer a lighter touch.[3]

Therefore, the degree of regulation one sees in different countries can and does vary considerably. In countries where the regulator is stronger and more forceful, companies may be less willing to depart from a strict construction of IFRS, because the regulator will object and may insist upon changes in their financial reports. In countries where the regulation is softer, companies may be more inclined to apply their own constructions of IFRS, believing that the regulator would not take any adverse action. The strength of the regulation is important to worldwide comparability.

Certain factors can influence the strength of a regulator. How much *authority* did the Parliament or national legislature give to the regulator? What is the size of its *budget*? How competent a *staff* can it recruit, and what is the quality of its subsequent training? The regulator will, of course, be dealing with the finance directors of some of the most important multinationals in the country. Will its technical staff be up to the challenge? This is very important. In some countries, are there companies with enough political 'clout' that they might succeed in bullying or intimidating the regulator? Ultimately, the degree of a regulator's proactivity in securing compliance with IFRS will be determined by the enforcement culture in the country.

Another point, which is relevant in *Civil Code countries*, is that the regulator may be unable to require companies to restate their financial statements once the shareholders, in their annual general meeting, have formally approved the company's financial statements. Only the shareholders in another meeting or the judge in a Civil Court could alter the financial statements if a regulator were to object to some of the accounting practices used. In *Common Law countries* such as Canada, the USA, Australia, and the UK, when the shareholders hold their annual general meeting, they do not vote to approve the financial statements. The financial statements are those of the company management that prepared and issued them and are its responsibility, and if the regulator, such as the SEC in the USA, were to object to one or more treatments in the financial statements, it could instruct the company to make a 'restatement', that is, change each questioned treatment to one that is acceptable to the SEC (Zeff, 1995).

In the USA, we have had a great many such restatements in the last 5 years, especially since Enron. But even before Enron, the SEC routinely imposed a requirement upon companies to restate financial statements with which it disagreed. The SEC's practice is for its staff to send the company a letter of comment, their commonly called a 'deficiency letter'. The company responds, and the two parties engage in a dialogue, until, finally, after the SEC has heard the company's defence of the questioned accounting practices, its staff decides whether the company must rectify its financial statements. When the SEC's staff decides in favour of a restatement, every company makes the indicated changes in its financial statements, else it would risk losing its trading privileges on the stock exchange on which its shares are quoted. If a prospectus is involved, the SEC would prevent the Initial Public Offering from going to market unless the company were to make the restatement. In a minority of instances, the company will send representatives to a meeting at the SEC's offices in Washington, DC, and the SEC staff's decision would be made at the close of the meeting.

In the UK, the preference has been for a private-sector body possessing statutory authority, the Financial Reporting Review Panel, to approach listed companies whose financial statements are believed not to give a 'true and fair view' and to importune them to modify their accounting. Eventually, the Panel could take an offending company into the civil courts, but it has not, until now, gone that far. In some other countries, a section in the Ministry of Finance or a private-sector agency recommends that listed companies make changes in this year's financial statements or perhaps only in next year's financial statements. In a considerable number of countries even today there is no effective organ to monitor the accounting choices in listed companies' financial statements. This issue of the vastly different regulatory environment from country to country has occupied much of the attention of the European Commission, the Committee of European Securities Regulators (CESR), and the International Organization of Securities Commissions (IOSCO).

[3]For some contrasts between the SEC and the UK Financial Services Authority, see MacDonald (2007).

2. Convergence

Let's talk about **convergence**.

'Convergence' is a term that gained currency in our field in the late 1990s. The earlier term was 'harmonisation', which was used during the first quarter-century of the International Accounting Standards Committee (IASC), beginning in 1973. Today, the IASB, the FASB, and other national standard setters regularly use the term convergence, which means the increasing compatibility of their respective standards at a high level of quality.[4] Of great importance today is the ongoing convergence between the IASB and the FASB because of the great significance of the US capital market to the future of IFRS. I will have something to say about that in Section 2.5.

2.1. Problems of interpretation

There are problems of *interpretation*, because interpretations are necessary to the effective application of the standards and therefore to the achievement of comparability. The IASB has created the International Financial Reporting Interpretations Committee (IFRIC), a body that proposes official interpretations subject to approval by the IASB. But then there are the regulators which conceivably could issue their own interpretations, making the application and implementation of IFRS different in one country than another. To counter a state-by-state approach to interpreting IFRS, CESR, working together with the European Commission, is trying to promote coordination among regulators in Europe. IOSCO is doing the same around the world, trying to coordinate the work of the national regulators.

There are no international, or pan-European, regulators of the securities markets. There are national regulators only. So, without the efforts of coordinating bodies such as CESR and IOSCO, we could well be confronted with different interpretations in one country than another. Yet the Australian Securities and Investments Commission (ASIC) has formed a Financial Reporting Panel to give advice on contested interpretations of IFRS as between ASIC and companies it regulates, which could potentially be a source of Australian-only interpretations.

2.2. Problems of language

Language could be a problem when translating IFRS from English. As an example, when the Fourth Directive was approved in 1978 by the European Economic Community (EEC), as the EU was then known, it included the all-encompassing requirement that the accounts give a 'true and fair view', which was a British concept, and it was translated into the languages of all of the EEC countries into the closest equivalents to a 'true and fair view'.[5] But the concern was not just the accuracy of the translations. It was more a matter, in each of the other countries, of whether accountants and finance directors understood the concept. It was a totally new concept, only partially understood or not understood at all in most European countries. In some countries, it seems to have been ignored altogether, while in others attempts seem to have been made to follow it. Yet perhaps the only country in which it really has been followed is the UK.

Thus, if one takes a concept embedded in the accounting traditions in one country but that has never been known or applied in another, even if it is translated as accurately as practicable into the language of the second country, the concept may not be understood. The words may be understood, but the concept may not be understood. The same may be so, at least for a time, for elements of IFRS, which represent new concepts, or which address problems that have rarely if ever occurred in many national cultures even though the words are being translated into their national language.

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[4]See the memorandum of understanding arising from the Norwalk Agreement of September 2002 between the IASB and the FASB: http://www.fasb.org/news/memorandum.pdf.

[5]For an examination of some of the travails when translating and implementing 'true and fair view' in the EEC/EU, see Nobes (1993) and Aisbitt and Nobes (2001).

2.3. Problems of terminology

As an example of different national interpretations placed on common terminology, an interesting question surrounds the term *probability*. The words 'probability' and 'probable' appear many times in IFRS, but do they mean a 60%, 80%, or 90% likelihood? The Germans may make a conservative estimate of probability, while others may adopt a lower, or less strict, percentage as the equivalent of probability.[6] What is meant by 'probability' or 'probable'? 'More likely than not'? These terms can be defined or interpreted differently from country to country and therefore can impair international convergence and comparability.

2.4. Adjusted earnings measures

An interesting practice that has recently been brought to light, which can dilute convergence, is the practice by many European companies to go over the heads of the IASB to adopt novel measures of profitability for the edification of financial statement readers. The Ernst & Young study referred to earlier, which studied 65 European company annual reports for 2005, found that nearly a third of the companies reported an *'alternative earnings per share'*, including in its numerator an *adjusted earnings measure*, which in the USA we call 'pro-forma earnings'. These are measures of earnings that, in the main, have had the effects of certain one-time charges removed, thus producing a smoother year-to-year trend. The Chairman of the IASB, Sir David Tweedie, calls these adjusted measures 'earnings before the bad stuff'. The companies add back restructuring costs, the cost of litigation settlements, and impairment losses, and they eliminate the losses and gains on the disposal of fixed assets (see IFRS: Observations on the Implementation of IFRS, 2006, p. 13).

These companies have devised a 'bottom line' which they regard as an *estimate of long-term earnings*. Such an adjusted measure is not disallowed by IFRS. Of the companies in the Ernst & Young study adopting this reporting practice, most were UK and French companies.

2.5. The role of the SEC

We now turn to the SEC.

The cooperation of the SEC is central to the success of the IASB's aim to secure the acceptability of its standards in all of the major capital markets. One of the goals of convergence has been to persuade the SEC to respect IFRS as the equivalent of US GAAP. It is hugely important to the IASB to get the SEC on board in support of IFRS so that there will no longer be the need for foreign registrants in US capital markets to reconcile IFRS to US GAAP. In order to determine whether overseas companies were fully adhering to the spirit and letter of IFRS, the SEC looked forward to receiving the first batch of IFRS financial statements for 2005.

Expecting some 300 foreign companies publicly traded in the USA to be filing their IFRS financial statements for 2005, the SEC was taken aback when it received only about 40 financial statements where both the company and auditor affirmed compliance with IFRS as published by the IASB. This shortfall troubled the SEC, as it had expected to be able to examine a 'critical mass' of IFRS financial statements to ascertain whether companies were indeed complying fully with all of the IASB's standards and interpretations.[7]

The SEC's staff reviewed the 2005 IFRS financial statements, and, as usual, they raised questions about companies' interpretations, application, and implementation of IFRS. The SEC wrote 'deficiency letters' to the finance directors of companies in those countries, some of whom reacted quite negatively, because they had not received such strong letters before from a securities market regulator (see Sukhraj, 2006). They believed that the SEC was imposing its own interpretations of IFRS.[8] Yet the SEC had been sending similarly strong letters to US-based companies in regard to US GAAP for many years.

[6]For a study showing that German accountants seem to construe 'probability' more conservatively than US accountants, see Doupnik and Richter (2004).

[7]For this expression of SEC concern, see the speech by Commissioner Roel C. Campos on 8 March 2007 (http://www.sec.gov/news/speech/2007/spch030807rcc.htm) as well as the speech by Deputy Chief Accountant Julie A. Erhardt on 11 December 2006 (http://www.sec.gov/news/speech/2006/spch121106jae.htm).

[8]In July 2007, the SEC posted in one release all of the 'deficiency letters' it sent in 2006 and 2007 to foreign companies registered with the SEC which had adopted IFRS in 2005 and 2006, together with the companies' responses. See http://www.sec.gov/divisions/corpfin/ifrs_reviews.htm.

In 2006, the SEC agreed with CESR on a work plan to coordinate with European securities market regulators.[9] Accordingly, it has communicated with regulators such as the Financial Services Authority in the UK or Consob in Italy in order to share experiences at a general level. Only where the SEC has questioned the accounting used by a foreign registrant and has learned that the regulator in the country where the registrant is based has taken a different position than the SEC's, will the SEC discuss the specific company's accounting with the regulator. Once the SEC has become fully apprised of the other regulator's view, and if there remains a difference of opinion that cannot be resolved, it will declare its own norm on the issue and order a restatement. This could mean that, as a practical matter, the SEC's interpretations of IFRS may become *'de facto' interpretations* around the world because of some of the 300 IFRS-eligible multinationals publicly traded in US securities markets and therefore subject to the supervision of the SEC.[10] This is a sizeable bloc of important companies, a circumstance which animates a great deal of concern both in Europe and at the IASB over the potential impact of the SEC, a kind of 'extra-territorial sovereignty'.

In 2005, the SEC agreed a 'roadmap' with the EU to set in place a definitive process for dropping its reconciliation requirement for foreign companies adopting IFRS (see Nicolaisen, 2005).[11] In June 2007, the SEC formally proposed a rule 'to accept financial statements prepared in accordance with the English language version of IFRS as published by the IASB without reconciliation to US GAAP'.[12] If the SEC's rule is eventually issued, which is highly likely, it is expected to apply to foreign companies' 2008 financial statements.

Another specification by the SEC in its rule proposal is that, 'in order to be eligible to omit the reconciliation, [a company] would be required, in a prominent footnote to its financial statements, to state unreservedly and explicitly that its financial statements are in compliance with IFRS as published by the IASB. In addition, in its report, the independent auditor must opine similarly on whether those financial statements comply with IFRS as published by the IASB.'[13] Clearly, the SEC wants to see a literal affirmation by both companies and auditors of adherence to the IASB's standards and interpretations.

One should take note of the SEC's important qualification in its rule proposal: 'the English language version of IFRS as published by the IASB'. As observed elsewhere in this paper, in the EU and in many other countries that have also signed on to the use of IFRS, companies and auditors refer to endorsed IFRS or to national GAAP, but not to 'pure' IFRS, that is, the precise version published by the IASB in the English language. It is interesting that audit firms in the UK now give two opinions on some listed companies' financial statements: on compliance with 'IFRS as adopted by the EU' (required by the IAS regulation of 2002) and on compliance with IFRS. Jurisdictions around the world are reserving to themselves the right to tailor the IASB's official rendering of IFRS to their own legal and other circumstances, including an accommodation to political pressures (see the next section). *One can verily say that, while the IASB was intended to be a retailer of accounting standards, it has become, in large measure, a wholesaler*. To address this problem of jurisdictional variations, the IASB decided in July 2007 to expose a proposed revision of IAS 1 to require an entity that 'is not able to make an explicit and unreserved statement of compliance with IFRSs' as published by the IASB, to describe each such difference from 'pure' IFRS as well as 'how its reported financial position and performance of the entity would have differed if it had complied with IFRSs'.[14] Does this proposal portend the imposition of a kind of 'qualitative reconciliation requirement'?[15]

[9]For the work plan agreed to by the SEC and CESR, see http://www.sec.gov/news/press/2006/2006-130.htm.

[10]The number of such foreign companies subject to SEC supervision will increase significantly once Canada completes its transition to IFRS in 2011.

[11]Nicolaisen's paper is also available at http://www.sec.gov/news/speech/spch040605dtn.htm.

[12]Quotation is taken from the summary of the SEC's release nos. 33-8818 and 34-55998, dated 2 July 2007 (http://www.sec.gov/rules/proposed/2007/33-8818.pdf). On 20 June 2007, the SEC unanimously approved the issue of this rule proposal. For a press report of the SEC's proposal, see Scannell and Reilly (2007).

[13]Quotation is taken from part III.A of the SEC's rule proposal. The key adverbs, 'unreservedly and explicitly', may be traced to IAS 1, para 14.

[14]During the board's July 2007 meeting, this was the staff's recommendation for the revision of IAS 1, which the board, by majority vote, approved for exposure. 'Information for Observers', board meeting of 18 July 2007, project on Annual Improvements, subject of Reporting Compliance with IFRSs (revised) (Agenda Paper 5J). The outcome of the board meeting was reported in www.iasplus.com.

[15]Under the proposal, entities would apparently not be required to quantify the effect of the differences on the reported financial position and performance.

After the SEC drops its reconciliation requirement for foreign companies adopting IFRS, it will be no less of a force in the work of the IASB and IFRIC, and its firmly held views on the proper interpretation, application, and implementation of IFRS will continue to have repercussions overseas. The much stricter regulation of financial reporting in the USA stands in stark contrast to that in virtually all other countries. There are still options available to IFRS adopters that are not available to companies using US GAAP, such as the revaluation of property, plant, and equipment, the revaluation of investment properties, and the valuation of certain biological assets. In time, these will likely be ironed out in the convergence process. Until they are, it is not clear what disclosures the SEC might impose on foreign companies that adopt these options, giving rise to material differences between US GAAP earnings and IFRS earnings, as well as between other key accounting numbers.

The SEC also announced, in April 2007, that it plans to issue a concept release to explore the possibility of allowing US-based companies to adopt either IFRS or US GAAP after the reconciliation requirement is dropped.[16] It approved the concept release unanimously on 25 July 2007, which limits the IFRS option to IFRS as published in English by the IASB.[17] A considerable number of US-based multinationals have many overseas subsidiaries that are required to use IFRS, and they would find it much less costly to be able to issue their consolidated statements also in IFRS. One can verily ask if, once the SEC were to allow US-based companies to use either IFRS or US GAAP, what will become of US GAAP and the FASB? That the SEC has no intention of witnessing the disappearance of US GAAP is evidenced by its decision announced on 27 June 2007 to form an Advisory Committee on Improvements to Financial Reporting. The membership of the advisory committee was announced on 31 July 2007 and represents 'key constituents in our capital markets'. In the announcement release, SEC Chairman Christopher Cox grandly said that he is counting on the advisory committee to 'recommend improvements that will keep America's financial reporting system as the gold standard for the world'.[18] One of the major issues it will address is the complexity in US GAAP, which will be a daunting assignment in a country as litigious as the United States.[19]

2.6. The impact of politics

Another issue that one must take into account is *politics*.

Companies place pressure on the IASB just as they have over the decades on the FASB. It has happened for financial instruments in a big way, coming from the French banks. If powerful companies or banks find that they are unable to persuade the IASB to their side on a pending matter, they will redirect their persuasive efforts towards the European Commission, the Accounting Regulatory Committee (ARC), the European Financial Reporting Advisory Group (EFRAG), the European Central Bank, or the European Parliament. Both the ARC, which represents the EU's member states, and EFRAG, whose Technical Expert Group is composed of accounting specialists in the private sector, advise the European Commission on the political and technical acceptability, respectively, of the IASB's standards and interpretations. A new body was established in 2006 to monitor EFRAG, called the Standards Advice Review Group (SARG), which is intended to satisfy potential critics that EFRAG's judgements are balanced and objective, whatever that means. SARG could also become the object of political forays.[20]

There are many places, nationally as well as internationally, to which financial statement preparers can go if they possess considerable political leverage and the determination to use it. In France, the power of the banks was so great that the President of France made a public statement in July 2003 critical of the IASB's proposed standard, IAS 39, on financial instruments.

There is a differing likelihood of politicking on accounting issues from one country to the next. In the USA, which is known for political activism and confrontation, it is very high. In the Congress, whose members and staff know virtually nothing about the technical aspects of accounting and financial reporting, they

[16]For the SEC's press release dated 24 April 2007, see http://www.sec.gov/news/press/2007/2007-72.htm.

[17]For the concept release, which is dated 7 August 2007, see http://www.sec.gov/rules/concept/2007/33-8831.pdf.

[18]For the full documentation, see http://www.sec.gov/news/press/2007/2007-154.htm.

[19]For the view of the Advisory Committee's chairman, see Pozen (2007).

[20]For a discussion of political activism on accounting issues at both the national and international levels, see Zeff (2006).

nonetheless are aware of which petitioners for relief from proposed accounting standards have contributed money to support their election campaigns. An aggrieved company executive comes in and says: 'Remember my financial support during your re-election campaign?' and the member of Congress replies, 'Yes', and then the visitor says, 'Now we need a favour from you. We need you to stop the SEC from enforcing a proposed FASB standard'. While members of Congress cannot prevent the FASB, a private-sector body, from issuing a standard, they can introduce legislation ordering the SEC, a governmental agency, not to require companies to follow the standard if it should be issued. Even a threat of such legislation can be enough to turn the tide. This is effectively a means of stopping the FASB. In the USA, companies have appealed to members of the Congress a number of times on financial reporting matters (on the investment tax credit, on oil and gas accounting, on employee share options, on financial instruments, and on business combinations, among others). If the FASB does not heed companies' strongly felt criticisms of a proposed standard, it is quite possible for the companies to appeal to one or more members of Congress to achieve their aim.

If companies' attempts to influence the thinking of the IASB do not meet with success with some regularity, it is possible for them and other interested parties (including the European Commission) to try to persuade the trustees overseeing the IASB to approve a broadening in the composition of the former's membership, thereby bringing in more trustees believed to be sympathetic to their views, or to approve an increase in the majority of votes required by the IASB to approve a standard. Recently, the trustees effectuated both of these changes.

So far, the lion's share, if not the entirety, of the politicking of the IASB has come from within the European Union and Switzerland. The EU represents a substantial bloc of countries, currently 27, and several other countries (for example, Norway) cooperate with the EU. The EU's some 8000 listed companies represent more than half of all of the listed companies currently adopting IFRS or IFRS-like standards around the world. Moreover, the IASB is based in the EU, in London, in close proximity to the seat of the European Commission and EFRAG, in Brussels. Interested parties in the EU seem to regard the IASB as their 'neighbourhood standard setter'. Will the political lobbying which emanates from special interests within the EU be congruent, or clash, with the special interests of important companies and countries based elsewhere in the world? Will such politicking contribute to national GAAPs that differ from IFRS or to 'IFRS as adopted by the EU' that differ from 'pure' IFRS, which in turn would lead to a dilution in convergence and international comparability?

Politicking within the EU has erected a possible obstacle to the endorsement of IFRS 8, on accounting for operating segments, a standard published by the IASB in November 2006 and which was closely patterned on an FASB standard. The EU's elaborate endorsement process during 2007 has so far given rise to a non-endorsement motion introduced in the European Parliament. As a result, the European Commission has sought responses to a questionnaire on the 'potential impact' of the standard and is to report its findings to the Parliament by September 2007.[21] The sometimes drawn-out process of endorsement in the EU and in other parts of the world can bring about non-comparability across borders solely because of prolonged time lags in the adoption process. The dissent over IFRS 8 has raised afresh, especially in UK circles, the issue of whether convergence between the IASB and the FASB mainly means importing US GAAP into Europe and therefore whether convergence between the two bodies is a good thing for Europe.[22]

A current controversial draft standard at the IASB, which has become politically sensitive to many European companies, is a revision of IAS 1, on the presentation of financial statements, which involves the issue that we in the USA call '*other comprehensive income*', that is, the treatment of unrealised gains and losses on the sale of 'available for sale' securities as well as on certain foreign exchange translations, which go into the shareholders' equity section of the balance sheet instead of into the income statement. The aim of the standard setter is to accord these gains and losses greater prominence and thus display them in a statement that reports on financial performance.

The IASB favoured a single statement, called a '*Statement of Recognised Income and Expenses*', to report on financial performance. It would be the regular income-statement figures plus or minus all of these unrealised gains and losses, that is, those not yet evidenced by a market transaction, which are currently lodged in the

[21]See 'IFRS 8: a convergence too far?' (2007), 'Commission questionnaire on IFRS 8' (2007), and http://ec.europa.eu/internal_market/accounting/docs/ifrs8-consultation-final.pdf.

[22]See, for example, 'US convergence under attack', *Accountancy Age*, 19 July 2007, 2.

shareholders' equity section of the balance sheet. But European companies applied pressure on the IASB, arguing that such a presentation would mislead readers into thinking that this combined ('comprehensive') measure could be used as the basis for predicting future earnings. The companies persuaded the IASB to allow the combined measure to be placed on a different page than the one on which the traditional earnings appear. To me, this is a bit ridiculous, as readers are capable of turning the page. But it was important to the companies.

Therefore, in its exposure draft, which was issued in March 2006, the IASB said it would permit companies the choice of reporting these items in one statement or two: a Statement of Recognised Income and Expenses alone, or this statement plus another one, which enables companies to put the second one on a different page, thus, they hope, according it less prominence.[23]

This kind of pressure on the IASB risks taking a step backward from convergence and comparability. Comparability would be achieved if all companies were to present only one statement, which is the IASB's preference. The choice of one presentation vs the other is not one that reflects different circumstances among companies. This is an example of self-interested lobbying that currently confronts the IASB.

3. Concluding comments

The following are a few closing comments.

The more rigorous the enforcement mechanism—that is, the more authority and the larger budget a country gives to its securities market regulator to fortify the effort to secure compliance with IFRS—the more lobbying pressure that will be brought on the IASB, because companies in such countries will know that they have no 'escape valve', no way of side-stepping the adverse consequences, as they see them, of a proposed IASB standard or interpretation. If the auditor is strict and the regulator is strict, political lobbying of the standard setter, the IASB, may become more intense. Therefore, if a powerful company or group of companies do not like a draft standard, they will have an incentive to engage in politicking of the standard-setting body. We have seen that in the USA for decades, because we have a strict securities market regulator, the SEC. As a country strengthens its regulator, which many people think is good, one of the consequences may be more self-interested politicking of the IASB, which is thought by many to be bad. Hence, it becomes a Catch-22.

The contemporary debate over principles vs rules arose in the wake of Enron in February 2002, yet the same issue was raised in the late 1960s (see Zeff, 2003, p. 197). Who brought up the issue in February 2002? SEC Chairman Harvey L. Pitt said in a speech, 'We seek to move toward a principles-based set of accounting standards'. He argued that the Enron debacle exposed a major flaw in the US rules-based system. Companies would say, 'Is there a rule that says I cannot do this?', as opposed to, 'What is the overriding principle?'

This expression of alarm by the SEC Chairman is ironic, because the SEC's accounting staff has been more responsible for the FASB's detailed standards than perhaps any other single external source. When the FASB develops a standard, the SEC's accounting staff typically is heard to say that there is a list of issues it wants the FASB to take up in specific paragraphs: this cannot be done, that cannot be done, and only this other can be done. And this leads to detailed and lengthy standards. To the SEC's staff, fewer open questions about the interpretation of the FASB's standards translate into fewer deficiency letters and fewer time-consuming meetings with companies to question their accounting choices. Additionally, audit firms also push for detail in the standards in order to bolster their defence in lawsuits.

A similar trend is occurring at the IASB. The IASB has become more of a force—recall that no companies had to adopt the IASC's standards in 1990s. There was not all that much overt politicking of the IASC: no regulator imposed an obligation to follow the standards, and there was no law that instructed companies to follow them. Now that the EU's IAS regulation has been issued, and there are strengthened national regulators that appear to be taking more insistent enforcement positions, there is more determined politicking on sensitive proposed standards: more pressure on the standard setter, more space in the standards allotted to exemptions, provisos, and exceptions to accommodate this pressure, and, because of the contentiousness of the arguments over the standards, more detailed norms, if only styled as implementation guidance. Despite the

[23]See the IASB's exposure draft, Proposed Amendments to IAS 1 Presentation of Financial Statements—A Revised Presentation, dated March 2006.

best efforts of the IASB not to proceed down this more rules-oriented path, such a trend is already evident. That the IASB is in active convergence with the FASB to some degree runs the risk that detailed prescriptions in the latter's standards will find their way into the former's.

In sum, what I have been attempting to say in this lecture is that, in the areas of comparability and convergence, there seem to be obstacles to what might be termed 'genuine' comparability, and there are obstacles to convergence at a high level of quality. Some of the obstacles are deeply cultural, while others are more susceptible to modulation by the principal parties.

It requires enlightened leadership and commitment from the accountancy profession, including academics, audit firm partners, and company accountants, as well as from company finance directors and national regulators and other instrumentalities of Government, such as the European Commission, the SEC, and legislators, to overcome these obstacles and therefore promote genuine international convergence and comparability.

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