Resistance to Changes in Financial Reporting Standards

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By

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This book is dedicated to my wife, Annie,
and daughter, Isabella Rose Lemus, and family.

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PREFACE

The adoption of the IFRS has experienced dramatic changes in the world's financial market. The four chapters presented in this book begin with the evolution of the U.S. GAAP and the IFRS, and the use of the IFRS worldwide. Historically, the main objective behind the convergence process, supported by the FASB and the IASB, is to improve the GAAP and eliminate accounting technical differences.

Chapter 1 introduces the similarities and differences between the financial reporting standards under the GAAP versus the IFRS. Chapter 2 explains the critical aspects between the EMH and the IFRS, and includes 19 critical areas that reveal the resistance to the change from the U.S. GAAP to the IFRS. Chapter 3 focuses on answering the question of whether the IFRS should be mandatory, or optional, in the U.S. market. Chapter 4 contains a brief discussion of results, a summary of major findings, conclusions, implications, recommendations for future studies, and a final summary of the study and conclusions related to the findings.

Since President Barack Obama nominated Mary Jo White as chairperson in the SEC, the adoption of the IFRS has not been a priority (McEnroe & Sullivan, 2014). As written by Lemus (2014), "More than 450 non-United States companies, operating in the United States market, are reporting under IFRS and hold a combined market cap of $5 trillion" (p. 4). The potential significance of this book is to contribute to the accounting practice to promote one singular accounting language and support the capital orientation of principles-based standards. Therefore, it will be beneficial for the SEC and the FASB to understand the benefits of the early optional adoption of the IFRS by 2016.

The IFRS can be viewed in terms of accounting language as principles-based standards and capital oriented. The critical aspects between the EMH and the IFRS include 19 critical areas that explain the resistance to change from the GAAP to the IFRS. The IFRS can also be viewed as financial uniformity. More recently, 138 countries officially adopted the IFRS as a singular reporting accounting language (See Appendix E). Presently, 114 public companies were operating under the jurisdiction financial requirement of principles-based standards. The combined GDP of the IFRS is $41 trillion. The EU appears to have the highest number of the IFRS adopters, and $24 trillion was reported from non-EU countries.

Finally, the SMEs - operating in 69 different countries - are reporting under the IFRS (Pacter, 2015).

Prof. Edel Lemus, DBA, MIBA
Albizu University, Florida, February, Thursday 4, 2016

ABSTRACT

IS IFRS MANDATORY OR OPTIONAL IN THE U.S. MARKET? WHY? The purpose of this book is to investigate the resistance to change from U.S. Generally Accepted Accounting Principles (GAAP), to International Financial Reporting Standards (IFRS). The number of countries that have officially adopted IFRS, as a singular accounting language, is 138 (IFRS Foundation, 2013). The Securities and Exchange Commission (SEC), the Financial Accounting Standard Board (FASB), and the International Accounting Standard Board (IASB) have determined that IFRS should be adopted optionally in the United States by 2016. The book shows that IFRS should act as a singular accounting language, which will promote high transparency and a better economic position in the world financial market. Future research should focus on understanding the cross-cultural psychological effects of the adoption of principles-based standards and the relevance of corporate social responsibility by reshaping economic and global political forces.

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About the Author

Dr. Edel Lemus is the acting director, assistant professor, and institutional business development professor for the Business Department (School of Business) at Albizu University. Dr. Lemus has lectured at several international universities, including Ramkhamhaeng University, Bangkok, Thailand. Dr. Lemus has a BA in Accounting from Nova Southeastern University; a Master's Degree in International Business Administration in Finance from Nova Southeastern University; and a Doctorate of Business Administration (DBA) in Accounting from Argosy University. Dr. Lemus's primary research focus surrounds international accounting; IFRS; international finance; international business; and new venture capital investment. His research on IFRS has been published in numerous journals, including *Global Journal of Management and Business Research*; *Journal of Alternative Perspectives in the Social Sciences*; *Universidad Complutense* (Madrid, Spain); *Observatorio Iberoamericano de la Economia y Sociedad de Japón*; and *ICL Journal* (New Zealand). In addition, he is a member of the editorial board of several journals, such as *ICL Journal*.

His research was selected to be showcased at several international conferences. Most recently, the international conferences attended were the International Conference on Leadership and Governance (October 31, 2015, Palm Beach, Florida), and in the Caribbean, visiting Jamaica and Haiti, for the 5th International Interdisciplinary Business-Economics Advancement Conference - IIBA - (16-21 November, 2015, Ft. Lauderdale, Florida, USA). Dr. Lemus also served as a member of the Scientific Committee of Congreso Universitario Internacional Comunicacion.

Dr. Lemus has been affiliated with Albizu University as an Assistant Professor of Business, and, more recently, as the Acting Director of the Business Administration Program. In recognition of his multiple achievements, Dr. Lemus was selected by his peers as the Mace Bearer for the 2014 Carlos Albizu University Commencement Exercises.

In his current role in Albizu's business program, Dr. Lemus is involved in conceptualizing and creating an online Master's in Business Administration (MBA) program under Title V –Virtual Graduate Campus Project.

During his years with Albizu University, Dr. Lemus has stood out for his scholarly achievements and popularity, as well as for his kindness and well-mannered demeanor. He has established solid relationships with other directors, faculty, staff, and students.

Dr. Lemus is a Kentucky Colonel; he is a Texas Navy Admiral, commissioned by the Governor of Texas (USA); he was elected Academician of Social Sciences, Academician of the Nobilis Academia Sancti Ambrosii Martyris Il; he is an honorary member of La Real Sociedad De Amigeros De Espana,; and he is a recipient of the President's Lifetime Achievement Award for Education.

CHAPTER ONE[1]

WHAT ARE THE SIMILARITIES AND DIFFERENCES BETWEEN THE FINANCIAL REPORTING STANDARDS UNDER GAAP VERSUS IFRS?

The worldwide adoption of the International Financial Reporting Standards (IFRS) continues to be one of the most important issues in the accounting profession. As research by Warren, Reeve, and Duchac (2014) revealed, 127 countries have officially adopted the IFRS as a singular accounting language. It is estimated that, by the next decade, the IFRS will be adopted by 150 countries. The Securities and Exchange Commission (SEC) has resisted changing from the U.S. Generally Accepted Accounting Principles (GAAP) to the IFRS. The SEC and the Financial Accounting Standard Board (FASB) have expressed a high degree of concern regarding the adoption of the IFRS as a singular accounting language in the U.S. market. The main objections to the adoption are the following technical accounting differences that exist between the two accounting standards:

- The importance of revenue recognition
- The lease accounting treatment
- The classification of impairment assets
- Accounting for stock based compensation
- The consolidation of financial statements under the IFRS (Elena, Catalina, Stefana, & Niculina, 2009)

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[1] This chapter was originally presented at the 11th Argosy University Business Conference Reinventing Recovery held in Sarasota, FL, USA.

Therefore, the United States was not expected to adopt the IFRS prior to 2016 because the issues of accounting technical similarities, and differences, remain unresolved under the two accounting standards.

Evolution through History of U.S. GAAP and IFRS

In 1447, Luca Pacioli, an Italian citizen, revolutionized the accounting industry by introducing the two principal accounting memorandum accounting books—the journal, and the ledger. By 1550, a new era began in the accounting industry that expanded the forces of commercial and political realities in the global arena. In the late 1700s, the French Revolution took place and, at the same time, affected the Italian government's accounting system. According to Radebaugh, Gray, and Black (2006), "However, the influence of the Arabs, Genoese, Florentines, and Venetians continues to be felt in the double-entry system we use today" (p. 5). These influences were attributed to the double-entry accounting system and the Industrial Revolution from 1760 to 1830.

In the 1900s, there was a shift in the direction for market economies and accounting standards; particularly due to the establishment of the SEC, the stock exchange, the international new development phenomenon of mergers and acquisitions, and the complexity of conducting business overseas (Radebaugh et al., 2006).

According to Stephen (2005) - as presented through historical chronological events - the implementation of the GAAP, in the U.S. capital market, was a big breakthrough in the economic system. In 1930, the American Institute of Accountants (AIA) implemented the GAAP as a result of the failure of the stock market in 1929. Moreover, from 1932 to 1933, the AIA presented five principles in the market to regain investors' financial confidence level. From 1934 to 1935, the SEC approved major security legislation to bring financial sustainability into the investment capital sector. As a result, in 1936, the AIA introduced the examination of financial statements under the GAAP. In 1938, the SEC, for the first time, established the conceptual analysis of accounting and auditing procedures (Stephen, 2005).

In 1940, for the first time in history, the American Accounting Association (AAA) evaluated and presented the historical cost theory in the accounting education curriculum. In addition, in 1947, three accounting inventory methods were introduced under ARB 29: First-in, first-out (FIFO); last-in, first-out (LIFO); and the average cost method. From 1947 to 1950, major changes occurred in the accounting industry, and companies began to evaluate their assets. Furthermore, in 1954, Congress enacted the Internal Revenue Code to allow for the acceleration of historical cost methods for income tax purposes only. As a result, from 1958 to 1960, the American Institute of Certified Public Accountants (AICPA) established the Accounting Principles Board (APB). In the early 1960s, the board was examining the possibility of evaluating the fixed assets of companies. From 1962 to 1963, Congress stimulated the purchase of equipment by companies, and, by 1964, the APB issued opinion number 5 by establishing the capitalization of leases through finance. In 1967, the APB established the Financial Executives Institute for major financial research investigation, as requested by the SEC. Nevertheless, in 1968, the SEC requested immediate attention to analyze cautiously the accounting precedents of the operational market economic volatility. Therefore, in 1973, the FASB began operating in the accounting industry by establishing rules and regulations - not just in the United States, but operating universal principle accounting standards around the world (Stephen, 2005).

In 1973, the International Accounting Standards Committee (IASC) was established by an agreement. The leading professionals were from 10 different countries around the world, including Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, the United Kingdom, and the United States with the objective to formulate the International Accounting Standards (IAS; Doupnik, & Perera, 2012). Moreover, in 2000, the IASC became the International Accounting Standard Board (IASB), by substituting the IASC and increasing the effort of establishing a new single financial reporting standard known as the IFRS.

In 2002, the European Union (EU) began studying the possibility of adopting a new financial reporting system - the IFRS - by 2005. As a result, in the process of the adoption of the IFRS in the EU, the IASB and the FASB decided to approve the Norwalk Agreement, which represented a remarkable moment in the implementation and adoption history of the IFRS (Zhu, 2012).

In 2007, the SEC voted to accept the condition of reconciling financial statements in accordance with IFRS principles. In 2008, the SEC gave a road-map contingency plan to public companies in order to follow and commence the financial statement consolidation process under the IFRS. Later, in 2010, the SEC officially authorized the execution of the financial statement consolidation contemplated under the principles-based IFRS (Zhu, 2012). Therefore, the expected convergence from the GAAP to the IFRS would take place as early as 2016 (Tyson, 2011).

Technical Differences between U.S. GAAP and IFRS

The accounting technical differences that exist between the GAAP and the IFRS consist mainly in the approach of understanding two different financial reporting and accounting systems. In addition, the GAAP is considered rules-based and provides more detailed specifications of business transactions, compared to the IFRS. Furthermore, the GAAP is consistent with the jurisdictional, legal, economic, and social systems in the United States. On the other hand, the IFRS is principles-based and is designed to meet the social and economic needs of countries around the globe.

For instance, the main differences that exist between the GAAP and the IFRS are indicated to be in the legal, political, economic, and social aspects. In order to measure the accounting technical differences that exist between the GAAP and the IFRS, it is necessary to understand their accounting objectives. The technical differences that exist between the GAAP and the IFRS are as follows: The presentation of the financial statements, the valuation of the balance sheet, and the recording discrepancies under both standard setting standards among economic, legal, and social diversity system aspects. The advantage of the IFRS is that they enable an entity to capture different accounting interpretations while conducting international business in sensitive avenues. Therefore, the IFRS offer more latitude judgment and provide extensive disclosure assumptions than the GAAP (Warren et al., 2014).

Since the SEC adopted the road-map convergence process to the IFRS, three institutional bodies have been interested in the transition process from the GAAP to the IFRS: (a) The government, (b) the accounting industry, and (c) the accounting academia at higher education institutions. In addition, the three institutional bodies are trying to understand the transition process from the GAAP to the IFRS. The SEC wants the implementation and adoption of the IFRS to take place as early as 2016. Leaders of medium-sized and publicly-traded companies are extremely concerned about the new accounting transition shift from rules-based to principles-based because the IFRS offer more flexibility than the GAAP, and, to some degree, the IFRS offer more freedom from the financial reporting perspective than the GAAP.

Bandyopadhyay and McGee (2012) indicated that educators in the higher education arena need to prepare for the new era of the IFRS. The SEC remains optimistic about the convergence process from the GAAP to the IFRS (Bandyopadhyay & McGee, 2012).

IFRS Investment Position in the U.S. Market

The main benefit of adopting the IFRS in the U.S. market would be in attracting more investors from around the world by having one singular accounting language in place. In addition, as companies continue expanding their venture capital investment in the global arena, they need more transparency in the disclosure of financial statements. The IFRS would bring three important aspects to the U.S. market: (a) Sustainable comparability, (b) expansion of the trading position of the market, and (c) attraction of more investors to continue investing in the U.S. market (Bolt-Lee & Smith, 2009). However, the IFRS have been posited to be more capital oriented than the GAAP. Therefore, the IFRS might likely increase the financial quality reporting position of the firm and investors in the U.S. market (Bandyopadhyay & McGee, 2012).

There has been some delay in the adoption process of the IFRS in the U.S. market. As illustrated, by McGee and Bandyopadhyay (2009), one of the probable causes of this resistance is the cost of the process. The cost, estimated by the SEC (as cited in McGee & Bandyopadhyay, 2009), for those companies that would tentatively adopt the IFRS would be in the range of $32 million in the filing of their financial statements in accordance with 10-Ks, and $50 million for the complete conversion proposed plan by the SEC.

However, companies, educators, and auditors in the United States are not prepared for the new shift from the GAAP to the IFRS. Therefore, the SEC wants to alleviate the negative effects of the adoption process of the IFRS by allowing medium-sized companies to commence the early adoption of the IFRS in 2016 (Bandyopadhyay & McGee, 2012).

An important aspect of the adoption of the IFRS, in the U.S. market, is in having a singular accounting language system that would increase the transparency level among investors in the U.S. market. In addition, the greater the number of companies that adopt the IFRS, the greater the chance of comparability and transparency within firms in the market (FASB, 2008). Moreover, the majority of companies worldwide are currently utilizing and adopting the IFRS.

Until 2005, the GAAP was the dominant source of setting rules and regulations locally, as well as internationally. However, in 2005, the IFRS gained a strong global market presence and the GAAP were no longer able to dictate the dominant set of rules and regulations in the global financial market. Therefore, one uniform accounting setting standard would help to attract more foreign capital investment to the U.S. market (DeFond, Hu, Hung, & Li, 2012).

Adoption Impact of IFRS in the Higher Education Arena

The accounting profession will experience a shift in education standards due to the expected early adoption of the IFRS by 2016. Researchers have evaluated the importance of universities adopting the IFRS in their accounting curricula because accountant students should be prepare to pass the IFRS in the CPA exam. Moreover, educators should consider the need to incorporate the IFRS in the accounting curriculum. As a result, according to Weiss (2011), new generations of accountant graduates are expected to hold some degree of knowledge about IFRS.

Educators at business schools should gradually begin to incorporate aspects of the IFRS into the curriculum because when accountant graduate students complete the curriculum requirement they should be ready for the early adoption era of the IFRS, expected to commence in 2016. For example, the primary benefit of adopting the IFRS in the accounting curriculum would be to better equip accountant students for the new challenges that lie ahead (Razaee, Szendi, & Elmore, 1997). The new challenges that would help new accountants are as follows: (a) Ensuring accountant students develop a global-thinking approach about professional recommendations; (b) ensuring accountant students become more marketable in the market; (c) preparing accountant students to be integrated into the global economy; and, (d) having accountant students meet the requirement credentials of the Association to Advance Collegiate Schools of Business (AACSB). Nevertheless, very little research has been conducted in the adoption and convergence process of the IFRS in the higher education arena. Therefore, educators should begin learning about the new approach under the IFRS (Mintz, 2010).

For the past 5 years, the SEC has worked closely with the FASB and the IASB in order to have a greater understanding of the transition process from the GAAP to the IFRS. Educators in the higher education arena are not ready for the transition from the GAAP to the IFRS. Educators should begin to incorporate into the accounting curriculum, courses in IFRS principles and standards in order to better prepare accountant students for the changes to come in the accounting industry.

It is suggested, by this author, that educators in the United States do not have the knowledge required to teach the IFRS principles and standards. Therefore, empirical research studies recommend that the adoption of the IFRS be considered in the first phase of changes to the accounting curriculum in the higher education arena (James, 2011).