The Importance of International Accounting Standards in Promoting Regional Business Growth

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As globalization works its way through local economies via deregulation and modern market reforms, there is a need for the convergence of local financial reporting standards with International Accounting Standard (IAS). But, in order to achieve greater transparency worldwide as part of a wider Global Accountability Framework (GAF) the fundamental institutions of a modern market economy must be put in place before the convergence becomes effective. A more effective corporate governance code and greater independence at listed Board of Directors level is also needed. Finally, the new GAF would need to embrace non-financial measures of effectiveness to provide corporations the basis to report on their social responsibility activities, while limiting the disclosure of financially sensitive corporate information.

The latest developments in global commerce are likely to lead to a further wave in deregulation and market reforms in local economies. The demands for capital of growing businesses from the major capital markets of the world are dependent on the convergence of local Generally Accepted Accounting Principles (GAAP) with IAS. More plainly, those seeking to raise funds will need to have their local adoption of IAS converge with American GAAP, the reporting standards of the dominant capital market of the world.

International Accounting Standards

The establishment of IAS alone is not sufficient to achieve the type of regional business growth that we may expect. However, the convergence of a worldwide IAS with that of the accounting standards of the U.S. capital market, will be of tremendous significance to effective capital flows. The U.S. Securities Exchange Commission (SEC) is increasing its involvement in a number of forums to develop a globally accepted, high quality financial reporting framework.

Over the years, the SEC has realized that foreign companies make decisions about offering or listing securities in the United States for a variety reasons. While many of these reasons are unrelated to U.S. regulatory requirements, some foreign companies cite a reluctance to adopt American accounting practices as a reason for not listing in the U.S. These companies have forgone listing in the United States rather than follow accounting standards that they have not helped formulate. Therefore, accepting financial statements prepared using IAS standards without requiring reconciliation to U.S. GAAP could induce cross-border offerings and listings in the United States.
However, other factors could continue to deter foreign access to the U.S. markets. For example, some foreign companies have expressed concern with the litigation exposure and certain public disclosure requirements that may accompany entrance into the U.S. markets. Foreign companies also may be subject to domestic pressure to maintain primary listings on home country stock exchanges.

Currently, the SEC will not permit a foreign company to trade their overseas stock on the New York Stock Exchange (NYSE) without first issuing financial statements in accordance with GAAP. This cumbersome and expensive translation requirement severely limits foreign firm access to U.S. markets and U.S. access to foreign investment opportunities. The investment potential is tremendous, as currently only about ten-percent of the over 2,000 major foreign companies list on the NYSE. Many believe that unless U.S. policy is adjusted the U.S. stock market could lose world prominence to London or other European exchanges.

Thus, issuers wishing to access capital markets in different jurisdictions must comply with the requirements of each jurisdiction, which differ in many respects. Different listing and reporting requirements increase the costs of accessing multiple capital markets and create inefficiencies in cross-border capital flows. The SEC is working with other securities regulators around the world to reduce these differences. To encourage the development of accounting standards to be considered for use in cross-border filings the SEC has been working primarily through the International Organization of Securities Commissions (IOSCO), and focusing on the work of the International Accounting Standards Committee (IASC).

Yet global accounting policies may soon change as key accounting rule makers worldwide work toward the goal of convergence. At the forefront is the IASC, committed to the development of accounting standards that will bring consistency to accounting policies worldwide. The SEC is willing to compromise and last year accepted three international accounting standards on cash-flow data, the effects of hyperinflation, and business combinations for cross border stock filings. Still, the general consensus seems to be that before any real progress can be made in the area of convergence, international standard setters need more resources and the active participation of the major parties involved.

A number of factors have contributed to this convergence. Specifically, large supranational corporations have begun to apply their home country standards in a manner consistent with IASC standards or GAAP. In addition, while the accounting standards used must be high quality, they must be supported by an infrastructure that ensures that the standards are rigorously interpreted and
applied, and that issues and problematic practices are identified and resolved in a timely fashion. Elements of this infrastructure include: effective, independent and high quality accounting and auditing standard setters; high quality auditing standards; audit firms with effective quality controls worldwide; profession wide quality assurance; and active regulatory oversight.

Corporate Governance

The term corporate governance refers to the processes and structure by which the business and affairs of the company are directed and managed, in order to enhance long-term shareholder value through enhancing corporate performance and accountability, whilst taking the interests of other stakeholders. The need to adopt an effective corporate governance code is essential as we confront the waves of globalization

A useful first step in creating or reforming the corporate governance system is to look at the principles laid out by the Organization for Economic Development and Cooperation (OECD) and adopted by its government members. These include: the rights of shareholders; the equitable treatment of shareholders; the role of stakeholders in corporate governance; disclosure and transparency; and the responsibilities of the board of directors. The guidelines provide a great deal of detail about the functions of the board in protecting the company, its shareholders, and its stakeholders. These include concerns about corporate strategy, risk, executive compensation and performance, as well as accounting and reporting systems.

Globalization

Globalization and the advent of new technologies have dramatically changed the way business, government and society are organized. A key driving force of these changes is a new business model. This new business model is a philosophy of human organization based on conscious teamwork, networking, motivating people and reducing waste, including the cost of under using human capabilities, and to build the infrastructure for the creation of knowledge. Distinctions in the classification between the old and new economy business model may be somewhat artificial, but what is significant is that IAS and the GAF should make the changed relationships and strategic alliance in corporations more transparent.

The way in which developing countries respond to the current forces driving globalization will have a major effect on their standard of living, growth rates, quality of life, and development process in the coming decades. In countries
where institutions are not deeply rooted, shifting to the new business model may meet less resistance than in countries where those institutions are more developed.

Indeed, in countries where corporate and political governance structures are very rigid (typically in conflict or tension-ridden societies), adopting the new business model is likely to be difficult. As a result, these countries may fall even further behind during this wave of globalization than they did during the previous one. Some developing countries are flexible and can adapt quickly, but they may face obstacles instituting changes. In short, whether or not developing countries will benefit or lose from the new business model and its competitive strength remains an open question. It depends largely on how the governments of these countries respond.

The wave of the future is in flexible production and flexible organizations. In that regard, many developing countries should continue to improve the quality of their educational systems and their physical infrastructure (notably telecommunications and transportation), which will enable them to compete more effectively in local and regional markets and, in the case of some industries, in global markets.

Conclusion

It is simple to state that we need more transparency and accountability. In reality, the GAF will need tremendous efforts from all parties. Prospering in the 21st century will require a multi-lateral dexterity in coordinating the activities of the players, both the workers and the owners, and balancing the needs of different stakeholders, the government and regulators. These players must also develop a timely report card that is understandable to all in both financial and non-financial measures of effectiveness.

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