

CHAPTER 1

The Growth of National Standards

EARLY DEVELOPMENTS

National procedures, organizations, and regulations for accounting are currently at a watershed, due to the increasing influence of the International Accounting Standards Board (IASB). Effective April 1, 2001, the IASB had assumed standard setting responsibilities from its predecessor body, the International Accounting Standards Committee (IASC).

The national standard setting bodies are also at various stages in their response and strategies. A number of major players, for example the European Union, China, and Australia have adopted, or will soon be adopting, International Financial Reporting Standards (IFRSs) for some or all entities. The U.S. Financial Accounting Standards Board (FASB), through the Norwalk Agreement, and the IASB have given a formal commitment to convergence. More on this is discussed in Chapter 4. Other countries have also declared an intention to converge their standards with international pronouncements, and some still have not decided on their course of action.

Smaller nations generally have not had the resources and infrastructure to generate their own standards, and have either adopted or modeled their regulations on the standards of the United Kingdom or the United States. With the formation of the IASB, several countries chose to adopt international accounting standards. This was particularly true for emerging economies, where the flexibility of the standards made them easier to implement and where

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there was a concern that adopting the standards of one particular country would have political connotations.

Although there is some public debate concerning the number of countries that will adopt IFRSs, very few countries or organizations will remain completely unaffected by the influence of international harmonization. Business is becoming increasingly global, and accounting is changing rapidly to meet the demands placed upon it. Words and phrases originally used in one country have gained acceptance in others. Pronouncements made by the IASB have found their way, either in part or whole, into accounting practices. Anyone involved in business needs to understand the events that are taking place and how businesses are affected by them.

What is surprising, given the long history of accounting, is that these international events only commenced 30 years ago, with progress accelerating over the last few years. The following brief examination of the very slow development of accounting will help explain the changes that are now taking place.

Since the earliest times, individuals, societies, and civilizations have all experienced the need for some form of record keeping of events, transactions, and other phenomena. Images carved on cave walls illustrated records of quantities, for example, the number of cattle owned, the number of animals killed, the size of enemy forces.

The use of a medium of exchange, whether beads, shells, or coins, allowed a record to be made of economic transactions and events. However, the transactions recorded and the values placed on them possessed many great regional and local variations. It was not until the twentieth century that countries began to establish regulations for identifying the transactions and events that should be recognized and how they should be measured.

The progress over many centuries from simple local records to internationalization of accounting policies and practices has been slow, but the major influences can be identified. Some order was introduced into local practices by governments that require citizens to pay taxation. Since most early taxation systems applied only to the rich, it was clearly advantageous to claim poverty, an argument that is often used today in dealing with government demands for payments from its citizenry. It was also useful to exploit any ambiguities on how wealth should be measured, and even how best to conceal it.

Even the impact of taxation did little to establish a common system of financial record keeping. At best, the records were simple and developed to meet the immediate needs of one specific authority, whether to a tax collector or the lord of the manor. It was not until the publication of Luca Pacioli's *Summa de Arithmetica* in 1494 that a robust system for recording financial transactions, known as double entry bookkeeping, was firmly established and is now used throughout the world.

A common system of recording the financial aspects of transactions does not answer the most fundamental questions, namely:

What constitutes an economic transaction and what aspects of it should be identified for recording purposes?

What methods should be used for measuring the economic transaction?

Who has the right to receive financial information on the economic transaction?

For what purpose can the information be used reliably?

For individuals these questions are important, but for both profit and not-for-profit organizations, they are critical for ascertaining financial performance and stability as well as discharging disclosure responsibilities to those who have some form of interest in the organization.

THE ADVENT OF REGULATION

With the impact of the industrial revolution and the growth of various forms of incorporated bodies in the nineteenth century, many countries tried to bring order to the variety of practices within their boundaries by either introducing legislation that set out accounting rules for businesses or providing a general framework for their conduct. An essential part of this legislation was the disclosure of financial information by organizations to various groups.

Legislation and informal consensus on accounting practices could not provide a complete answer to all accounting problems. A more flexible and comprehensive mechanism for regulating practices was required, thus the emergence of standard setting bodies. It was not until the 1970s that the term *accounting standards* came into widespread use as various bodies and committees were formed to discharge this responsibility. The Accounting Standards Steering Committee (ASSC) in the United Kingdom was established in 1970. The U.S. FASB succeeded the Accounting Principles Board (APB) on July 1, 1973, two days after the IASC was formed. The process is still continuing. The Malaysian Accounting Standards Board (MASB) came into being as recently as 1997.

Prior to standard setting boards or committees, accounting bodies issued guidance, bulletins, notes, and other documents to their members to assist them. The step to legal recognition of standards was a key factor in the influence of regulatory pronouncements on financial accounting and reporting.

The aim in developing standards is to produce financial statements that are

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useful, as well as conceptually and technically sound. In doing this, certain assumptions can be made about the reasons for undertaking financial accounting and communicating the results to other parties. There are two main schools of thought. One is that the purpose of financial accounting and reporting is primarily a stewardship function designed to demonstrate to owners that the business has been properly conducted. The other is that financial reporting is primarily concerned with providing information that is useful for decision makers.

The implications of these two different functions are substantial. With the stewardship function, financial statements are concerned primarily with past activities, and costs and revenues are expressed in terms of those incurred at the time of the actual transaction. With the decision-making function, financial statements are concerned with current values and growth in wealth, adjusted by changes in the value of money.

In order to address the issues concerning the purpose of publishing financial statements and their form and content, many national standard setters have produced “Conceptual Frameworks” or “Statements on the Preparation and Presentation of Financial Statements.” Critics would argue that, although these have been helpful in setting standards, there are still too many ambiguities and contradictions, because existing theoretical frameworks are not sufficiently robust. In addition, it can be argued that accounting standard setting is a political process in which the flexibility to influence decisions is preferred to the fetters of theoretical constraints.

In addition, accounting standards do not reflect one strong theoretical approach, because they are issued sequentially and not simultaneously. Standards have been issued for over 30 years. There have been revisions, but standards that are 20 years old are still being applied. Present national bodies have inherited pronouncements made by predecessors with different organizational structures, ways of working, and legal powers. Establishing standards is an evolving process that is built on both strengths and weaknesses of past accounting regimes.

Initially, the demands and pressures of national environments largely formed the nature of standard setting bodies. Over the years, however, they have converged in many of their characteristics. Experiences, mistakes, and good practices have been shared and, at least as far as organizational structures and processes are concerned, there are now few significant differences. However, the contents of the standards issued by various national bodies have contained marked differences. These differences have resulted in difficulties when making international comparisons of organizational financial performance.

The next two chapters explore the drive to pursue international accounting harmonization and the present structure, funding, and operation of the IASB.

This material is followed by two chapters detailing the experiences and strategies of several countries. The penultimate chapter, “Responding to Internationalization,” analyzes the potential impact of events on education and training, professional accounting bodies, national standard setters, and organizations. The final chapter is concerned specifically with the role of the accountants. The long-term impact, even in countries not adopting international accounting standards, is substantial and recommendations are given for responding to these challenges.

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