Critically evaluate the effectiveness of the European Union and the International Accounting Standards Board in promoting harmonisation of accounting standards in Europe.

2,280 words (excluding cover sheet, contents, quotes, references, tables and bibliography.)

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1. Introduction:

This essay highlights that the existence of major differences in the financial reporting practices of companies in different countries in Europe lead to great complications for those preparing, consolidating, auditing and interpreting financial statements. It is for that reason that the EU and the International Accounting Standards Board (IASB) are involved in attempts to harmonise accounting mainly to facilitate the comparisons of financial practices in different countries.

The expression harmonisation has been used to explain efforts to move towards a global financial accounting system. It is a process of increasing and improving the compatibility of accounting practices, by setting restrictions to their degree of variation. Wolk at al. describe harmonisation of accounting standards as the "*degree of co-ordination or similarity among the various sets of national accounting standards and methods and formats of financial reporting*"[1]. It can also be described as the "*process of bringing accounting standards into some sort of agreement so that the financial statements from different countries are prepared according to a common set of principles of measurement and disclosure*."[2]

This essay aims therefore to evaluate the effectiveness of the EU and the International Accounting Standards Board in promoting the harmonisation of accounting standards in Europe.

2. Reasons and importance of harmonisation of accounting standards

There are many reasons for the promotion of the harmonisation of accounting standards. The main reason of harmonisation is that comparisons of financial reports can be made in different countries and providing interested parties in international markets with improved quality information upon which they can base their credit and investment decisions. The harmonisation process would therefore avoid any difficulties for multinational businesses to analyse accounts from different European countries. Especially investors and financial analysts need to be able to understand the financial statements of foreign companies when deciding to buy their shares. For them the statements from different countries need to be reliable and comparable.

This means that harmonisation of accounting standards removes barriers to international capital flows by reducing differences in financial reporting requirements for actors in international capital markets and it reduces financial reporting costs for multinational companies so that they can achieve substantial savings on costs of recruitment, training and staff development

[1] Wolk at al.

[2] Haskins at al. 1996

With the Cecchini report of 1988 it was also proven that on the benefits of the single market different national accounting systems caused between 10% and 30%[3] of the total accounting costs for multinationals. It was therefore in the interest of larger companies, not only within the European Union, to reduce these costs by being encouraged to a change in the financial reporting system. However for smaller companies the benefits of harmonisation might not be as large as for the multinational businesses, which have to pay higher costs in the implementation of the harmonisation.

3. Obstacles to harmonisation

There exist four main obstacles to harmonisation[4]. The most fundamental of obstacles is the size of actual differences between the accounting practices of different countries. Another obstacle is the lack of strong professional accountancy bodies in some countries. (e.g. the IASB operating in private sector, will not be effective in all countries). A further problem is the nationalism in some countries, which include the unwillingness of certain countries to accept compromises. The last obstacle is the effect of 'economic consequences' on accounting standards, as they vary by country, which might be a force for de-harmonisation.[5] Those four obstacles were reasons that EU member states were not being able to take on an EU-wide financial reporting system in the past. Many EU countries feared that some would have to make fundamental changes to their national systems whilst other countries would only have to make minor adjustments.

4. The effectiveness of the IASB in promoting harmonisation

Efforts to harmonise accounting standards began even before the creation of International Accounting Standards Committee (IASC) in 1973. However, the IASC was perhaps the most important and most effective body working for international harmonisation from 1983 to 2001[6]. Their objective was to *"formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements"*[7] and to promote their worldwide acceptance and observance, by issuing 41 standards along with a conceptual framework.

The International Accounting Standards Board (IASB) which became one of the most important bodies in harmonisation of accounting standards since 2001 is an independent, privately-funded

[3] Harmonisation Lecture Notes
[4] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation
[5] Harmonisation Lecture Notes
[6] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation
[7] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation

accounting standard-setter based in London, UK.[8] The IASB is committed to "*developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements*".[9] In addition, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world.

The IASB is the body within the IASCF structure which develops and approves IFRSs. They have decided, that, apart from small amendments to old standards, any new or revised standards will be labelled 'International Financial Reporting Standard' (IFRS) so that the new Board's work can be distinguished from the old one.

Their objective was the harmonisation of accounting standards and to promote the use and application of these standards. The IASB's main work was additional and continuing projects, major reforms and new improvements projects.[10] The continuing projects include accounting practices for insurance companies. The major reforms include extensions of capitalization to all leases and also an extension of the income statement so that all aspects of proposals. These were issued jointly by the IASC and other standard-setters in 2000, for the introduction of a new standard on financial instruments based on a full 'fair value' model.

In order to determine whether the IASB has been effective in promoting harmonisation of accounting standards it is necessary to establish the criteria by which effectiveness should be measured. We might start by looking at the stated objectives of the IASB, though we need to confirm that these are reasonable and useful objectives before adopting them as the measure for the IASB's effectiveness. The IASB's basic objective is to improve, promote the acceptance of standards on a worldwide basis. This objective might once have been thought to be too ambitious in one respect and not ambitious enough in another.

Until recently, to attempt worldwide harmonisation seemed hopeless and unnecessary. However due to the huge impact of globalisation and new technology, harmonisation plays more and more an important role for many European countries and represents a reasonable objective. The greatest benefits come from harmonisation among countries where there are companies that publish financial statements and that have foreign interest.

Despite, the effectiveness of the IASB in promoting harmonisation of accounting standards can be argued, particularly because the IASB has no authority of its own to impose its standards on companies. It can however recommend and suggest possible amendments to them.

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[8] IASB: www.iasb.org

[9] International Accounting Standards Board Website: IASCF. Apr. 2006 <www.iasb.org>.

[10] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation

Since the IASB is interested in issuing standards worldwide it can be argued that it is more difficult for them to develop standards that suit the different countries and that the "*implementation is a relatively slow process*"[11]. This could have the effect that certain standards are already out of date by the time each country agreed on implementing them and do not adjust to the national economic circumstances.

The IASB has completed a platform of accounting standards for large-scale adoption in the EU and in a number of countries in 2005. In order to achieve this goal the EU and the IASB had to work closely together. With the help of IASB's professionals and the EU's power of imposing the standards on the member states and companies within that country they could issue directives that give clear dates for implementation.

It can be said that the IASB has to ensure the fast implementation of standards to avoid uncertainty while working closely together with the EU.

To summarize, the IASB was relatively effective in promoting harmonisation of accounting standards, however the fact that they could not impose the standards on companies decreases their power and makes it harder for them to promote the harmonisation. The IASB has to ensure fast application of new standards and communicate them to the member countries as well as it has to improve its efforts and work closely with the European Union, especially after the implementation of IFRSs in 2005 in order to avoid any uncertainty throughout the EU.

5. The effectiveness of the EU in promoting harmonisation

The EU has itself "*placed great emphasis on accounting harmonisation but it will be a slow progress…since national idiosyncrasies in accounting are deeply rooted and intertwined with ideas and practices outside the confines of accounting itself*".[12]

On the 14th of March 2002, the European Parliament regained initiative to harmonise financial reporting standards by proposing that by January 2005, listed companies are required to publish their group annual financial statements in accordance with International Accounting Standards rather than comply with the national reporting requirements.

However the EU established the basis of the harmonisation programme even earlier. Since the Treaty of Rome of 1957, which include the establishment of the free movement of persons, goods and services, and capital, the EU was active in promoting harmonisation of European countries.

[11] International Accounting Standards Board Website: IASCF. Apr. 2006 <www.iasb.org>.
[12] Alexander and Archer 1998

More specifically, the Common Industrial Policy (1970)[13] encouraged the creation of a unified business environment, including the harmonisation of company law and taxation, and the creation of a common capital market. In order to encourage the free movement of capital within the EU, it was necessary to create a flow of consistent and homogenous financial information from European companies.

The EU attempts to harmonise company law and accounting through two main instruments[14]: Directives, which must be incorporated into the laws of member states; and Regulations, which become law throughout the EU without the need to pass through national legislatures. The Directive cover both public and private companies in all EU countries.

In 1978, the EC implemented the 4th Directive on the Format and Rules of Accounting, which harmonised the general layout and content of company financial statements. Although a limited number of national options were permitted, companies registered in member states were required to produce a profit and loss account and balance sheet with attention to a clearly defined and highly structured common format and content.

The fourth Directive's first draft was published in 1971, before the UK, Ireland and Denmark had entered the EU in 1973. German company law, particularly the Aktiengesetz of 1965[15], heavily influenced this initial draft. However, the influence of the UK and Ireland on the Commission, Parliament and Groupe d'Etudes had the effect that a much-amended draft was issued in 1974. This introduced the concept of the 'true and fair view' and more flexibility of presentation. The fourth directive was supposed to be enacted in member states by July 1980 and in force by 1982. However no country actually managed this former date (see table[16]).

[13] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation
[14] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation
[15] The future shape of EU financial services regulation - A UK perspective: Apr. 2006 < http://www.fsa.gov.uk/Pages/Library/Communication/Speeches/2004/SP178.shtml>
[16] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation

EU Countries	Fourth Directive in force
Denmark	1981
United Kingdom	1981
France	1983
Netherlands	1983
Luxembourg	1984
Belgium	1985
Germany	1985
Ireland	1986
Greece	1986
Spain	1989
Portugal	1989
Austria	1990
Italy	1991
Finland	1992
Sweden	1995
Norway	1998

The Companies Act implemented the Directive in the UK in 1981. The changes included compulsory formats and detailed valuation requirements. In other countries the introduction of the 'true and fair view' as an overriding requirement, the requirement for extra disclosure, and the extension of publication and audit to many companies were significant.

However it can be seen that neither asset valuation, nor formats, nor disclosure have been completely harmonised as a result of the laws consequent upon the fourth Directive.

However, it can still be said that harmonisation has been noticeable. Shareholders and accountants in the EU have reasonably welcomed the present degree of harmonisation. It should also be mentioned that several other countries, e.g. Poland and Switzerland, have made legal changes that are strongly influenced by the fourth Directives (for possible membership of the EU). Members of the European Economic Area (e.g. Norway) are also obliged to implement the Directives.

It is particularly in the area of measurement practices that a lack of harmonisation remains obvious. In 1990, the EU introduced a Forum of European standard-setters, which has discussed issues, which had not been covered by the Directives, e.g. lease accounting and foreign currency translation. However, it was also made clear that further, additional accounting Directives were relatively unlikely. It could be said that the Forum was more a type of a discussion group, which in the end was closed down in 2001.

Since 1995 the EU gave backing to the IASC and later to the IASB. In 2001 there was a first substantial amendment to the fourth Directive since its adoption in 1978. This is designed to allow the requirements of IAS 39 relating to the fair valuation of financial instruments, so that European companies can obey the Directives and IASs at the same time.[17]

Other EU promotions towards harmonisation of accounting standards came in 1983 with the 7th Directive on Consolidated Accounting, which required some degree of harmonisation in the preparation of consolidated financial statements. In many aspects, the implementation of this Directive meant that most member states adopted the UK "*method of consolidating accounts for a group of companies, which was based on identifying 'economic control' of subsidiaries*".[18] This policy contrasted with the practice often used in some other European countries, which was based on consolidation companies on the basis of voting control. National law implementing the Directive were required to be enacted by 1988 and their provisions were to apply by 1990. However, these requirements were not met (see Table[19]).

Countries	National laws	In force (year ends)
France	1985	1986(Listed); 1990 (Others)
Germany	1985	1990
Greece	1987	1990
Luxembourg	1988	1990
Netherlands	1988	1990
Spain	1989	1991
United Kingdom	1989	1990
Belgium	1990	1991
Denmark	1990	1992
Austria	1990	1994
Italy	1991	1994
Portugal	1991	1991
Ireland	1992	1993
Finland	1992	1993
Sweden	1995	1997
Norway	1998	1998

[17] Nobes. International Accounting and Comparative Financial Reporting. Chapter European Harmonisation
[18] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation
[19] Nobes and Parker. Comparative International Accounting, Chapter Harmonisation

These time lags might give rise to a considerable distortion. The Commission should not have accepted this slow proceeding of its members and should have pressured them to implement both directives sooner.

It should be clear that the aim of harmonisation of accounting standards is not pure uniformity. The term harmonisation does not suggest a rigid and narrow set of rules. There is no doubt, however, that the seventh Directive was a major step towards the production by European companies not only of more consolidated statements but also of more comparable ones. It also had the effect of bringing continental European practice more into line with that of Anglo-Saxon countries.

Nevertheless, the Directive was only adopted as the result of many discussions and a series of compromises, and therefore many options are available to member states. That is the reason why, consolidation practice will vary within the EU and will not represent a 'full harmonisation' because it was an option built into the Directive and member states could impose stricter requirements (e.g. more detailed disclosures). However in summary, it can be said that most European countries have closely implemented laws based on both Directives (Switzerland).

A more recent step towards harmonisation of accounting standards was done by the EU Lisbon Summit in 2000. It produced a considerable degree of political impetus for the adoption of international standards[20]. The EU believed that the harmonisation of accounting standards was of an economic benefit and movement towards this objective was given widespread political backing. The EU's goal was to become "*the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth and more and better jobs and greater social cohesion*"[21].

The EU believed it was important to remove barriers to cross-borders trading in company securities by ensuring corporate financial statements being more comparable and transparent.

To summarise, the EU has from an early stage on identified the importance of harmonisation of accounting standards in Europe, mainly because national differences could impact on the single market as a whole. The EU took the initiative to take a step forward in promoting harmonisation in 2002 but they need to put pressure on the member states so that the directives become implemented more successfully. By announcing the introduction of IFRSs in 2005 it has found a common financial reporting method for businesses in the EU. With the introduction of the Euro,

[20] European coporate reporting, lecture notes
[21] EC. 2000. <www.wikipedia.com>

this helped the introduction of the IFRSs because it facilitated cross-border comparisons of financial statements. All in all I think that the EU has been relatively effective in promoting harmonisation.

The harmonisation has the results that it is now is more sufficient and more effective for companies in particular, because it is now easier to make comparisons of companies in different countries in the EU. There is a reduction in the risk of misinterpreting the financial numbers or time lags in evaluating the results. That means that it reduced investment delays and missed investment opportunities.

6. Conclusion

It obvious now, that compulsory use of IASs for listed companies' consolidated statements may lead to an end of the use of national standard setting in some countries. For example the UK is likely to adopt the IASs for all purposes, because it makes no sense for them in running two different accounting systems.

The IASB and the EU were both concerned and active in promoting harmonisation of accounting standards. However, in my opinion the most powerful promotion towards regional harmonisation among leading countries is the EU. This could be explained, as the harmonisation of accounting is one of the many aims of its Commission as part of the EU's overall objective, which is to remove economic barriers within the EU.

The harmonisation in Europe was mainly achieved by the introduction of the EU Directives. The fourth Directive has caused some change in most EU countries in formats of accounts or disclosure or valuation procedures. The seventh Directive has achieved a significant degree of harmonisation of group accounting.[22]

The EU's transition to IFRSs it can be argued is one of the largest accounting conversions in history, as they impact on over 9,000 companies and bodies in the European Union.

[22] European coporate reporting, lecture notes

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