

Comparing and Contrasting the History of the Euro With the History of Accounting Convergence

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The purpose of this paper is to propose a theory that the historical development, the perceived/actual benefits and the problems of Accounting Convergence are somewhat parallel to the historical development, perceived/actual benefits and problems of the Euro. In addition, the paper provides a concise summary and analysis of the fifty year history of International Accounting Standard Convergence while simultaneously intertwining certain aspects of the history of the Euro's development.

Keywords: IFRS, FASB, Accounting Convergence, Euro

INTRODUCTION

For many years the accounting profession had a goal to create one set of global standards for public company financial statements. In short, instead of international accounting standards developed by the International Accounting Standards Board (IASB) and United States Accounting Standards developed by the Financial Accounting Standards Board (FASB), there would be one set of standards used globally.¹

Prior to 2008, the momentum for one set of global standards was progressing very well for many years (Hail et al. 2010). However, the financial crisis of 2008 and the related fallout resulted in changes that make the prospect of one set of global standards very unlikely. Before explaining why this is the case, it is important to define some important terms and also to provide a history/background of the initiative to develop one set of global standards prior to 2008.

Important Terminology

When thinking about global standards the terms convergence and adoption are often misinterpreted. Adoption means that countries like the US that do not currently use IFRS set a specific timetable when publicly listed companies would be required to adopt IFRS as issued by the IASB. In essence, US Accounting standards and other countries standards for public companies would cease to exist (Jermakowicz et al. 2006).

In contrast, Convergence of accounting standards technically refers to the goal of establishing a single set of accounting standards that would be used internationally by all countries (Baculik 2010). Convergence is generally interpreted to mean the work that the FASB and the IASB have been undertaking to develop high quality, compatible accounting standards over time (Schipper 2005).

The parallels between the establishment of the Euro and the establishment of one set of global accounting standards are numerous. For example, today the euro is one of the world's most powerful currencies (Columba 2008). The Euro is used by more than 321 million Europeans in 19 of the 27² European Union Countries. Approximately 120 nations and reporting jurisdictions permit or require IFRS

for domestic listed companies, although approximately 90 countries have fully conformed with IFRS as promulgated by the IASB and include a statement acknowledging such conformity in audit reports.³

Perceived Benefits of Accounting Convergence/ the Euro

The perceived benefits of Accounting Convergence and the Euro are also very similar. For example, both these initiatives were partially motivated by the goal to reduce transaction costs. In the Euro's case with a single currency, there would be no longer a transaction cost involved in changing currencies. This would benefit individuals and firms who traded within Europe (Blanco 2001). In the case of Accounting Convergence, countries that use the same accounting system don't have to incur the costs to translate their financial statements to issue stock on foreign exchanges. Also there have been academic studies that IFRS reduces the cost of equity capital for participating countries (Epstein 2009).

Another similarity is one of the goals of both initiatives was to help mitigate uncertainty. With the Euro a single currency helps the member countries to eliminate volatile swings in exchange rates, thereby improving business confidence and exports, which leads to economic growth (de Nardis & Claudio 2003). With convergence if countries are using the same accounting standard there is less to interpret and make judgement on with regard to financial statements.

Another similarly perceived benefit/goal was greater transparency. In the Euro's case, since the goods of all member countries would be denominated in a single currency, the expectation was it would be easier to compare prices and therefore, easier for firms and consumers to buy cheaper goods and supplies (Noor-Drugan 1999). In the case of IFRS adoption or convergence it was thought it would lead to greater substance in reporting rather than focusing on form (Gates 2009).

OVERVIEW OF THE FIFTY YEAR HISTORY OF THE GOAL OF INTERNATIONAL ACCOUNTING CONVERGENCE AND THE DEVELOPMENT OF THE EURO

1950's and 1960's

International convergence of accounting standards is not a new idea. The concept of convergence first arose in the late 1950s in response to post World War II economic integration and related increases in cross-border capital flows. Initial efforts focused on harmonization, or reducing differences among accounting principles used in major capital markets around the world. By the 1990s, the notion of harmonization was replaced by the concept of convergence, or the development of a single set of high-quality, international accounting standards that would be used in all major capital markets (Strouhal et al. 2015).

With regard to the Euro, in many respects everything began with Treaty of Paris (1951) and the Treaty of Rome (1957). The Treaty of Paris called for a common market arrangement and contemplated/proposed the total elimination of tariffs on goods traded between the partners (Swann 1992). The Treaty of Rome, signed in 1957, set the objective for Europe of creating a "common market" to increase economic prosperity and contribute towards "an ever closer union among the peoples of Europe". The advent of the euro in 1999 was arguably the culmination of the Treaty of Rome signed 42 years earlier (Buch 1999).

In 1962, the American Institute of Certified Public Accountants (AICPA) hosted an International Congress of Accountants. The discussion at the congress focused on the world economy in relation to accounting. Many participants urged that steps be undertaken to foster development of auditing, accounting, and reporting standards on an international basis (Lemarchand et al. 2008).

In 1966 an Accountants International Study Group was formed by the AICPA and its counterparts in the United Kingdom and Canada to study the differences among their standards. The group was active for about 10 years, producing studies of differences in 20 areas of accounting that also included conclusions on best practices (Cummings 1975). In the late 1960's a textbook on international accounting was first published (Bracken et al. 1997).

With regard to the Euro, in 1969, Pierre Werner, a long-serving prime minister of Luxembourg, was asked to chair a high-level group on how a European Monetary Union (EMU) could be achieved by 1980.

Werner and his colleagues eventually produced a report that proposed a 3-stage process for achieving a complete monetary union within a decade. The Werner Report urged that the European Community considers a monetary union (Barber 1997).

1970's and 1980's

The modern monetary era arguably began almost 50 years ago in 1971, when U.S. President Richard Nixon ended the Gold Standard. That act led to the collapse of the postwar Bretton Woods system that led to floating currency exchange rates. For the first time in history, the entire global economy rested on paper currency with no formal link to precious metals or, for the most part, to each other (Kadlec 2011). Although it would take 28 years from 1971 to achieve, the desire for a “euro-like” currency was an attempt to return to a hard currency.

In 1973 the International Accounting Standards Committee (IASC) was established. The IASC, the predecessor body to the IASB, was established by the American Institute of Certified Public Accountants (AICPA) and its counterparts in 8 other countries. Its mission was to formulate and publish, in the public interest, basic standards to be observed in the presentation of audited accounts and financial statements and to promote their worldwide acceptance (Yallapragada 2012).

In 1979, the FASB formed the first task force that included representatives from various International Accounting Standard Setters Bodies. When the FASB took on a project to revise its accounting standard on foreign currency, it decided to include representatives of the UK Accounting Standards Board, the Accounting Standards Board of Canada, and the IASB on its Task Force. This was one of the FASB's first significant efforts to formally collaborate internationally when developing a standard (Street & Shaughnessy 1998).

With regard to the Euro, in 1985 the Jacques Delors' European Commission produced a list of 282 "stepping stones" towards a single market. This commission helped transform the political landscape and produced a quantum leap in European integration. It also brought previously undreamed-of benefits to the periphery of the Union and encouraged Europe to look at itself for the first time as a world power (Wyles 2003).

In 1987 the IASC Embarked on Its Comparability and Improvements Project. This project eventually developed 25 standards covering various accounting issues. (Radix & Loudermilk 1998). The purpose of the comparability and improvements project of the IASC was to revise existing international accounting standards to permit fewer free choices of accounting treatment for like transactions and events and to require better disclosures. The IASC hoped to ensure that international accounting standards met the needs of all capital markets (Thompson 1992).

A very significant event happened in 1988 when the FASB became a Member of the IASC Consultative Group and a Non-voting Observer at IASB Meetings. This was very important because until this point, the FASB/IASB relationship was an informal one (Carey 1990).

However, when the FASB became a member of the IASC Consultative Group FASB representatives were now permitted to attend and participate in IASC meetings and provide input on technical accounting issues. Also in 1988 the FASB expressed support for Internationalization of Accounting Standards.

By the late 1980s, the need for a common body of international standards to facilitate cross-border capital flows had generated a high level of worldwide interest. The FASB decided that the need for international standards was strong enough to warrant more focused activity on its part. FASB Chairman Dennis Beresford expressed his support for “superior International standards” that would gradually replace national standards and identified new initiatives to get the FASB more directly involved in the drive to improve international standards (Korero 1997).

1990-1995

With regard to the Euro, the Maastricht Treaty signed in 1992 transformed the European Community into a full Economic and Monetary Union. The participants adopted a range of macroeconomic criteria

which had to be achieved in order to qualify for membership of the Monetary Union (The Maastricht criteria) (Spikula 2006).

With regard to convergence of accounting standards in the early 1990s, the FASB developed its first strategic plan for international activities and significantly expanded the scope of its collaboration with other standard setters. The U.S. Congress and the Securities and Exchange Commission (SEC) also became involved in the issues of international accounting standards (McBride, & Fearnley 1999).

In 1995 at the Madrid European Summit formal undertakings were initiated by 15 Member States in favor of a single currency, accompanied by a timetable. The timetable was adopted on the basis of the Green Paper drawn up by the European Commission on the practical arrangements for the transition (Jones 1996).

At around the same time in 1994 the FASB and IASC undertook their first collaborative standard-setting effort and in 1994 the FASB updated its strategic plan and undertook a project to compare U.S. GAAP and IASB Standards (Murphy et al. 2013). In short, by the end of 1995 the momentum for the euro and accounting convergence were both very strong.

1996-2004

In 1996, the U.S. Congress expresses support for high-quality International Standards and the SEC Announces its intent to consider the acceptability of use of IASC Standards by Foreign Private Issuers (Reinstein et al. 2000). In 1997 the Stability and Growth Pact is adopted by all the member countries at the Amsterdam European Council. For the countries joining the euro, it lays down certain common constraints relating to public finance (Gros 2005).

On January 1, 1999 the euro was launched as an electronic currency (Shiamptanis 2008). Later in 1999, the exchange rates of the participating currencies are irrevocably fixed. The countries of the euro area implement a single monetary policy. The euro is introduced as legal tender although until 2002 the euro exists only in the form of cashless payments (i.e., cheques, transfers, bank cards) (Thomsen 2003).

As far as accounting, in 1999 the FASB issued "International Accounting Standard Setting: A Vision for the Future" statement. The underlying aim of the statement was to express support for the position that "the worldwide use of a single set of high quality accounting standards for both domestic and cross-border financial reporting". The FASB's position at the time was a single set of high-quality international standards was desirable because its use would improve international comparability; reduce costs to financial statement users, preparers, auditors, and others; and ultimately, optimize the efficiency of the world's capital markets. Ideally, those standards would be set by a quality international standard-setting organization. The FASB report conveyed the Board's intention to maintain its leadership role in standard-setting and to ensure that the standards used in the US capital markets, whether developed by the FASB or an international body, are of the highest possible quality (FASB 1999).

On January 1, 2002 euro notes and coins are introduced and start circulating in twelve European Union (EU) countries (Shiamptanis 2008). Also in 2002, the EU issued a directive requiring all listed companies of the member states to prepare consolidated financial statements based on IFRS beginning January 1, 2005 (Doupnik et al. 2020).

With regard to Accounting Convergence in 2002, the Norwalk Agreement was reached between leadership of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). In summary, with this agreement the FASB and IASB formally agreed to work together to bring the US Generally Accepted Accounting Principles (GAAP) toward compatibility with International Financial Reporting Standards (IFRS). The agreement was reached at the FASB's headquarters in Norwalk, CT, and was documented in a memorandum of understanding (Wagoner 2009).

2004-2008

In 2004 ten new countries join the European Union, increasing the free trade zone and committing to the Euro. (Cecil, M. 2004). In 2007, the U.S. Securities and Exchange Commission voted to eliminate the 20-F reconciliation requirement for foreign issuers listing their stocks or bonds in the U.S. capital markets. Prior to 2007 companies preparing their financial statements under International Financial

Reporting Standards (IFRS) had to reconcile their financials to US Generally Accepted Accounting Principles (GAAP) (Chen 2019).

In early 2008, the SEC formally proposed a "Roadmap" for US Public companies to eventually prepare their financial statements in accordance with IFRS instead of U.S. GAAP (Bukics et al. 2009). The most eye-catching aspect of the SEC Roadmap was the goal that by 2014, IFRS would be required by all US listed companies if several milestones were achieved (Kang 2009). This represented the high water point for one set of global accounting standards like the Euro represented one monetary currency.

September 15, 2008 When Everything Changed

September 15th 2008 the Financial Crisis arguably began with the collapse of Lehman Brothers. The stock market started to decline rapidly on September 15th and continued that decline throughout the year. By the end 2008, stocks in the US had their worst annual fall since the Great Depression. While in Asia some markets ended the year with their worst performance since records began. Specifically, the S&P 500 fell over 35 per cent on the year, its worst run since a drop of 47.1 per cent in 1931, while the Dow lost 34.7 per cent, its worst annual decline since it fell 52.7 per cent in the same year. (Mackenzie & Rappeport 2008). Massive layoffs in various industries occurred and valuations of various other assets like real estate went down.

Post-Financial Crisis Impact on Euro and One Set of Worldwide Accounting Standards

The impact of the financial crisis on the Euro and the movement towards one set of accounting standards was extremely significant. After 2008 the problems with the Euro began to outweigh its advantages. For example, the loss of autonomy over monetary policy was particularly problematic during the recession that followed the financial crisis. The member countries of the euro lost the discretion of using devaluation as a means to boost exports or to borrow more to boost job creation or use fiscal measures such as tax cuts that they deemed to be appropriate for their respective country (Berg 2014). With regard to accounting convergence, the FASB and SEC also become much more concerned with the ability to have control over their own accounting policy and to lobby the U.S Congress (Coyne 2015).

With regard to the Euro, the problems with the loss of some national sovereignty after the financial crisis became more obvious. The simple fact was that most of the member countries involved in the Euro were not as strong as the country with the best economy (Germany) and not as weak as the least financially stable countries (Greece, Portugal) but they were all tied together monetarily (BBC Monitorin European 2010). The level of cooperation needed in this union had to be very high to deal with a host of issues including inflation, interest rates and asymmetric shocks. (Monnet et al. 2014).

For example, before the crisis began in 2005, Spain and Ireland were growing quite fast and needed higher interest rates to control inflation, which was not what some of the other countries needed. These same countries in 2009 were facing a deeper recession than the other members, and needed lower interest rates then (Warnock & Debaere 2012). In other words, it was very difficult to set interest rates that might be acceptable to all countries for the stage of growth and economy that they were in (Redwood 2011).

The Eurozone crisis brought to light that as long as things were looking rosy, the pros of one united currency outweighed the cons. However, problems in one or more of the member countries raised questions on the merits of a single currency in much the same way the US was much more concerned about giving up their sovereignty over accounting standards.

With regard to Accounting Convergence, on July 13, 2012, the SEC released a conclusive staff paper, "Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Final Staff Report". In its introduction, two main points were emphasized: First the SEC did not make any policy decision as to whether IFRS should be incorporated into the U.S. financial reporting system or how this would occur if implemented. Second the report called for additional research in the form of analysis and consideration of the changes that would have to occur before the SEC could make any decision. By failing to make a clear cut recommendation, it disappointed constituents for and against one set of accounting standards (Ciesielski, & Weirich 2013).

The reaction to the SEC report was almost immediate. Shortly afterwards the IFRS Foundation, which oversees the IASB, issued a statement that it "regret[s]" that the U.S. has not made a more definitive choice regarding the adoption of IFRS and that an action plan by the SEC would be welcome." Hans Hoogervorst the head of IFRS was even more pessimistic, declaring in the IFRS Foundation statement that the era of convergence was coming to an end. (Whitehouse, T. 2012).

CONCLUSION

For the last 50 years the progress of the development and implementation of one European currency was somewhat analogous/parallel to the development of one set of accounting standards though the progress of one set accounting standards was always somewhat slower. In short, the optimism and initial success of the Euro may have sparked and increased momentum of convergence for the 50 years prior to 2008. Post 2008 the perceived/real problems of the Euro may have been a factor in in hindering the one accounting standard initiative. The IFRS and FASB still work together to converge standards whenever possible. However, the FASB reserved the right to reject IFRS standards that they deemed might not be in the best interests of US investors. In other word, the heady days of a "Roadmap" to prepare their financial statements in accordance with IFRS instead of U.S. GAAP has ended.

ENDNOTES

1. "IASB" is an independent accounting standard-setting body, based in London. It consists of 15 members from multiple countries, including the United States. (<https://www.ifrs.org/groups/international-accounting-standards-board/>) "FASB" is the Financial Accounting Standards Board, an independent body that establishes and interprets United States Generally Accepted Accounting Principles (GAAP). It is based in Norwalk, Connecticut USA. (<https://www.fasb.org/home>).
2. European Union: What Countries use the Euro (https://europa.eu/european-union/about-eu/euro/which-countries-use-euro_en)
3. IFRS Frequently Asked Questions (https://www.ifrs.com/ifrs_faqs.html)

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