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**Convergence of accounting standards between EU and US. Practical issues and future prospects**

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**Abstract**

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Day-to-day our world is getting smaller than ever been because of globalization trend. It did not pass away from accounting sphere too. Aim of paper is directed to investigate paybacks, issues of uniform standards and to find appropriate answer to this question: *Why should US approve IFRS on the national level? Which differences currently exist between IFRS and US GAAP?* The thesis consists of 3 main parts, in which first one describe causes stimulates convergence trend, returns and risks tracked from IFRS adoption. In second chapter it was examined practical differences of US GAAP and IFRS, also dissimilarities between local standards of EU and IFRS. And in third part I have shown real situation related with IFRS adoption by US and EU businesses. Additionally, I have explored factual situation about conversion to IFRS in Azerbaijan and main issues related with that trend in our country.

**Key words:** IFRS, US GAAP, convergence, adoption, financial reporting, financial statements, convergence of accounting standards

**Table of Contents**

Acknowledgement………………………………………………………………2

Abstract………………………………………………………………………….3

Introduction……………………………………………...………………………5

**Chapter 1. Theoretical basis to the convergence of standards**

**1.a** Influencing factors to the integration of the standards ……………..….….10

**1.b** Expected paybacks and menaces sourced from convergence ………….....22

**Chapter 2. Practical cases demonstrating conversion impact in US and EU businesses**

**2.a** Case of US based company: Results of the conversion to IFRS………….29

**2.b** Case of European companies: Impact of the adopting IFRS……………..43

**Chapter 3. Actual position of the convergence trend and future prospects**

**3.a** Current and future of convergence phenomena in US and EU……………47

**3.b** Expert opinions on IFRS adoption………………………………….…….58

Conclusion ………………………………………………………………….....61

Appendixes……………………………………………………………………66

Reference………………………………………………………………….…..70

**Introduction**

Bookkeeping standards are as “Pearls of the accounting system”. Where accounting standards are more qualitative and detailed there business life is more healthy and flourishing. Time to time accounting sphere gains much more independence and transparency from the local government within its borders. We owe this independence in the accounting to the process of convergence standards of accounting which has long history behind itself. The convergence process didn’t start and reached its goals in one day, vice versa it required years to set today’s relative developed accounting system over the world. And it is conscious that the trend of convergence is a long process which requires much more time than we think. I had investigating a lot before finding this theme as the topic of my diploma paper, because in my opinion the thesis topic should be written not only for passing the exam but also getting deeper experience related with one’s specialty, learning its characteristics more elaborately and preparing useful outcome which can be used by future generation. So I hope choosing the theme which name: **Convergence of accounting standards between EU and US. Practical issues and future prospects** – will bring me plenty of virtual interesting adventures related with accounting out of borders of my country.

Three main purposes which will be attempted to find responses within this thesis work and these are the below enumerated items:

* Clarifying role of convergence on the development of EU and US;
* Highlight current issues against full adoption of IFRS in US and future threads in EU states;
* Evaluate factual preventions of establishing uniform standards in Azerbaijan.

Before starting to discuss about the main purposes of the thesis it would be respectful to give background information about mostly used standards by different countries, how and when the convergence trend appeared and who are the essential intended parties of this process.

**Mostly used accounting standards**

Standards – are the sum of statements which are designed to give frame into business operations. Standards help businesses to report and present their financial results and also show financial performance to the users (stakeholders) of their financial statements. So, main aim of accounting standards is to create a transparent bridge between internal and external side of organization. Even though that, different enormous accounting anomalies in the various international companies, such as Enron, Worldcom displayed us that there is no guaranty if the company uses accounting standards it is firmly transparent business.

However massive lack of accounting standards in any country’s or even region’s companies can lead to horrible financial crisis. One of the effective examples of such circumstances can be 1997 Asian financial crisis, which started in Thailand and spread over several Asian countries such as Indonesia, South Korea, Hong Kong, Laos, Malaysia and the Philippines. Main source of this crisis was that giant firms could easily benefit from the poorness of accounting standards of their countries. So, these companies could easily cover huge debts, losses of theirs using just little manoeuvres in the accounting system. Eventually all of that process resulted in financial crisis.

Crucial standards of today are IFRS, which is accepted by different countries partly or in whole. IFRS were fashioned and sustained by IASB. EU countries have been forced to use IFRS in their accounting system since 2005. Some countries started to adopt local versions of it.

Other mostly wide standards of accounting are GAAP which was appeared in The US and were promulgated by FASB.

Besides these standard there are also national standards of every country which were used only within this country’s borders.

**The intended sides of the convergence**

Originally, the root of convergence was come from collaborative struggles of FASB and IASC. Both of their wish is to eradicate differences among U. S. GAAP and IFRS. They were created approximately at the same period, in 1973, however, the motherland of one of them (FASB) is US, but the other one (IASC) was created in London by the efforts of different states, included France, the Netherlands, Germany, Australia, the United Kingdom, Ireland , Japan and Canada. In 2001, IASC founded IASB as its continuer.

The other essential side of the convergence process is SEC of US. SEC has issues work plan as road map of convergence firstly in 2008 and then after 2 years it released its vital report about convergence which was accepted as finishing stage of its work plan.

Besides those international collaborators each country has its particular organization which deals with establishing and making amendments to accounting standards of its. In the US this organization is called Financial Accounting Standards Board, in the UK it is duty of Financial Reporting Concil to approve accounting standards, in Australia this role belongs to the Australian Accounting Standards Board and finally, in our homeland country, Azerbaijan to work or make any changes over the national accounting standards is the task of Ministry of Finance. All above listed organizations are created by the government and it means that the sphere of accounting captures the center part of interest of every state.

**Chronology of the steps toward convergence**

In different literature convergence is described as two-way movement, which means that at least two sides should participate in the convergence process. In the further development of that process globalization tendency has immortal role. Because after the creation and development of the world wide web certainly firms of different countries started to set more tight business relations with one another. But setting successful business affairs first of all required clear and reliable accounting system for each side. So companies which wished to take benefits from the globalization flows started gathering around new trend at the accounting industry which called Convergence of the accounting standards. Actually, convergence is not innovative idea. This concept first ascended after the period of World War 2nd. It was related with the circumstances of increasing cross-border capital flows. But at those times the word of convergence was replaced with the word of harmonization. In that case harmonization meant decreasing differences among accounting standards which were used in key capital markets of the world. In 1962, in International Congress of Accounting which was hosted by AICPA lots of members pronounced the basis for groundwork of accounting standards on the international level; After this meeting Committee about International Relation started to carrying out within accountants altogether. Then there appeared IASC in 1973 which had released nearly 30 standards by 1985. From 1990s, the conception of harmonization was switched by the thought of convergence which main purpose is the progress of integrated set of superior, worldwide accounting standards. By 2000s the speed of convergence has accelerated. There were sparks of collaboration between FASB & IASB, it means that U.S. began to adopt IAS.

The standard formers (FASB & IASB are also called founders of standards of accounting) have defined what convergence worth to them. They expressed what are their tactics for future by signing two vital dissimilar documents. First, they have been cooperating together toward convergence later 2002 by signing of “Norwalk Agreement”. Second, they also agreed on the Memorandum of Understanding (MoU), in 2006, and made some amendments to it in 2008 and in 2010. The MOU contained in itself following obligations:

* make existing standards fully companionable and practicable;
* coordinate their upcoming work sequencers for warranting compatibility.

It will be much clearer and understandable if I describe the origin of the convergence process via smart art illustrations. So, in Appendix Figure 1. demonstrates how the convergence appeared and became one of the most popular and vital topic of the agenda of the accountants’ world.

Today, not only companies with large amount of turnovers but also small firms even which don’t have any international operations are influenced by the the convergence process. Because only via the convergence comparability of financial statements can be provided. Comparability of the statements of different firms’ helps stakeholders to make right analysis while they are investing or making other important decision about the particular company.

**CHAPTER 1. THEORETICAL BASIS OF THE CONVERGENCE OF ACCOUNTING STANDARDS**

**1.a Influencing factors to the integration of the standards**

Accounting is defined as the outcome of certain economic environment and period of history. So, accounting of nowadays is determined as the global convergence era. The central part of every country’s accounting system is captured by the accounting standards. They differ from plentiful aspects across countries, and these alterations have significant effects on a company’s financial statements. Accounting standards are seen as the linguistic means of financial reporting of dissimilar businesses which have been used in different formats all over the world. Today main aim of the accounting autonomies such as IASB, FASB is to unify these “languages” and create simple one among businesses of the world. The basis of integration of the standards is related with the merging of IFRS and US GAAP and also assimilation of the national standards to IFRS. The situation is like that if US approved IFRS whole it would accepted them as its national standards immediately and this process of convergence hadn’t been lied for so much period. Likewise, if further countries believed that US GAAP is the excellent standards they probably would elect this one as their national set of standards. But the fact is that the world needs converged version of them.

After the breakup of the Soviet Union it is observed that globalization process accelerated in economic environment too and indicated itself from different aspects which I mentioned in the below lines:

* rapid growth of international trade and worldwide investment activities,
* increasing support of international organizations to accounting area,
* growing number of multinational companies,
* developed capital markets, cross-ocean mergers of companies,
* Brain streams of educated labour resources.

Except these factors which are related with globalization process, there are also some other significant elements that have great importance on the adoption of IFRS. Those are:

* Equity finance,
* Foreign credit finance,
* Legal Systems of states,
* Taxation,
* Political - economic conditions
* Inflation rate,
* Economic development,
* Level of education.

All of these causes have resulted in the foundation of the new trend – Convergence of the standards of accountings. Since that time till today this topic has been revised one of the hot themes of the financial arena.

Initially, I need to mention the impacts of globalization originally factors which were written above page.

**Effect of worldwide investment**

One of the most impactful factors to the adoption process of IFRS is the necessity to the transparency for investors. Cause of all investors should understand and appreciate possible threats related with the establishment which they are preparing to make an investment. It is approved that the more company have detailed and clear financial reports the more it can attract investments to itself. As regardless of the amount of the investment each investor wants to get more and more useful information about the target entity. Because via true information financial statements of corresponding companies are considered much more comparable. And intended parties can easily analyze or at least give pre-opinion about these firms’ financial credibility. On vice versa, if certain company’s financial statement is not appropriate or clear to particular investor who has some plans about this firm, he/she will hesitate on making investment or other related activities to this business. The other advantage of the convergence for investors is lowering costs. Investors don’t have to modify the financial datas to synchronize with the standards of its country’s accounting standards. As it is known the translation process of financial information from one accounting system to other can require long time, lots of money, also numerous high educated and reliable employees.

In fact, main motive behind the foundation of IFRS is to reduce moral hazard issue which is related with information asymmetry that causes principle-agent problem. This problem arises when the management and shareholder of particular company are different from one another. Especially, this happens when an investor from one country make FDI (foreign direct investment) to the company located in the other further country. It means these two sides’ accounting system are significantly differs from each other. For instance, if the investor living in Japan decides to make investment to the company located in Nigeria, what can happen in the absence of IFRS? Let’s say Mr. Kim Hong Lee (Japanese man) have made his investment after plenty of translation cost and long time period to the Aladdin LTD (the firm in Nigeria) but how he will receive monthly, quarterly or annually reports related with the financial results and position of Aladdin LTD? In this case Mr. Kim Hong Lee will have two choices: 1) having deep confidence in the internal management system of the Aladdin LTD and doesn’t feel necessity for examining or translating the financial data which was prepared in Nigerian GAAP and obtained from the Aladdin LTD for every certain period; 2) treating prudentially and believed only in one devise-**Never trust anyone!** It means that although many years have passed Mr. Kim is continuing to checking and translation the monthly/annually financial data acquired from the Aladdin Ltd despite the huge amount of processing costs and time lag. If Mr. Kim chooses first case, it will likely the internal management will send him complex and non-understandable financial indicators surely with some embellishments and “blossoms”. In business this type of problem sourced from the information asymmetry which is called also as Moral hazard or Principle-agent problem. In this case, Mr. Kim would be seen as the virgin of that situation. So, creating IFRS really helps to growth of the productivity of capital investment.

**Effect of the strong support of international organizations**

One of the most powerful contributing factors to the convergence of bookkeeping standards is the motivating behavior of international organizations toward the acceptance of IFRS. Main examples of such establishments are WTO, World Bank, FASB, IASB and SEC which have done enough works for adoption process of IFRS by different states’ securities markets, banks, government organizations and local companies. All of these organizations are very enthusiastically for coordinating their way with IFRS because it was founded that essential basis of this willingness is raising welfare, charming investment, enhancing economic progress and directly lessening poverty.

It was announced by the Foundation of IFRS that a new collaboration treatment was agreed with World Bank in 2017. Crucial role of this agreement is to give immense support to the countries with developing economies in the usage of IFRS standards. For several years, World Bank functioned with different organizations to strength the use of single set standards among companies, especially within SMEs in non-developed countries for the formation of transparent financial environment. IFRS Foundation also has intention to spread its capability and know-how about IFRS to SMEs in such economies. So this significant goal encouraged them to form strong cooperation, because final product of this collaboration can accelerate reaching their public mission in short time. The primary focuses of this agreement includes:

* Expansion of scholastic programs in developing states which can be either online or face to face. They may help for building preliminary understanding and impressions about IFRS. It is also required to provide these subjects with essential actual educational materials.
* Just the expansion of such projects or implementation only one time is not enough for great success. So packaging these programs permanently is as vital as their development.
* After reaching initial goals it was planned to open the gate door of IFRS Foundation to the delegations of developing countries and allow them to demonstrate their active role within IFRS Groundwork.

According to Michel Prada who is Board Director of IFRS Foundation recently a lot of developing nations have accepted IFRS. But fact is that most of them requisite extra support or realizing vital changes to standards. Cooperation with WB can help to achieve those aims. And also, Joaquim Levy, the Management Director, CFO of WB, said that he was delighted the two of them are working faithfully for restructuring transparent, efficient and of course comparable financial reporting standards for developing states. The other major supporting parties of the wide spread of IFRS are IASB and FASB. Initially, these collaborators paid essential attention to the implementation of short-term projects which include:

* Segment reporting –related with IFRS 8, published in 2006;
* Fair value option–US made amendment on fair value option in 2007;
* Joint ventures­–related with IFRS 11 which pressed in 2011;
* Income tax–however, its priority level lowered, related draft was published in 2009.

The parties declared in their joint report which was published in 2012 that approximately 80 % of short-term projects had been finished. Though that the convergence process have not stopped yet, because of long-term projects. They include following points:

* Derecognition;
* Fair value measurement;
* Financial instruments related with equity;
* Revenue recognition.

**Effect of the growing number of multinational groups**

One of the most essential instruments of economic, social and technical dynamism is the development and growth of multinational firm. Because establishing their branches, subsidiaries in different countries multinational companies help to increase welfare of people and bring new ideas to our life. From pasy years till today one the major challenge for multinational companies (MNCs)was different GAAP standards of various countries in which they had established their branches. Because the main business actions of MNCs are taken place in the host countries rather than the home countries of theirs. It was noted by Owojori & Asaolu (in 2010) that different sides of business actions of MNC directed to the activities which revealed in bookkeeping. Essential reason of complexity of the accounting system of the certain MNCS is that its bookkeeping contains in itself various operations with different countries in different currencies using unlike reporting standards. It means that if the MNC operates in 22 countries it must prepare various sets of statements related with finance due to every state’s local GAAP standards, the more statements the more cost. So local GAAP standards in most case prevent worldwide investment activities which results in decreasing of FDI to the country. One of the problems for MNCs sourced from the translation of financial reports to IFRS is related with time lag. Especially when it comes to exchange conduct exchange rates. Because exchange rate of the transition time in most cases is different from the exchange rate of preparing time of financial statement in host country.

So reforms related with facilitating the financial reporting of MNCs are directed to convergence trend. It’s stated that countries which have similar bookkeeping standards it will be beneficial if they start to collaborate with each other on their accounting standards. It is definitely recommended by MNCs that transformation from rule-grounded standards to the principle-based ones is crucial for the world economic and business life.

**Effect of developed capital markets**

The other impactful factor for steering to convergence is deliberated as the internalization of the financial capital. Nowadays essential capital markets insist on using IFRS rather than US GAAP. This is explained with:

* better transparency of IFRS adopted companies;
* facilitating character of M&A within IFRS,
* provision of comparable reporting across borders in cheaper costs,

However, there are still some developed capital markets in which using IFRS is not stated as compulsory. The major ones are:

1. US businesses –despite its high convergence efforts there have not any mandatory declaration by the government related accepting full IFRS for the all businesses located within its borders. US regulation just permits using IFRS for non-local businesses established their affairs in its lands.
2. Japan – like US just the voluntary implementation of IFRS is permitted.
3. China –it endures to make corrections to the local bookkeeping standards so they are similar with IFRS.

From the aspects of the protection of current and potential investors the significance of IFRS is very great. Even investors who originally come from US are carrying on to capture cross-border investment chances. According to modern assessments more than 7 trillion dollar US originally capital is spent in stocks of foreign companies which are situated out of US borders. And from the other side US markets are also considering one of the attractive capital areas for investment purposes. So it is important for companies founded and operating in the US to be bilingual while preparing their financial announcements.

**Effects of brain streams of the educated labour resources**

Nowadays accounting is measured as the most elastic specialty because any student graduated this field and learning international sides of it can find job easily in other countries too. With the help of internet educated accountant find high-paid jobs in developed countries and move to there. However, in some cases we observe contrary process. It means accountant which have passed ACCA or other international accounting exams spread their knowledge to developing countries by moving and working there. It should be noted that essential role in the increasing number of such high educated bookkeepers belongs to the massive scale of accountancy courses which give deep knowledge to their students on details of IFRS. Another reason of such brain streams can be explained by different international audit firms establishing their branches in developing states. But why do they do it? Surely, because of multinational companies which are also increasing their subsidiaries in such developing countries. And to get valid audit report about their financial statements they need collaborate with reliable and international audit firms. For instance, if Coca-Cola establishes its branch in Azerbaijan surely it will work together with and get audit report on its activities from the audit firms included in “Big Four” not from local and non-famous audit companies which deal with.

As it seen all aspects of economic globalization are relating with each other and have significant influence on the convergence process.

Now, I memorize about other different factors’ impact to the convergence or adoption process of IFRS (which minimize or maximize its acceptance speed). These influences are government’s strategies on taxation, political position, education, inflation level, legal system. Besides these ones, general model of equity and debt finance is also vital points which has effect on the convergence trend.

**Effect of equity and debt finance**

Equity or capital is one of the three elements (assets, liability and equity) of accounting system. According to Nobes the more equity system of company is powerful, the more its equity is penetrated by outsiders (investors). Although that penetrating power of these outsiders there is still existing information asymmetries between managers and shareholders. And those investors are stimulating the need for more elaborated financial disclosures. In which state equity financing is stronger, their bookkeeping system is considered extra equity market oriented. Nonetheless, if any country already has got the developed and reliable accounting system which gives an investor validity and confidence on financial indicators of the particular company, in this case there is no need to convert the existing datas from one type of standards to the other type one. For ex, The US already has its own GAAP standards which has been already gained confidence by some parts of stakeholders. It avoids the adoption of IFRS. So greater conviction on the equity financing results in the negative effect on the adoption of IFRS.

Debt finance also has power on adoption process. With the acceptance of international standards companies can acquire minor expense of equity and increased liquidness which is beneficial in the attraction of loans, especially foreign ones. So it is observed that in which corporations bank financing is dominant these companies are displaying more interest towards convergence procedure. Particularly, today it is trend for big corporations to get debts from international organizations such as World Bank, World Trade Organization etc. Subsequently, companies with higher amount of loans which gotten from overseas are more directed to adoption of IFRS.

**Effect of legal system of states**

It is known that states are classified in two parts due to their legal system:

1. Common law republics (federals);
2. Code law republics (federals).

Common law jurisdictions are characterized with their high investor protection policies which are mainly focused on decreasing of information asymmetry. This model is also called as *shareholder model,* where shareholders are provided with enough public disclosures. But the other type of jurisdictions differs from the first one with its confidentiality among political groups and called *stakeholder model.* Therefore, companies which come from common law states have more comparable information than code law ones and their accounting standards are more alike with IFRS.. So the probability of the adoption of IFRS is much greater in common law jurisdictions than others.

**Effect of taxation system of the government**

It is obvious fact that one of the most crucial users of the financial reports of companies is representatives of Taxation system of the state. So there is tight correlation relation between quality of reporting and tax system of the country. In which governments it is existing immense control mechanism over assets, capitals it means those states are tending to be key sides of the formation of reporting details. In such countries the primary objectives of the reporting is relating with providing governments’ needs on financial information for taxation purposes. So they do not have intention to raise quality of accounting system, converge standards of bookkeeping for meeting the information requirements of investors. When companies adopt IFRS there can appear additional costs which were not recognized by the tax reporting before adopting of IFRS. So the as the deductible expenses of companies are increasing they will pay less profit (corporate) tax to government. Thus in which nations gathering profit tax is capturing essential part of government’s interest there will be poor chance for acceptance of IFRS on the national level.

**Effect of the political position**

Historical events of nations play decisive role in the form of its bookkeeping system. Cause of long term political relations among nations result in having similar reporting standards. For instance, the countries which were colonists of UK till to the past century revealed IFRS as their national reporting standards much earlier than others which did not have such relations with UK. Because during the colonialism period the UK dispatched its professional accountants to those areas for creating similarity between the accounting system of theirs and UK. Despite that today they are independent and can create their own accounting system, because of long run colonialism traditions they just continues to following UK’s decisions in all aspects including in reporting too. It is fact that UK is the most prominent participant of IASB that regulate IFRS over the world, so the countries which have had political links with UK are easily adopting IFRS.

**Effect of education**

It’s expected that nations whose society are more educated tend to convergence process more promptly. Because it is difficult to cheat educated people with embellished financial datas. These societies will insist on much more sophisticated bookkeeping system to prevent information asymmetry. As sophisticated reporting standards are more compound, it requires more educated people to work and interpret them. If country’s education level is low, the transition of local GAAP to IFRS can be seen very costly (because in this case the firms should bring specialist with deep knowledge in finance from oversees) to companies, so they will continue their business in previous standards and will not get any attention from foreign investors. Therefore states with highly improved education system converge to IFRS easily.

**Effect of inflation**

One of the major indicators of the country is the level of inflation. It affects to the businesses from numerous aspects including accounting sphere. It is anticipated that countries with high inflation level hardly approve IFRS. Best example for this case can be Latin American countries. In these states hyper level of inflation is considered as integral part of business operations. And because of according to IAS 29 non-monetary assets should be restated at the current date of balance due to fluctuation in prices, it causes difficulties for hyper-inflation nations to implement this requirement periodically. Therefore, it is observed negative relations between inflation rate and acceptance of IFRS: higher inflation equals to weak implementation of IFRS.

As it seen from the first part of my theoretical analysis adoption process depends on several factors which of them are relating with one another. It also straightly hangs on the policy of government and general point of views of nations. From the second part of theoretical investigation of mine you will get information about beneficial and risky sides of convergence for countries.

**1.b Expected paybacks and menaces sourced from convergence**

Before start to mention about returns and challenges coming with convergence or adoption of IFRS it would be beneficial to describe main relations between the two of them. Actually, both of them have the same objective which is obvious for whole of the world: establishing uniform and qualitative bookkeeping standards. Despite that main similarity there are also some essential alterations. If any country deciding on the implementation of IFRS adoption it means that state is directly beginning to remove all of the variations between local GAAP and IFRS, and replace the whole of its national standards with world-wide popular ones. However, if another country starts to join convergence trend it will only reduce some of main dissimilarities of accounting standards but not all of them. When accounting standards are converged with one another completely in long run period, it results in the full adoption of IFRS.

So, it is revealed that in the short run period it is more beneficial to support the convergence effort, conversely for the long run it is recommended to accomplish the adoption of IFRS.

**Expected benefits**

Nowadays, most of the developed and developing countries founded special deadlines for themselves on converging or furthermore on adopting IFRS in near prospects. Recently, leaders of the G20 countries have noticed their interest and attention to the utilization of qualitative universal accounting standards within of their areas. For defining whether adoption of IFRS bring more benefits and less costs, it is advised to conduct cost-benefit analysis. And only if the benefits will be more than costs the adoption or convergence can be allowable. The generally accepted benefits of the convergence or adoption towards IFRS are shown Figure 2 in Appendix.

Transparency, comparability and also efficiency are the most crucial characteristics of IFRS. The improvement in these three characteristics results in right investment analysis and minor capital costs. Also it is expected that via convergence toward single set of international standards in any country, it will be reduced the level of corruption, tax avoidance and generally, shadow economy. So they are defined as primary advantages of IFRS. Because of them it is explored that after mandatory adoption of IFRS the FDI invested to European countries have increased by 22%.

The comparability characteristics of IFRS can be provided when it has been adopted and used by more countries, regions. With the help of comparability feature managers of the companies which converged to IFRS can easily evaluate actual financial situation in their company and implement benchmarking to get compared results about local and foreign rivals.

Actually, the major identical feature of applying to IFRS is related mostly with attracting numerous investors and achieving more increased capital. Because of IFRS is not rule-based but principle-based so converging to it results in provision of the investors’ interests as following manners:

1. Comprehensibility of the reporting with IFRS is higher, so that both current and potential shareholders can make related analysis easily as they are provided with necessary reliable information;
2. IFRS prevent inequality on getting qualitative information among investors. Due to conservative opinions there were always discrimination between shareholders, they were separated as new or junior investors (who invested little amount of money) and professional or superior ones. IFRS give chance to place all shareholders despite the amount of investment for the same position. It results in decreasing risks within junior and professional investors.
3. IFRS help for saving certain amount of money which had been spent as translation cost of financial reports before. So it reduces additional analyst charges significantly.

All the above mentioning facts result in falling of the expenses of capital. Because if investors have high qualitative information the loss risks related with their investment is lower.

The other golden benefit for all stakeholders is relating with recognition of the firm’s loss instantly. This feature of IFRS is explained with increasing transparency. Well-timed loss recognition makes the company evaluate the historical values of the equity, assets and liabilities with their fair values in time.

There are also several beneficial factors for adopting IFRS by governmental side. One of them is solving unemployment problem. How? Making IFRS adoption mandatory in financial reporting and totally in accounting sphere within the country’s borders, surely will attract a number of multinationals. Because, from multinational firms’ aspects it is more efficient to make reporting according to one similar bookkeeping standards in several countries rather than using different domestic reporting standards of each state. So, when MNCs have established in any country which converged to IFRS, 90 % of their labour force will be consisted of the local people of that country. So, it is estimated that convergence to IFRS will positively affect to employment.

There are two progressive effects of the adoption process:

* Network effect
* Sociability effect.

They had given such explanation for the first effect, the worth of any products or even services will increase when much more individuals decide to use them. It means that if IFRS is adopted by more nations, its value (benefits) will subsequently outweigh its costs (issues coming with its adoption). So their research showed us that states will support the convergence toward IFRS when their essential goals are growth in foreign capital and volume of trade in economy. Therefore, adopting of IFRS by developing countries where it is necessary to attract oversees investments and increase international trade would be extra beneficial. The second effect – sociability is explained by the authors in this way, as less developing states feel pain from the illegal activities, corruptions, shadow economy, tax avoidance and other negative cases, therefore they need to construct an improved accounting and regulating system to raise welfare of nations, so using IFRS in accounting can be act as their saviour in the above mentioned situations.

The reimbursements gained by different sides who converged to IFRS. These are:

1. advantages for companies
2. advantages for investors
3. advantages for policy makers
4. advantages for regulators

Advantages for companies are listed as follows:

* Negligible capital cost;
* Sophisticated management of risk;
* Improved mechanism for internal audit;
* Reduced external audit fees;
* Effective decision making.

Advantages for investors are considered as following:

* Getting right-timed reports of financial position and results;
* Higher opportunities for comparison of companies;
* Right estimation of risks and profits;
* Greater confidentiality of the information gotten.

Policy makers also have some benefits from the convergence, which are:

* Qualitative planning and forecasting for future;
* Supporting of over sea investments;
* Easy entrance to developed capital market;

And the last beneficial party is regulatory bodies of the country, their benefits are shown in short context as below:

* Getting consistent and undependable information about the participants of market more easily;
* Follow and monitor the activities happened in the financial market and react quickly when it needs;
* Establishing advanced enforcement of accountancy system.

According to these and other beneficial sides which getting via convergence European Parliament declared in 2002 that from the year of 2005 all listed companies (more than 9000) within European boundaries should start to align their financial reporting with IFRS and also, publishing consolidated statements under IFRS was compulsory.

**Expected costs**

Despite its numerous paybacks and returns, adopting IFRS still have generated some issues, especially in developing countries. Main sources of these issues is relating with that IFRS is a system which designed and founded in developed economies, therefore essential focus is not on the developing countries. According to Pawsey (2017) the biggest problematic side of the implementation of IFRS is that it is more theoretical rather than practical system and it is noted by the author that the transition costs from local GAAP to IFRS are very huge, so particularly for small firms it may capture outsized amount of the company’s budget. And these cost mainly sourced from carrying out of the “endless” principles, disclosures which IFRS requires periodically. The large amount of these costs are connecting with training costs for teaching the employees working with new system, fees on consulting or applying external auditors’ services, IT expenses and the most important one is opportunity cost. The last one is very significant for any companies, because firms make analysis before converted to IFRS and ask them such question – To which activities can this money be spent instead of conversion to IFRS? And which decision will bring more returns to their companies?

The costs related with adaptation of IFRS in any company are classified in three groups, as below:

* The costs which formed during the adoption process;
* The costs that occurred after implementation.

Examples for the expenses which appear during the adoption process can be, training charges for upgrading employees with new system, advertisement costs which main purpose is to aware the users of financial reports about the changes occurred. The other important cost carried out during the adoption is about making amendments to the beginning saldos of the current period, also making modifications in retro-perspective ways where it is required under IFRS, for instance, changes to the method of the calculation of amortization of company’s long run assets. According to the Pawsey’s research, the average transition cost from the local GAAP to the IFRS for the European medium-sized company is equal to approximately €130 000.

It is noted that the same costs which listed above are been continuing to charge after the implementation of the new standards for several years. Because it is essential for the company to send its employees to the IFRS teaching courses continuously for strengthen their knowledge and get more benefits from them, it is also important for the firm to use consulting and audit services for preparing financial statements or getting audit advice on this theme periodically. So converging to IFRS can increase the costs in the company about 20 %.

According to another author, Lasmin who made research (2012) about the impacts of approval of IFRS in developing countries it seems that there are some specific disadvantages of applying to IFRS in these states. These are:

* Preparation process of IFRS was not occurred in the developing countries, so the special cases of theirs are not taken into account.
* Problems with languages appeared in the initial years of the adoption. In the first years it was obtainable only English versioned books about IFRS, so as it is known that in developing countries not everybody knows well in English, especially in scientific level. (Now IASB created the TAC group for the solution of this problem.)
* Developing countries rarely have liquid market for getting efficient data about competitors and other facts.

Despite all of these disadvantages and costs coming with convergence it was recommended by most countries to support the adoption of IFRS unambiguously. Because most of these issues are happened in short run and it is expected to get positive influences of convergence for long run period. The other important point is that today the escape from IFRS is impossible because of globalization process which is wide spread on the world.

In chapter 2 I have intention to describe main challenges which European and US businesses coped with in the transition period.

**CHAPTER 2. PRACTICAL CASES DEMONSTRATING CONVERGENCE IMPACT IN US AND EU BUSINESSES**

**2.a Case of US based company: Results of the conversion to IFRS**

**General review of differences between IFRS and US GAAP**

It is revealed by some researchers that differences between American GAAP and IFRS are less than similarities of theirs. Plus most of these differences are considered cosmetic ones. For example, the terms placed in the financial reports are differing from one another under each of accounting systems. The following list can be best patterns:

* Turnover versus sales
* Stocks versus inventory
* Share capital versus common stock
* Debtors versus accounts receivable
* Creditors versus accounts payable
* Revenue reserves versus retained earnings and etc.

But in other researchers’ opinions the dissimilarities are covering resemblances. They described significant differences in their works and explained possible results of them. For instance, Murphy Smith showed in his investigations main contrasts as below listed:

* Distinctions in the preparation of cash flow report;
* Variations in the bookkeeping of the inventories;
* Differences in the revaluation of long term assets (tangibles/intangibles);

Despite the same title name of cash flow statement in the two bookkeeping systems, there are significant alterations too: According to IFRS interests and dividends obtained should be recorded in the operation or in the investing parts of the cash flow reports. However interest and dividends spent must be classified as either operating or financing activities. Contrary, due to US GAAP dividend consumed must be recorded in finance part of cash flow, but dividend and interest gained and also interest spent should be accounted in operation part of this statement.

The other noticeable difference between the two standards is about the costing methods of inventories. ASC 330 in US GAAP and IAS 2 in IFRS are main standards called Inventories and deal with main principles of this item. It is allowed using LIFO method according ASC 330 under GAAP, but forbidden the usage of that method in IFRS.

One of the sensational differences among US GAAP and IFRS is related with revaluation of the companies’ assets. Revaluation of firm’s assets are not permitted in US, but allowed under IFRS. IFRS gives a chance to entities showing their assets in fair value using revaluation. A short example described below can make clear this point:

Nin Ltd, has premise costing $50 000, after revaluation it was known that the fair value of the premise on the market risen to $65 000. What will happen under both of GAAP and IFRS? Under IFRS its value on the balance also will be increased to its fair value in market, so double-entry:

Debit Premise account $15 000

Credit Revaluation surplus account $15 000

However, under GAAP any changes will not happen. An asset will be evaluated at historical cost, at $50 000.

Additional to these differences I investigated further more dissimilarities between the two standards. These are shown in below part:

* More rules – less principles. GAAP is more rule founded, conversely IFRS is known as principle based one. Sometimes issuers of the statements easily manipulate those rules and make their financial performance more attractive for stakeholders. The rules also make the context of GAAP more difficult than the IFRS. So, GAAP is larger than IFRS in quantity.
* Issues related with write-down. According to GAAP cost of inventory (also non-current asset) can written down by accountants to its current market price. The important moment here is that GAAP does not permit to reverse the written down amount of the inventory if the value of this asset increased in the market. But due to IFRS this amount may be inverted for matching with market value. It means that GAAP does not permit to describe the positive changes which occurred in market.
* Research & development cost. Research costs are shown as expense both in GAAP and IFRS, but the difference arose when it comes to development costs. According IFRS development costs can be capitalized (it means added to the fixed asset item in a balance sheet) and amortized in the periods more than one. The major criteria for recognition of development costs as fixed asset is identified as PIRATE. However, under GAAP all development costs should be recognized as expenses in P&L.

**Time to CASE**

Galaxy Corporation, is one of the biggest companies established in the US in Minnesota. It produces special tasted syrups with the aroma of chocolate and fruits for cake makers. Currently, it makes its return uniquely in US, but the company’s key target for 2020 is about expanding its businesses toward European countries: The Netherland and Italy. As it is known that both of these states are using the reporting under IFRS, so Galaxy Corp, also is required to reconcile its US GAAP statements to IFRS, for attracting the attentions of its future partners. For early time, the financial director of the company decided to identify the effects of the adoption IFRS only to the income statement.

**Balance Sheet of Galaxy Corp. (in US GAAP)**

**31.12.2018 (‘000, dollars)**

**Assets Liabilities & Equity**

**Current Assets Current Liabilities**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash | $ 40 000 | Accounts payable | $ 21 000 | |
| Inventory (LIFO Basis) | 45 000 | Taxes payable | 6 000 | |
| Prepaid Expenses | 2 000 | Accrued expenses | 13 000 | |
| Marketable Securities | 30 000 | **Sum of current liabilities** | **$ 40 000** | |
| Accounts Receivable | 70 000 |  |  | |
| **Sum of current assets** | **$ 187 000** |  |  | |  |
| **Long term Assets**  Assets (valued at historical Cost) $ 150 000 | | **Long term Liabilities**  Bonds payable-6% Coupon | | $ 33 000 |
| minus: Accumulated | | Deferred Income Taxes | | 6 000 |
| Depreciation (60 000) | | **Sum of long term** lia**bilities** | | **$ 39 000** |
| Net value of PPE **$ 90 000** | | **Sum of Liabilities** | | **$ 79 000** |

**Equity**

|  |  |  |  |
| --- | --- | --- | --- |
| **Intangible Assets** Common stock ($10 par) | | | $ 58 000 |
| Paid in Capital | | | 35,000 |
| Patent 8 000 |  | Retained Earnings 122,000 | |
| (Net of $14,000 Accumulated Amortization) |  | **Sum of equity $ 215 000** | |
|  |  |  | |  |

Goodwill 9 000 **Sum of liabilities & equity** **$** **294 000**

**Sum of intangible assets 17 000**

**Sum of assets 294 000**

And the following is the P&L statement of Galaxy Corp, which also was prepared under US GAAP for the time of 31 December 2018.

# Profit & Loss statement of Galaxy Corp.

**31.12.2018 (‘000,dollars)**

|  |  |  |
| --- | --- | --- |
| Sales | $ 552 000  $ 550,000 | 552 000 |
| COGS | (395 000) |  |
| **Gross profit** | 157 000 |
| SGA expenses |  |  |
| (including $3000 amortization, $12000 depreciation) | (104 000) |  |
| **Operating Income** | 53 000 |  |
| **Other income or loss:** |  |
| Dividend income | 1 200 |
| Interest income | 1 000 |
| Loss from the sale of marketable securities | (3 000) |
| Loss of restructuring Chicago state plant (8 000) | | |
| Earnings before interest and taxes | 44 200 |  |
| Interest expense | ( 3 000) |  |
| Income before tax | 41 200 |  |
| Tax (30 %) 35 % | $ (14 420) |  |
| **Net Income** | $ 26 780 |  |
| Earnings Per Share GAAP based | $ 4.62 |  |

**Accounting policy of Galaxy Corp:**

1. Company’s depreciation method is straight line: defined useful life for transportation assets is 10 years and for the premises (buildings) is 40 years; none of the assets has any residual values.
2. Amortization method of the intangibles is also via straight line, 10 years;
3. In 2018 the number of common shares were 6000;
4. It is known that pre-tax discount rate defined by market for patent is 11%;
5. In 2018 common shareholders received $ 6 000 cash dividends;
6. Galaxy’s tax rate equals to 35%.

**Other facts about Galaxy’s account system:**

1. The company uses LIFO method while calculated COGS and ending inventory at balance. Beginning inventory of 2018 was $ 40000, cost of goods produced was $ 400000, and ending inventory is $ 45000. LIFO reserves are as following:
   * 1. *01.01.2018, LIFO Reserve =$ 3300*
     2. *31.12.2018 LIFO Reserve = $ 7300*
2. The Galaxy Corp also has problematic lawsuits related with customer litigation, in condition of losing the company must pay $ 7400 to the customer. According to professional legal consultants the probability of losing the court is 53 %;
3. Long term assets of the company is classified as follow:

Transportation assets Machinery Premises Total

Cost 30000 70000 50000 150000

) (60000)

(Accumulated depreciation) (10000) (25000) (25000 Net Value 20000 35000 25000

90000

According to independent expert Mr Rayan fair value of these assets are:

* *Transportation assets $25000*
* *Machinery $40000*
* *Buildings $30000;*

1. Machinery has the second key component called engine which calculated as 40% of machinery. Its useful life predicted as 5 life, null residual value;
2. Management should assess possible impairment loss on the patent of company. It is predicted that cash flows getting from patent for 2 years equals $ 9000 ($ 4500 per year). Estimated NRV for patent is $ 7750 on 31.12.2018;
3. On 01.12.2016 Galaxy Corp, declared that it will stop its Chicago state plant. Departure from the plant planned to start in 01.01.2017 and completed in 31.12.2018. Exit costs stated as $16000 for 2 years ($ 8000 per annum);
4. In 2018, Galaxy Corp has spent $ 3000 development cost on its commercially powerful product – Lily aromatic Syrup. Management expectation on that product is great, according their estimation it will be best-selling of theirs.

After all of these given information it is required to identify **core differences in practice between US GAAP and IFRS**, and describe effects of them to P&L statement by **preparing new Income statement on the basis of IFRS** of Galaxy Corp for 31.12.2018. Before the new P&L statement it will be beneficial to prepare **Reconciliation of the conversion from US GAAP to IFRS**. I am going to comment on following essential points while solving this case:

* LIFO Inventory
* Loss of the company from the contingencies
* Asset Revaluation
* Asset Componentization
* Impairment Losses
* Restructuring/Exit Costs
* Capitalization of Development Costs

**SOLUTION**

1. **LIFO inventory**

Fact is that LIFO cannot be used in IFRS, so we should replace it either FIFO or AVCO. Considering the information we have, there will be used FIFO. In the above part I have shown LIFO reserves for beginning and ending period. While conversion COGS from GAAP to IFRS we should find change in LIFO reserves of 2018 year. Because the change in LIFO reserves equals to the difference among LIFO and FIFO COGS.

In Galaxy Corp difference between these reserves equals to $ 4000 (calculated as $ 7300-$3300), which means reduction in the new COGS in the amount of $ 4000. Therefore according IFRS FIFO COGS of the company will be reported as $ 391000 in P&L. Additionally it raises the amount of ending inventory at the balance of Galaxy by $ 7300 and Gross Profit in Income statement by $ 4000. Double-entry will be posted as:

Dr. Inventory account $ 4000

Cr. COGS $ 4000

It has been shown more elaborated explanation of the adjustment to COGS for conversion from LIFO method to FIFO in below part:

LIFO Adjustment FIFO

Beginning inventory $ 40000 $ 3300 $ 43300

+ Cost of goods produced $ 400000 $ 400000

Sum of inventory kept for sale $ 440000 $ 3300 $ 443300

– Ending inventory ($ 45000) ($ 7300) ($ 52300)

**COGS $ 395000 ($ 4000) $ 391000**

The other furtive impact of the conversion to FIFO method arises in the growth of tax payable of the company. Because when COGS decreases retained earnings increases so the tax obligation of the company also increases. Therefore most of the American companies happily choose to use LIFO rather than FIFO.

1. **Loss of the company from the contingencies**

According to ASC 450 (the standard about loss contingencies) the company cannot recognize its liability and loss as expense because of probability of happening is higher from 50 %. However due to IAS 37 the loss should be recognized when its occurrence probability is higher than 50 %. Actually both of these standards can recognize the loss as expense but unlike IFRS US GAAP does not set defined down limits for the percent of probability.

Double-entry of this effect due to the numbers of our case will be like that:

Dr. Loss from contingency $ 7400

Cr. Contingency payable $ 7400

1. **Asset Revaluation**

One of the key alterations between IFRS and American GAAP is on the valuation models of assets. Due to ASC 360, the standard of GAAP about revaluation method of PPE, it is demanded to use only cost model, but according to IAS 16 it is allowed using both of cost and revaluation methods. Revaluation model is related with the fair value of these assets, so if company once has selected this model it must conduct regular re-assessment of its assets to their fair value. US GAAP never let to write the value of PPE higher than its net book value.

Because of in our case it is noted to re-assess buildings only, we will work only with them. For simplicity I want to use reduction of the depreciation variant of the revaluation model. Corresponding double-entry will be as:

Dr. Acc. depreciation-PPE account $ 25000

Cr. OCI-Revaluation Surplus account $ 5000

Cr. PPE account $ 20000

Result of this transaction new carrying value of building will be presented equal to its fair value – $ 30000 in balance sheet prepared accordance with IFRS.

1. **Asset Componentization**

Due to the standard of IAS 16 bookkeeping under IFRS claim over the separate calculation of depreciation expense if one asset has isolated parts. However, in US GAAP that rule does not exist, so despite the number of multiple parts of an asset the company should recognize its depreciation for the whole asset. In the above I noted about the second vital part of machinery, with the expected useful life of being equal to 5 years.

So annual depreciation expense will be calculated under GAAP as below:

* For Transportation assets: $ 30000/10 years =$ 3000
* For Machinery: $ 70000/10 years =$ 7000
* For Premises: $ 50000/25 years =$ 2000

The sum of these numbers equals to $12000.

However, harmony with IFRS gives us different result, which explained as:

* For Transportation assets: 30000/10 years =$ 3000
* For 60% of machinery: 60% X $ 70000 = $ 42000/10 years= $ 4200
* For 40% of machinery: 40% X $ 70000 = $ 28000/5 years= $ 5600
* For Premises: 50000/25 years = $ 2000

The sum of above numbers is $ 14800, which is greater than US GAAP’s depreciation by the amount of $ 2800. Double-entry will look like to:

Dr. Depreciation expenditure – Machinery $ 2800

Cr. Accumulated depreciation – Machinery $ 2800

1. **Impairment losses**

Under both of system the impairment loss must be calculated for PPE and intangibles. In IFRS it has been shown key attributes of impairment of an asset includes in itself two main parts: internal factors, that are related with the decisions of management on an asset; external factor appeared from the condition of an asset in the market, attitudes of customers toward this asset, etc.

In American GAAP impairment of an asset is determined when its net book value is bigger than the evaluated forthcoming cash flows, if the expected future cash from the asset is superior or equal to the net book value there is not any impairment. But in IFRS due to IAS 36 asset has been impaired when its book value is larger than its recoverable or net realizable value.

*Determining the impairment loss via US GAAP:*

* Carrying value = $ 8000
* Undiscounted cash from the asset in future = $ 9000 ($ 4500 per year)

As $ 9000>$ 8000, there is no impairment loss in Galaxy Corp.

*Determining the impairment loss via IFRS:*

* Carrying value = $ 8000
* NRV = $ 7750
* Present value of the forthcoming cash predicted with asset= $ 7706 (this number calculated: 7706= (4500/1.11) + (4500/1.112); discount rate=11%)

It means that book value of asset is higher than both NRV and present-day value of the expected future cash, so loss of impairment equals to excess number between them; $ 8000 – $ 7750=$ 250. Double-entry will be:

Dr. Impair loss – Patent of Galaxy $ 250

Cr. Patent account or Accumulated amortization $ 250

1. **Restructuring or Exiting Costs**

ASC 420 states that exiting costs should be acknowledged when they happened, not in the date of their starting and declaration by responsible party. So in accordance with US GAAP exiting cost would be recognized equally at their occurrence date in 2017 ($ 8000) and 2018 ($ 8000).

However in IFRS these costs should be approved equally in the date of declaration of the plan and the date of starting the implementation. It means for the demand of IAS 37 the reporting of restructuring costs must be held on whether in 2016 (time of declaration the plan) or in 2017 (starting to implementation of the plan). IFRS is well-known with its prudency principle-knowing liabilities and expenses earlier than GAAP. Difference between the two regimes is described as following:

# Exit Expenses

**US GAAP IFRS**

2016 0 15,000 in 2016–Declaration of the plan to public

Or in 2017-Starting to the implementation

|  |  |
| --- | --- |
| 2017 | 8000 |
| 2018 | 8000 0 |
| Total | 16000 16,000 |

From the timing effect there will not appear any changes in P&L statement of the company, but in applying IFRS would make some corrections in a balance sheet on the date of 31.12.2018. As IFRS recognized all of exit expenses till 2018, these costs must be identical to $ 0 in 2018. The decline on restructuring expense by $ 8000 will result in the drop of tax payable by $8000X35%=$2800 and in the decrease of retained earnings by the amount $ 5200. Double-entry of these transactions described as:

Dr. Retained earnings $ 5200

Dr. Tax payable $ 2800

Cr. Exit expenses $ 8000

1. **Capitalization of Development Costs**

It is acceptable to capitalize the amount of development cost as intangible asset and calculate amortization for it under IFRS due to the standard of IAS 38. However in American GAAP according to ASC 985 development costs must be charged in their occurrence time as research costs. Therefore while conversion to IFRS from GAAP we should decrease the amount of SGA expenses by the amount of the development cost in our example. And also calculate annual amortization expense for that asset. Double –entries of these operations are as:

1. Dr. Asset account-Development cost $ 3000

Cr. SGA expenses $ 3000

1. Dr. Annual amortization expense **\*** $ 300

Cr. Accumulated amortization-Devel.cost $ 300

**\*** Calculation of this amount via straight line => $ 3000**/**10 years=$ 300

All of these modifications have shown us large or small differences between IFRS and GAAP which make obstacles for the convergence of these standards. The two standard creating organs IASB and FASB have been working on the joint projects for reducing those dissimilarities in several decades. And according to their activities the names of main differences in my case are listed from A to G, not A to Z.

After the main adjustments it is time for preparing reconciliation of net income from GAAP to IFRS as in the following form:

**Reconciliation of Income from US GAAP towards IFRS (in $’000)**

Income before Tax – US GAAP 41200 Adjustments:

1. COGS $ 4000
2. Contingency losses ($ 7400)
3. Additional depreciation expenses ($ 2800)

from asset componentization

1. Impairment Loss coming from Patent ($ 250)
2. Impact of restructuring costs $ 8000
3. Effect of development costs $ 3000

G) Additional amortization expenses ($ 300)

from the capitalization of intangibles

***Overall amount of adjustments: $ 4250***

**EBIT $ 45450**

Tax expense (35%) ($15908)

**Net income – due to IFRS $ 29542**

Analysing these numbers with the previous US GAAP founded results we can see the positive effects of IFRS for all society:

* First, company recognizes its liabilities and expenses more conservatively and truly;
* second, it gives a bit more taxes to government and it affects to the social welfare of people,
* third final growth in its net income will help Galaxy Corp, to attract more additional capital to its company.

**Income statement of Galaxy Corporation on the basis of IFRS**

**For the period of 31.12.2018 (in $’000)**

Sales $ 552000

Cost of goods sold (391000*)*

Gross Profit 161000

Operating expenses (86000)

Depreciation and amortization expense (18100)

Other Income/ (Losses):

Dividend income 1200

Interest income 1000

Loss on sale of marketable securities (3000)

Contingency loss (7400)

Impairment loss-patent (250)

Ebit 48450

Interest expense (3000)

Income before tax 45450

Income tax expense (15908)

**Net Income $29542**

EPS – IFRS based $ 5.09

EPS is one of the most interesting indicators for potential and current investors which is calculated by dividing net income to the numbers of common stock like this: $ 5.09= $29542/5800

**2.b Case of European companies: approach towards IFRS**

**General overview**

It is accepted that IFRS owes its widespread utilization to the European Union. As EU approved its regulation known as Reg.1606/2002 it was required that starting from 2005 whole of the defined companies (approximately 9000) should make their reporting accordance with IFRS. Today 43 countries located in Europe mandated running reporting via IFRS except Switzerland. As it is known Switzerland is not the member of EU and the status of IFRS here is revealed just permitting not requiring. It means companies can choose to report either under IFRS or Swiss GAAP FER (its national bookkeeping standards are called so). Europe has great penetration on IFRS setting v bodies, so that it was provided for all EU countries full translation of the each standard in every nation’s language. In Figure 3 it was described the real jurisdiction of IFRS in Europe.

In not every country the trend of convergence or adoption to IFRS is observed, for instance in Switzerland since 2009-2014 years companies have started to transform their financial reports from IFRS to Swiss GAAP FER.

So I have decided to use two examples in my paper and demonstrate which effects are arising while any company in Switzerland moves the reporting from IFRS to the national GAAP of Swiss. Especially I would like to comment on the effect of the transition to Swiss FER GAAP on shareholder’s equity. As we distinguish due to IFRS goodwill cannot be charged as expense on P&L statement and it should be placed as intangible asset on a balance sheet. Any company must not amortize goodwill, rather than it should be incurred to annual impairment test (if there are indicators of impairment for intangible asset). **But what is the approach towards goodwill in local GAAP of Switzerland?**

**Is goodwill considered as assets or additional expenses in Switzerland?**

**Time to CASE: 1) Swiss Prime Site**

Swiss Prime Site is a well-known company in Switzerland in the real estate businesses. It was established in XXXX. It has XX subsidiaries. More detailed information about the history, main missions and activities of the company can be acquired from its site: [www.swiss-primesite.com](http://www.swiss-primesite.com)

Since 2017 company started to exploit its domestic GAAP in financial reporting rather than IFRS. While switching from IFRS to the Swiss standards essential change in financial performance and accounting policy was observed in the treatment to goodwill. Goodwill appears when one company acquires other one. If the purchase price of the acquired company is greater than its net assets’ amount, in this case the difference between them is named as goodwill. According IFRS goodwill is recorded as intangible assets on a balance sheet and cannot be amortized, while under Swiss GAAP FER 30 goodwill can be amortized or directly charged with equity of shareholders. The amortization period for goodwill is determined 5 years (in some cases it is permitted to lengthen the period till 20 years). However board managers of Swiss Prime Site decided to offset the amount of goodwill with equity, they also decided to display theoretical effects of the amortization of goodwill in their annual report.

As the company of our case had acquired shares of several companies and gained control over them, there were some goodwill amounts which were recognized as intangible assets under IAS 38. These companies are listed below:

1. Acquisition of Boelevue Bae AG

* Short term assets 2066
* Long term assets 4756
* Current liabilities (5220)
* Total net assets 1602
* Purchase price 4560
* Goodwill **2958**

1. Acquisition of Gottuz Résidence

* Short term assets 7500
* Long term assets 13250
* Current liabilities (9250)
* Non-current liabilities (5640)
* Total net assets 5860
* Purchase price 12322
* Goodwill **6462**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| * *(in ‘000 CHF)* | **Share**  **Capital** | **Capital Reserves** | **Non-governing interests** | **Retaining earnings** | **Total**  **equity** |
| **Equity in IFRS 31.12.2016** | 10650 | 10230 | 200 | 27650 | **48730** |
| Offsetting goodwill |  |  |  | –9420 | –9420 |
| **Equity in Swiss GAAP 31.12. 2016** | 10650 | 10230 | 200 | –11170 | **39310** |

Double-entry of this transaction will be shown as below:

Dr. Retained earnings 9420

Cr. Intangible asset-goodwill account 9420

Transferring from IFRS to Swiss GAAP the company has encountered with following changes in its shareholders’ equity:

**Time to CASE: 1) Northern Bear**

After mandating status of IFRS in EU as other companies The Group of Northern Bear also started to transfer its reporting to IFRS. This transformation had resulted in several new changes to financial statements of the company and its subsidiaries. This case will take away you to the year of 2007-2008.

The reporting year of the company starts in 01 April 2007 and ends 31 March 2008. Essential changes on the financial reports of the company appeared in balance sheet and income statement items. Because of under UK GAAP the company amortized its goodwill annually and subtracted this amount from profit and goodwill’s historical value. However IFRS do not require amortization of goodwill, so the company must add the subtracting amortization amounts both to balance and income statement items, such as:

Adjustments

IFRS

UK GAAP

£000 £000 £000

Revenue 4750 - 4750

COGS (3460) - (3460)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Gross profit | 1290 |  | - |  | 1290 |
| Operating income | 55 |  | - |  | 55 |
| SGA | (1200) |  | 180 |  | (1020) |
| Results of operating activities | 145 |  | 180 |  | 325 |
| Finance income | 14 |  | - |  | 14 |
| Finance expenses | (190) |  | - |  | (190) |
| Income tax expense | (31) |  | - |  | (31) |

**(Loss) or profit (62) 180 118**

The changeover process results in positive changes in equity. Journal notes of above modifications will be described as: Retained earnings

Dr. Intangible asset-goodwill account 180

Cr. Retained earnings 180

Dr. Accumulated Depreciation 180

Cr. SGA 180

**CHAPTER 3. ACTUAL POSITION OF THE CONVERGENCE TREND AND FUTURE PROSPECTS**

**3.a Current and future of convergence phenomena in US and EU**

**Attitudes towards IFRS in US**

While I was conducting my previous chapters it was interested me why convergence process is did not direct towards adoption of US GAAP rather than IFRS. Why have most of the world’s countries preferred to IFRS not US GAAP despite that The US is one of most powerful states of the Earth Planet.

In fact, first financial markets are appeared and developed in US, in 1990 years US was known as leader country which companies had penetrating positions in financial markets compared with other states’. The most liquefied stock and capital markets were located in New-York. Most investors came to the decision of listing their shares from NYSE or NASDAQ. For your comparison, in 1990 there existed only 25 firms from EU in NYSE; however their number had grown to 150 by 2001. Because of SEC demanded from all those firms to make statements theirs’ under US GAAP on an American stock markets, so in those times, many professional analysts forecasted that US GAAP would gain dominant position among a lot of countries and most of them would switch their own standards to US GAAP. And it really had worked; in the middle of 1990s firstly Canada showed its sympathy toward US GAAP and started to bring closer its national standards with it. However increasing reputation of US GAAP had frightened the EU on the strengthen power of US, so it started to develop its own standards system. And from the beginning of 21st century countries decided on that they did not need rule based bookkeeping system such as: US GAAP, but it would be beneficial moving towards standards which are full of principles, such as IFRS. There were two main signals of stopping to move towards US GAAP:

1. Enron and other similar financial scandals, which had shocked the faith of investors and other stakeholders of those companies;
2. The decision of EU about mandating the reporting under IFRSs, as it was mentioned on above part of my paper, in 2002 EU declared that after 2005 all companies (nearly 9000 which were included in special list) must make their reports due to IFRS, rather than local standards.

After these scandals the regulating organ – SEC gave an order to FASB for making modifications on rules based system and turning them into principle based ones starting from 2003. Noteworthy stimulating acts carried out towards convergence between FASB and IASB and also by SEC are including following (RamMohan R, 2014):

* Agreement of Norwalk (2002) – regarding to this agreement convergence was stated as a focal goal of the two organizations, as nations.
* MoU (2006) – via this draft IASB and FASB revealed crucial convergence missions.
* Elimination of reconciliation issue – in 2007 SEC stated that foreign private entities operated in US could report under IFRS without any reconciliation with GAAP.
* Road Map designed by SEC in 2008 which determined specific deadlines for US businesses on acceptance of IFRS.
* Work Plan also was designed by SEC in 2010; it defined issues arising in different zones relating convergence phenomena.
* In 2012 SEC decided to publish its Final Report of Staff, it presented with this report no provision on improvement of IFRS approval.

I want to give Norwalk Agreement’s interpretation and effect of it on real convergence procedure in US. The focus areas of Norwalk contract are listed as:

1. Revenue recognition;
2. Leases;
3. Insurance;
4. Financial instruments.

Except the first one, other problematic areas still cannot find their solutions. As it is known before the approval of IFRS 15 there is used IAS 18 on the measurement of revenue. But it was too different from US GAAP’s revenue measurement criteria, so in 2014 IASB issued IFRS 15 and FASB released the standard named as ASC 606 as a purpose of convergence effort. They hope converged version of new revenue recognition standards will results in following benefits:

* Improved disclosure requirements;
* Help for dispatching advantageous facts of financial statements to interested sides;
* Eradication in defects and differences of revenue recognition norms;
* Enriching benchmark of revenue recognizing process over different companies, markets and areas.

But the problematic side of the new standards is that some firms are uncertain about implementing them. Most of them got accustomed to the old ones and do not know how to use new ones. Unlike IFRS, for giving hand those firms US GAAP provide large guidance on the new standard which riches over than 200 sample transactions, rules.

Other mutual projects besides the above mentioned revenue recognition are not completed or implemented. They could not prepare joint regulation on insurance sector. Actually, main goal for preparing guidance to insurance area were related with developing recording requirements associated to insurance contracts. Because it is really important to display consistent information about position, results and performance of the entities while they are going to negotiate on insurance contract.

IASB and FASB could not develop mutual project related with financial instruments. Although they (IASB and FASB) tried to develop mutual guidance on grouping of them, impairing them, hedging and offsetting in balance sheet, however both of them have chosen to act disjointedly. IASB carried out its mission on financial instruments area later of 2014, and stressed that there is great divergence between IFRS and GAAP.

The most efficacious outcome of joint cooperation was gained from leases. IASB and FASB came to an agreement on an area of the accounting of leasing and issued General Draft on this theme, explaining that entities must recognize their obligations from lease agreements in 12 months. But there are some companies in US which are wishing to demonstrate higher liability in a balance sheet started to deny that Draft’s requirements. Nevertheless IASB and FASB have not come an agreement about recording expenses related with leasing on P&L statement. In 2015 they released updated version of their mutual projects, which include their final decision on lease accounting. According to this document essential difference is related with the accounting model of lessee. FASB is continuing to support dual categorizing of lessee leases, such as finance and operating, while IASB has chosen solo approach (only as finance) in classification and recording of lessee leases.

Besides these 4 listed projects there are also several little scaled short-run tasks which are stayed out of convergence. For instance, grants by government, post-employment remunerations and etc. There is also some successes which can be remained such as assessment of fair value accounting. IASB and FASB came to an agreement about this matter in 2011.

SEC also has given an opportunity for foreign firms to make their reporting under IFRS without reconciling it with US GAAP. Today, real situation in the accounting sphere of US is like that to determine whether any company should make its reporting under US GAAP or IFRS, it must be known if this company operates as domestic entity or foreign originally entity. Because according to the laws, rules related with the reporting in USA which are declared by the Securities Exchange Committee the foreign formerly private companies can use IFRS in their preparation of statements, but domestic private entities must not use IFRS, they have to make their reporting only according to US GAAP. The other main point here is that foreign entities are not obligated but permitted to use IFRS. It means they can report their statements both under IFRS and US GAAP. And according to the Rules which released by the SEC in 2007 foreign companies who use IFRS in their reporting it is not necessitated to reconcile their statements with US GAAP. However there are two main requirements for foreign entities:

1. Having auditor’s report;
2. Showing footnotes related the basis their financial statements prepared. If foreigner is not appropriate to these demands, then he/she must reconcile their reports with local GAAP.

Because of I have explained some sensitive variations among IFRS and GAAP it would be pointless to repeat the same thing. I have not satisfied with explaining only theoretical differences, but also I have demonstrated their real effect via the case of Galaxy Corporation in chapter 2. And it would be useful to analyse real effects of transformation from US GAAP into IFRS over that case in this section. As it was stated Galaxy’s EBIT was $ 41200 due to US GAAP and $ 45450 due to IFRS calculations. Notable fact is that I used only a little part of differences between the two standards; therefore the variation between them is not great. But in reality while converting from GAAP to IFRS amount of difference between previous and current income (as well as net income or profit) is much greater. In our example growth of EBIT was 10,3% which is found as:

**($ 45450-$ 41200) / $ 41200 = 0.103x100 = 10,3 %**

Additionally, it should be reminded that COGS and depreciation-amortization expenses also are undergone to the modifications. Today nearly 36% of US firms are using LIFO in their inventory valuation. But due to IFRS it is not permitted to utilize this method. So because of using LIFO method the company had embellished its COGS and transition to IFRS demanded to apply FIFO method which decreased COGS by 1,02% , and increasing gross profit nearly 2.55%. Depreciation and amortization expenses also have increased after applying IFRS. Because of assets’ componentization is allowable under IFRS the depreciation expenses rose by 23.3%. Moreover be amortization expenses also have raised by 10% according to recognition of development costs as intangible asset in a balance sheet under IFRS.

All of these and the other effects on income statement resulted in increasing tax expense of the company accordingly 10,3% (because its EBIT increased by 10,3%). Not only income statement elements have been changed after transition process, but also financial position and changes in equity statements’ items, for example, retained earnings are modified. In Galaxy Corporation retained earnings have increased because of profit got bigger.

So transforming its P&L statement to IFRS gives the company new opportunities in attracting additional capital, as its earnings per share indicator increased. Using IFRS also brings extra revenue to the government’s budget.

Main impediments related with convergence of standards in US businesses are categorized differently in various literatures but for my opinion they should be divided into 2 essential parts as below:

* *Challenges sourced from technological infrastructure or IT system;*
* *Organizational challenges.*

Both of these challenges’ solutions depend on companies’ CFOs and CEOs effective decision-making abilities. Firstly, every CFO should consider the impact of new accounting policy on IT system of financial reporting area. Chief considerations are listed following part:

* New standards bring with themselves unalike report requirements with previously used GAAPs. It results in that new requirements often demand on new interfaces among ledger accounts and IT sphere of company. Therefore huge amount of entities complaint about significant system update costs, after approval IFRS.
* Updating Ledger accounts – it is another issue that appears while transforming to new bookkeeping system. Despite that many experts claim on exploitation of large amount of money, the others certainly stress on that all of those expenses are occurred in short run period and in long run they will enjoy using IFRS rather than US GAAP. Because in IFRS the number of ledger accounts are lesser than in GAAP.

Core organizational challenges sourced from convergence of standards are related with preparing plans for implementation of IFRS, training of employees and communication with stakeholders on this topic.

* Preparing plans for readiness means executive workers of finance or related departments make inner strategy for implementation, they should also organize fleeting sessions, including workshops;
* Communicating and illustrating beneficial sides of adopting IFRS to stakeholders are another important factor, which should be taken measure by companies’ CFOs and other executives while converting to new accounting sphere.

Even so many benefits of IFRS, which including showing superior net income and EPS, more principles than rules, providing greater transparency, effectiveness and comparability within financial statements there is still existing hesitation on convergence in US. Many of US businesses cannot come to the final decision on whether to implement IFRS or stay in old standards–US GAAP. One of such obstacles is about volume of costs expended towards conversion of US GAAP to IFRS. Most US companies are afraid whether these costs can be extra-large. Especially costs of training and purchasing or setting new software in the computers of those companies. Due to SEC’s prognostications these costs can be greater than $30000000 in SMEs (McEnroe & Sullivan, 2014). However this number will be higher for large entities and generally MNCs. It is emphasized that the transition costs can be equal to 1-2 % of twelve-monthly revenue, approximately $45-50 billion in large enterprises such as companies which shares are bought and sold in S&P 500 (Lin, 2013).

As I harassed in chapter two’s example one important cost is additional tax expense. Because of using FIFO while valuing inventory results in greater tax expenses than using LIFO. So many firms cannot accept this additional cost.

Not forget that crucial costs are not measured just as in monetary value, there is also time which the conversion process capture from the company. Various sources define not the same time incurred for implementing IFRS in companies. One source showed it is enough 16-24 months period for this process and a bulky part of this period will be spent on the training of workers (Fischer & Marsh, 2012). However in the other source the switching period was revealed as 2-3 years and incurs 5% of total revenue (Thomas, 2009).

Will the adoption of IFRS impact only to business sectors of US? What about other spaces of life? It is expected that one of the greatest area which full convergence will affect is education, especially high schools and universities. According to Thomas who researched the additional impacts of convergence in life of US, it is crucial to give education on the direction of IFRS in business schools of US. But before starting to teach students IFRS teachers themselves should learn it in a perfect level (Thomas, 2009). For that reason different universities should cooperate with IFRS teaching courses for training their teacher staff. In other literature it is mentioned about creating related faculty with IFRS in a master degree of different universities for those who feel that their US GAAP knowledge is out of date and it is time to learning IFRS deeply (Tyson, 2011). But how is the real situation in US business schools/universities on the education of IFRS? Looking at the experience of Carolina University we can observe that IFRS is included just briefly to the textbook of the program of finance accounting. The basis of this program is curriculum oriented and totally, the sum of materials related with IFRS is equal to nearly 4-6 pages. Teachers of this university stated that the IFRS study is not considered as central part of their lecture or general discussion with students. Professors of US universities and colleges see the main reason of the uncertainty related with teaching of IFRS in the unclear future of international reporting in US.

In appendix I put the Figure 4 which shows an effect on earnings of reconciling IFRS from US GAAP.

All of these investigations have shown us how it is crucial to be ready for full adoption of IFRS. Full convergence does not depend on only from central government regulators (in US the delegation of government is SEC and FASB), but also other spheres of life such as education and psychological readiness of whole nation. It means besides MNCs other sized companies do really want to change their reporting rules-principles? Because according results of survey conducted by ACCA in 2012 which is about measurement of familiarity and convenience level of using IFRS by US businesses, it is seen that 34% investors and other intended parties can expose main differences between the two of them, and only 22% stockholders found that the reporting quality of IFRS is higher than GAAP, but other 25% preferred GAAP to IFRS, additionally 28% believed that quality of reporting is directly depends on professionalism of employees who works in those businesses. And also the other 25% convinced that there are not any significant variations among GAAP and IFRS. So, it is essential to conduct such surveys periodically and learn real attitudes of businesses to IFRS.

**Attitudes towards IFRS in EU**

I described history of IFRS in European Union on my previous chapters. It is obvious fact that the sponsor and generally “mother of IFRS” is Europe. It was created, developed and spread over the world from here. According statistics of IFRS Foundation due 2018 88 % jurisdictions defined IFRS as main reporting standards for local companies (it is equal to 144 countries). In Europe 43 states have chosen it as crucial bookkeeping system, only one country – Switzerland which has not joined EU, is just permitting use of IFRS. I gave information on my practical case in chapter 2 about its local accounting sphere. But utilization of IFRS for SMEs in EU is weaker, only 8 jurisdictions allowed to its using. Strange fact is that though IFRS appeared in Europe, today statistics shows us that most amount of world’s GDP generated by IFRS using countries belongs to the states which are utilizing IFRS but not located in EU. In 2017 it was known that $ 27 trillion GDP was earned in non-Europe, only $ 19 trillion was netted in EU.

How is today’s endorsement process of new published IFRS standards in EU? Document of 1606/2002 stipulates that standards can be ratified by European Commission only if they have approved by ARC. This point gives the permission of minding to inappropriate standards, elements of IFRS to European Council. Main norms for adopting of IFRS by EU are following:

* Showing matters in true plus fair views;
* IFRS should meet with the general missions of EU;
* High level of comparability, transparency must be kept in all cases.

They can be denied but not modified by EU members and also there are no rules for replacing any item with other one if this item is not suitable for EU.

Despite all efforts related smooth implementation of IFRS there have still some predicaments for EU countries. For brief analyse I have chosen 3 countries–which are UK, Ireland and Italy. I have shown in Chapter 2 the influence of reconciling to IFRS from UK GAAP results in greater profit and equity sourced mainly from goodwill factor. Before implementation most of EU members were offsetting goodwill from equity, which had drawn a result to reduce retained earnings. Main challenge for 3 countries was about time which had spent to realise and assessing general effects of each standard into the certain company. Cultural factors compressed greatly to adoption process in Italy, where main focus of reporting was creditor in all time. But switching IFRS changed its focus towards shareholders. Standards that resulted in deep obstacles for those countries were: IFRS 2,3,8 and IAS 38,19,36. Main reason of their difficulties was related that these standards were new in those countries and before their arrival these nations did not use such items in their reporting. For example, Italian GAAP did not require to placing EPS indicator on statements (because creditors were not interested in this number), but IFRS required it. But from the UK and Ireland perspectives implementation of IFRS does not created any additional positive effect on their business operations or investor attractions. As their local ones also were very appropriate and useful. These countries even claimed on that balanced version of historical and fair value is considered very mystifying. Generally, unlike to US the separation among countries due to accounting origin of policies is stronger within EU, there are having 2 main categories: a) Anglo-Saxon; b) Continental Europe.

Attitudes towards IFRS changes according this classification, as first group is more happily accept and use IFRS, while delegators of Continental group approved it only for consolidation aims in unlisted entities. Other issue was declared by lease industry. Under IFRS 16 the classification of firms’ leases stopped to dividing into 2 categories: operating and financial. IFRS 16 recognizes only financial leasing. That attempt frightened the participants of leasing industry; they started to state that the decision of IASB on leasing direction decreased turnover of lessors’ business. Many firms will take leases just for hiding their liabilities in a balance sheet. Therefore new approach to leasing accounting of IASB is seen as trouble for some lease businesses in EU.

I mentioned costs of implementing IFRS in US on previous section and while conducting my research paper it was obvious that most of these costs are the same regardless of region/country. For instance, in UN’s report which was prepared in 2008 main switching costs in moving to IFRS from GAAP displayed as follow:

**Costs of transformation (in 1 000 euro)**

***Cost component Average expenditure***

House staff 255.51

IT related expenses 247.63

External consultants 154.22

Training fees 59.45

***Total Costs € 716.81***

**3.b Expert opinions on IFRS adoption**

To get more realistic facts about benefits and disadvantages of IFRS implementation I have prepared specific questions related to this topic and asked to answer them from professional experts. Because of currently I am working at Coca-Cola Ltd, which is known as major MNC in the world, so most of repliers of my questions are senior or executive employees of Coca-Cola too.

First question was about starting to use IFRS in the company (Coca-Cola) all of respondents stressed that as the company was established in 1994 Turkey and spread over the world its subsidiaries in 1995 they had used only IFRS as their reporting basis. Its financial reports are known as publicly available for all users in CCI’s webpage and Borsa Istanbul.

Next 2 questions were about forthcoming and cumulative benefits of IFRS using. Their answers were alike with each other as below listed:

* Increase in FDI
* Higher level of economic activeness
* Lower unemployment
* Growth of per GDP
* Higher quality public services due to upsurge in taxes
* More tight and transparent relations with creditors and investors
* Smoothing the works of international external audits
* As TNCs and MNCs will start to work in a country adopted IFRS it is expected increase in human rights on health, safety and working conditions
* To gain access for broader borrows by international finance institutions
* Dropping cost of capital
* Intensification of personal disposable income
* Import/export transactions will be simpler due to uniform standards.

Should small sized companies also accept IFRS as main reporting tool or stay in local GAAP? To this question answers were differently. Some of respondents insisted on that all entities should follow IFRS unrelatedly their size. However other repliers stressed that IFRS is efficient for medium and especially large companies. But other ones emphasized that small entities are also applying to banks for credits, loans. So it is crucial for them adopt IFRS, at least IFRS for SMEs for providing comparability and transparency.

Depending on countries there are some standards of IFRS which are not used at the companies operated in those countries. In CCI Azerbaijan mostly used important standards are IAS 2 and 16, IFRS 15. Contrary the most irrelevant ones are IFRS 16, IAS 39, IFRS 9 and IFRS 20. As you notice because of in Azerbaijan there is not founded financial (share) market in our country, so it is meanless to utilize IFRS 9 or IAS 39 standards related with derivatives in the companies.

Other essential fact which I gained from my respondents was about their first meeting with IFRS. Some have studied it at university; others in different courses (such as ACCA); the other parts have learnt it during real work practice. There also were some participants who had studied at US and learnt details of US GAAP, so they did not know IFRS deeply when they started to their first jobs.

In expert opinions the biggest implications on IFRS adoption in our country are follows:

* Many companies in our country escape from reporting their financial results and positions publicly;
* Dual reporting: according to tax and financial accounting;
* Lack of experience
* Changing systems

My other question was about consequences of cancelling to use LIFO on inventory valuation in inflation period. They revealed that utilizing FIFO in inflation would be unfavourable, but because of CCI chosen AVCO method so they could avoid significant losses.

**CONCLUSION**

Eventually, we arrived at final stop of our virtual journey which was rich by adventures. If you remember I promised in my introduction part to find answers three main points, they were:

1. Explain role of convergence on a further development of EU and US;
2. Highlight current and imminent concerns against full adoption of IFRS in US and future threads in EU states;
3. Evaluate existing preventions of establishing uniform standards in Azerbaijan and giving suggestions to them.

My first chapter was dedicated to the investigation of paybacks gotten from joining the trend of uniform standards. I discover how the convergence process can help countries to stabilize their economy, provide higher employment, raise economic activity in a macro level. The relationship between implementation of IFRS by certain country and at the same time growing number of MNCs in the same country is highly positive straight. As any republic (federal, kingdom) starts to adopt universal standards like IFRS (it could be other standards too, for example, US GAAP. But why the world has chosen explicitly IFRS was explained in previous sections) on national level and requires or permits to carry reporting under it, the businesses of other countries are beginning to be interested in that country’ s companies or establishing their own subsidiaries in this state’s lands. In previous times the significance of worldwide standards did not be as vital as today. First of all the number independent countries were not so many as now. From one hand African states were under the colonist regime of European states. From other hand Soviet Union was one of the hegemon areas of the world, and many European countries were parts of it. According these factors developed countries’ investors did not have large choices on which counties to make investments. Therefore, great pellucidity, comparability, reducing occurrence of moral hazard issues and much more elaborated disclosures of IFRS are the major paybacks of it from investors’ approaches. For entities paybacks include easy access to additional capital, higher liquidity and less external auditors’ fees. So I think states should not miss the chance called “IFRS” which can solve their many micro and macro problems at the same time.

Although, there are endless cumulative positive effects, full acceptance of IFRS by US have not completed yet. Like other countries in US also some businesses claim on higher level of transition costs and certainly the additional tax obligations are remained as crucial hindrances of convergence process in US.

Eventually, I have discovered following enumerated categories of impediments against convergence in US:

* System costs, including training and changing IT system;
* Transferring from LIFO to FIFO or AVCO causes additional income expense;
* TRUMP EFFECT.

I have desire to introduce you with my suggestions on those obstacles. First, training costs can be seen as investment to education. As we know those type of investments never loss. Any company who try to increase talented employees’ of it will be gain more benefits in future. Because additional outsourcing costs and expenses which incurred from wrong decision making process would be eliminated if the firm has highly educated and practical workers on financial sphere. The other effort should be made by government. Education ministry must increase the hours devoted to IFRS in American colleges, universities.

My second suggestion on solution of above mentioned preventions is directed to Tax authority of US government. As the entities will have less COGS and more EBIT in their first years of IFRS adoption they will be forced to pay more taxes. However change 50 years rules in one day is impossible, so government may understand real situation and give tax exemption to the companies on their first 5 or 10 years activity after embracing IFRS.

Unfortunately, I could not find any suggestion to Trump effect. As you follow from today’s media Donald Trump who has been selected as USA’s president since 2016, are currently conducting anti-globalization policy which affects US businesses in uncertain ways. What prospects of IFRS are expected in US? To answer question I noted the experts’ opinions on future of IFRS in US as grouped into four categories:

* Compulsory acceptance of IFRS by American government;
* Voluntary approval of IFRS;
* Obligatory using of both GAAP and IFRS in US;
* Implementing new – third standards on the basis of GAAP and IFRS.

I think creating third alternatives to IFRS and US GAAP might cover the interests both EU and US, and these standards should be known as “objective-oriented” rather than “principle based” or “rule founded” ones.

I cannot find any significant obstacle in adopting process of IFRS in EU, I think today Brexit is the main thread against convergence. Today, there are supposed on 3 main ideas:

* Switching to old UK GAAP;
* Stay in current IFRS;
* Build up UK based IFRS.

In the Accounting of AR law which had in 2004, IFRS is compulsory for significant formations of our country, such as credit, investment & insurance organizations, funds. Relative small entities are not mandated making report under IFRS; they can utilize either Local GAAP or IFRS. Finally, to find detailed answer for my third point of research paper, I inserted some questions about impediments towards full IFRS acceptance in our country. First reason is requirement for dual reporting: tax and financial. Because the differences between them are immense and for that reason most of SME businesses prefer to make only tax reporting. But MNCs or local large companies are forced to conduct both reporting which is requiring extra deeply educated labour force, time and other resources. Stressed variances are on below subjects:

* Deductible expenses;
* Depreciation Calculation;
* Revaluation model;
* Allowances;
* Inventory accounting.

Another issue which keeps us far from convergence is lack of IFRS experienced and knowledgeable employees. To solve this problem I would like to give my own suggestion which is related with our university’s scholarship system. Scholarship is the strongest motivation almost for all students. Most of students try hard and score high GPA for getting greater amount of stipend. But after graduated university most of them understand that getting high scholarship and spending them to useless things cannot bring them future benefits. So, I suggest that students whose GPA is greater than the averages should be send to courses related with their specialty and earn real value – KNOWLEDGE. They also can be sending to large companies as interns which have contracts with university. So in this case they will earn other worthy thing – EXPERIENCE.

I hope my paper will be useful and beneficial for future generations who have interests on this topic.

**Appendix 1**

It was started to make comparison of unlike states accounting standards and exposed resemblances and variances

It was accepted that measurement of economic growth stimulate international harmonization of accounting.

Running by globalization and main goal is to establish worldwide general standards of accounting

**Figure 1. Steps till convergence**

**Appendix 2**

**Implementation of IFRS**

**Greater transparency**

**Upgraded disclosure**

**Increased comparability**

**Better credibility**

**Lower uncertainty**

**Decreased stewardship costs**

**Minor assessment risks**

**Decreased data asymmetry**

**Greater liquidity**

**Less capital costs**

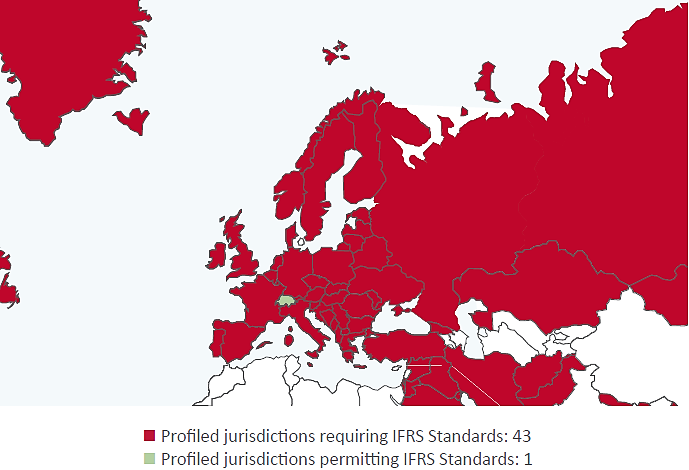
**More investors**

**Sophisticated capital market**

**Economic Growth**

**Figure 2. Positive effects of the convergence**

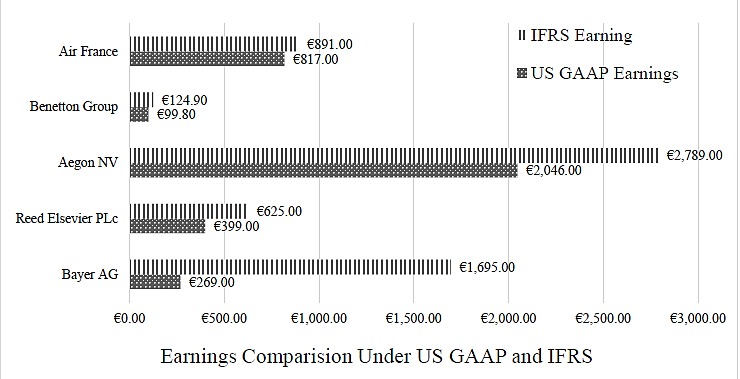
**Appendix 3**



**Figure 3. Jurisdiction of IFRS in Europe**

***Source: IFRS Foundation 2018***

**Appendix 4**



**Figure 4.** Reconciliation effect on earnings

*Source: Vincent L. and Lo Cascio.(2017) The Convergence of US GAAP and IFRS*

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