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Global Financial Reporting: How Does the U.S. Fit In?

When I give presentations in the United States about the International Accounting Standards Board (IASB) and its activities, the most frequent question I am asked is, "How does the U.S. fit in?" One understandable reaction might be, "U.S. companies do not apply International Financial Reporting Standards (IFRS), so IFRSs and international accounting does not affect U.S. firms." I would like to convince you that that answer to the question would be incorrect. Globalization is inevitable and, as is obvious, the U.S. is on the globe. Therefore, the question is how and when, not if, globalization of financial reporting will affect U.S. companies. Globalization of financial reporting will affect all of us in this room - standard setters, regulators, auditors, companies, academics, and students. The short answer to the question of how the U.S. fits in is "Centrally and everywhere."

Global Standards and the IASB

Before elaborating on that short answer, I first would like to give you some background on the IASB. I often find that many in the U.S. do not quite know who the IASB is, how we operate, or what we are working on. My sense is that is because they think the activities of the IASB do not affect them. The mission of the IASB is to develop a single set of high quality, global accounting standards that are accepted worldwide. As is the case with many other mission statements, it sounds great. However, it is very difficult to accomplish. Every word is carefully chosen. "Single set" is important; we want one set of accounting standards, not more than one. "High quality" - how can anyone argue with that? We certainly do not want a single set of low-quality standards! "Global" accounting standards; we are seeking standards that are applied and accepted worldwide. The "accepted" part is proving to be quite challenging, but we are working on it. Global standards are a necessary condition for global financial reporting and the IASB is charged with setting global standards.

Why would the world want global standards? Most of us involved in globalization of financial reporting believe, and research I will talk about in a few minutes supports, that using global standards will improve the functioning of the global capital markets by providing better information to investors and other users of financial statements. One dimension of improvement is decreasing the costs global companies incur in preparing their financial statements. I think that dimension of improvement is indisputable. Global companies that operate in many different countries say that it is extremely costly to prepare financial statements using several sets of standards. A second dimension of improvement is decreasing the costs financial statement users incur in interpreting financial statements issued by companies around the world. The result of global financial reporting will be one language of business. A third dimension reflects the ultimate goal, which is decreasing the cost of capital for global companies.

It is important to note that there is demand for global financial reporting not only from global capital markets and global companies, but also from local capital markets, national standard setters, and private providers of capital. It is costly and time-consuming to develop high-quality financial reporting standards. The U.S. has been doing it for years. Some other countries, particularly smaller ones, do not have the resources to do it on their own. Therefore, they would like to be able to adopt a global set of standards.

Who is the IASB? For those of you who are unfamiliar with the IASB but are familiar with the U.S. Financial Accounting Standards Board (FASB), many of the features of the IASB organizational structure will be familiar. This is because the structure of the IASB was modeled after that of the FASB. There are some differences, but the basic structure is the same. There are fourteen members of the IASB. It is a full-time, independent board. Well, almost. There are twelve full-time board members who are independent; there are two part-time members. There is no required country or geographic representation; the notion is that the board should comprise technical experts drawn from the pool of technical experts around the world, regardless of their nationality. This is important because the notion is not for board members to represent a particular country or country's interest. Instead, board members are to develop financial reporting standards in the public interest. As with the FASB, all of IASB meetings are open to the public and we have an extensive due process for promulgating standards. A board of trustees oversees the IASB and raises funding for the IASB's activities, as the Financial Accounting Foundation does for the FASB.

The IASB also works with national standard setters around the world to help them understand our standards. Some countries are adopting IASB standards as their own and we work with these countries to learn about their issues and concerns and help them address those issues and concerns. Our offices are in London. We meet, typically, the week that begins the third Monday of every month. So, if you are in London during board week, come over and sit in. As I said, the meetings are open to the public. If you are unable to make it to London, you can listen to and watch us on the web at www.iasb.org. The audio and video of the meetings are retained on the web to enable you to listen to the debate on any topic you choose, at any time you choose.

The IASB perspective is also similar to that of the FASB. The IASB follows a conceptual framework and our conceptual framework is quite similar - although not identical - to that of the FASB. Our aim is to develop principles-based standards. In principles-based standards, the principle is clearly stated. There are rules; principle-based standards does not mean that companies can do whatever they want. Quite to the contrary. The principle tells companies what the accounting is trying to achieve - why they must do what they are required to do. The IASB also hopes to promote global consistency in application and enforcement of the standards. As I said, global standards are a necessary condition for global financial reporting. They are not a sufficient condition. All players in the capital market have to work together before global financial reporting can become a reality.

With respect to the IASB's goal of a single set of standards, we have a two-pronged approach: adoption and convergence. Regarding adoption, at this time, more than one hundred countries have said that they have adopted or plan to adopt international financial reporting standards. This adoption applies to all publicly listed companies in the European Union, Australia, Russia, among others, plus some non-listed companies. Those countries are taking IASB standards as their own. Regarding convergence, the IASB is working closely with countries that do not want to adopt our standards, but want to converge their standards with ours so that eventually the two sets of standards are the same. Japan and China are examples of convergence countries. Our most active convergence efforts are with the U.S.

U.S. and Global Standard Setting

To understand how the U.S. fits in with global financial reporting, it is important to first remember the U.S.'s role in the history and structure of the IASB. The U.S., particularly the U.S. Securities and Exchange Commission (SEC) and the FASB, was instrumental in setting up the IASB. A key contribution of the U.S. involvement was to help ensure that the IASB be a group of technical experts, not a group of country or industry representatives. The detailed structure of the IASB and the International Accounting Standards Committee Foundation (IASCF), the organization of which the IASB is a part, was developed by a Strategy Working Party that comprised interested parties from around the world, including the U.S. Several trustees of the IASCF are from the U.S. Arthur Levitt was the Chairman of the Nominating Committee that nominated the original board of IASCF trustees. Paul Volcker was the first Chairman of the trustees; he just stepped down last year. The U.S. continues to be active in, and an integral part of, all of the IASB's activities. In addition to having U.S. trustees, the SEC is a member of our Advisory Council and of the International Financial Reporting Interpretations Committee. There are U.S. members on all of our working groups. It is not "we' versus "they." Global financial reporting is a team effort and the U.S. is a key member of the team.

The FASB is the U.S. counterpart to the IASB and, as I have mentioned, a focus of the IASB's convergence efforts is with the FASB. As a result, the FASB and IASB work closely together on all technical projects. There is goodwill on both sides. In 2002, the two boards issued what was termed the "Norwalk Agreement." The Norwalk Agreement said that two boards agree to agree to common answers to financial reporting questions. Although the agreement had few details, agreeing to agree is better than agreeing to disagree. However, the Norwalk Agreement was a tangible first step in the IASB/FASB relationship. Since then the relationship has evolved. Now, most major agenda projects are joint projects. Joint projects mean that the same staff work on the project for both boards. We analyze the issues in the same calendar time. We look at the same staff papers to analyze issues. We have a video hookup in London to Norwalk and they have a hookup in Norwalk to us. Twice a year the two boards meet together jointly. In April, the FASB goes to London for two days and in October, the IASB goes to Norwalk. So, if the staff is unable to resolve a difference between the two boards by discussing it with each board in their separate board meetings, twice a year the twenty-one of us sit around the table together and resolve them.

The two boards seek to achieve both convergence and high quality. Of course, quality can be in the eye of the beholder, and change is never easy. Convergence means that sometimes the IASB needs to change its standards and sometimes the FASB needs to change its standards. Let me give you a few examples. First, international standards had an option either to capitalize or to expense borrowing costs, whereas U.S. standards require capitalization. The IASB is about to issue a final standard to eliminate the expense-only option to converge with the FASB. Second, the international segment reporting standard was based on the old U.S standard; the IASB is about to issue a final segment reporting standard that is the same as the U.S. standard. Third, international standards include a fair value option for financial instruments; the FASB has recently added a similar option to U.S. standards. Fourth, the international standard on subsequent events is more recent than the U.S. standard and, thus, includes more current thinking. The FASB is considering changing its subsequent events standard to converge with ours. As you can see, we are each changing standards to converge when we determine the other standard setter has a better answer.

The ultimate goal of our convergence efforts with the FASB is standards that are the same, word-for-word. Achieving this goal is very difficult. It is one thing to agree on the same answers, or at least for the standard setters to believe they have come to the same answers. That was our initial plan for convergence. But, the boards decided that if we agreed on the answer, but did not use the same words in the standards, persons reading the standards would be reading different words and would naturally presume that the different words meant something different. After all, if the two boards meant the same thing, why wouldn't they use the same words? The first example of the two boards issuing a document that is the same, word-for-word, is the business combinations exposure draft. We released that exposure draft simultaneously and it is word-for-word the same, except for some legacy differences in other standards and some differences between British and American English. For example, in the international standard we replaced some Zs with Ss and added Us in a few words. The final business combination standard will be word-for-word the same as well. That is the plan going forward for other standards. In my view, we are making quite a bit of progress working together.

Of course, as in any relationship, there are challenges. One of the challenges is maintenance of existing literature. As you know, the U.S. has a large number of standards and interpretations, and extensive authoritative guidance. The number is much smaller for international standards. More or less is not good or bad; it is just different. As a result, sometimes the FASB needs to take projects onto its agenda to update, maintain, and improve its existing standards. The IASB needs to do the same thing. However, because the existing standards are not the same, the two boards are not making exactly the same changes. This results in what we refer to as "leapfrogging." Leapfrogging occurs when one board starts a project and the other one does not, so the second board needs to catch up. But, of course, it is difficult to stop upon catching up - it is the nature of standard setters to make additional changes to improve the standard. Doing so then puts the first board in the position of having to catch up. We are jointly trying to avoid this leapfrogging, but it is not easy.

Accounting for stock-based compensation is an example of leapfrogging. The FASB issued Statement of Financial Accounting Standards (SFAS) 123, then the IASB issued IFRS 2, and then the FASB issued SFAS 123(R). The two effective standards are still not identical. The two boards are leapfrogging now with pensions. As you know, the FASB just issued a final standard for phase one of its pension project. The IASB also has a phase one of its pension project. Our phase one is somewhat different from the FASB's. The ultimate goal is to have a joint pension standard. To that end, phase two for both boards will be a joint project. But, in the meantime, we are not quite converged. Leapfrogging also occurred with fair value measurement. The FASB just issued SFAS 157 on fair value measurement. The IASB plans to issue SFAS 157 as a discussion paper next month and invite comments from around the world. Meanwhile, it is a final standard in the U.S. This leapfrogging occurred because the FASB was almost done with its fair value measurement project by the time our relationship had evolved to the point that we were conducting most projects jointly. So the FASB was ahead of us and, with our expression of understanding, it issued its standard. Now we are behind. Hopefully, we will not leapfrog them!

Another challenge to convergence with the FASB is differences in political pressures. Standard setting is subject to political pressures, there is little question about that. But, the pressures are different for the FASB and IASB. Sometimes the pressures offset, which is a benefit to the boards. That is because if, for example, the FASB is under pressure and the IASB is not, the FASB can blame us in the name of convergence, and vice versa. Thus, the two boards are somewhat freer to do what they think is right. I believe this difference in political pressure played a role with stock-based compensation expensing in the U.S. because the IASB had already issued IFRS 2. The fact that the FASB had issued SFAS 133 on financial instruments helped the IASB with International Accounting Standard (IAS) 39, the international financial instruments standard. Many persons do not like IAS 39, particularly its requirement to recognize derivatives in the statement of financial position. The issues are similar to those that were controversial in the U.S. ten years ago when the FASB issued SFAS 133. But, the U.S. has accepted SFAS 133 and gotten used to it. Life as we know it did not end with the effective date of SFAS 133. So, the IASB could say with confidence that recognizing derivatives at fair value would not be the end of Western Civilization. Although offsetting political pressures can benefit the boards, sometimes the political pressures compound each other. That is more of a problem. This could be happening on business combinations. As I mentioned earlier, the two boards issued the same business combinations exposure draft and are getting some of the same negative reactions from all over the world, including the U.S. We will have to wait to see how that turns out.

A third challenge is dealing with differences in priorities. Sometimes one or the other board faces a need to focus on an issue at a particular point in time and the other board does not. If the first board tackles the issue and the second does not, leapfrogging could result. One example is accounting for insurance contracts. The U.S. has several standards and a rather extensive authoritative literature on insurance accounting. This literature is not totally internally consistent, which the FASB readily admits. But, at least it exists. There was no international insurance standard, and so the IASB faced the need to take on a major project on accounting for insurance contracts. The IASB issued an interim standard so that when companies that issue insurance contracts adopted international standards in Europe on January 1, 2005, there was a standard in place. But, it is not a comprehensive standard and is, clearly, interim. Thus, the IASB has on its agenda an active project on insurance contracts and the plan is that the FASB will join the project at a later stage.

Another challenge relates to different styles of writing and standards. The two boards are in the process of getting the differences in writing styles ironed out. A standards style issue that is proving nettlesome is determining what level of detail to include in the standard. U.S. standards have quite a lot of detail; international standards have less. The question is how much detail is the right amount. We need to determine what material needs to go into the standard, what goes into application guidance, what goes into educational material, and what is not necessary to include at all. It is not necessarily a tug-of-war between the two boards, it is just a matter of determining what each board thinks its constituents need and will accept. Often, constituents say that they do not want detail in the standard - unless, of course, it answers their question. If it answers their question, then they want the detail in the standard someplace. Answering all questions leads to a lot of detail.

Yet another challenge relates to a logistical issue, which is the size of the staff. The FASB has about 50 staff and the IASB has about 25 or 30. The IASB staff is getting larger, but the IASB staff often feel outnumbered by the FASB staff. In the beginning of our joint efforts, this was more of a problem. At that time, each board viewed its staff as working only for it. So, we viewed the staff as either IASB staff or FASB staff. Now the staff on each joint project is just that, joint. We form a single staff for a project comprising some staff who work for the FASB and some who work for the IASB. The composition of the project staff depends primarily on their expertise and availability, not which board they work for. But, several of the FASB staff have more experience than the IASB staff and their number can be overwhelming to their international counterparts who are just learning.

Regulators, Auditors, and Companies

There are other key players involved in global financial reporting. One group is securities regulators, particularly the SEC. The SEC is a key player not only in the U.S., but also internationally through the International Organization of Securities Commissions (IOSCO). IOSCO is working to globalize securities regulation. To enable principles-based global financial reporting standards to work as they should, regulators need to tolerate some differences in interpretation of the standards. As you know, the SEC is not shy about telling companies that it does not like what the companies are doing and telling companies how it wants things done. However, the SEC has said that it will resist the temptation to specify particular implementation approaches and refrain from issuing U.S.-specific rules. This is not to say that the SEC plans to sit back and defer its regulatory authority to another organization or refrain from taking timely action regarding a problem it perceives with a registrant. In fact, it is likely that the SEC will need to issue a ruling on an issue to deal with the issue in a timely fashion. But, the plan is that when the FASB and IASB complete their due process and issue a standard or interpretation resolving the issue, the SEC will accept that resolution. This helps ensure that the SEC does not inadvertently set rules for the world. No one wants that, including, I am told, the SEC. IOSCO seems to be taking the approach of determining whether the registrant's application of the standard is consistent with the principle in the standard. That is a promising approach, and would help make principles-based standards successful.

Auditors are also key players in global financial reporting. Their challenge is to ensure globally consistent application of standards for their clients. In the past, even when two countries' standards had the same or similar requirement, for example, asset revaluations in U.K. and Australian standards, it is not clear to me that the auditors in the two countries talked to each other to make sure that the application and interpretation were the same. After all, in the example, one requirement was in Australian standards and the other was in U.K. standards. But now that companies all apply IFRS, the auditors know the application should be consistent around the world. My understanding is that the large audit firms are organizing themselves to ensure globally consistent application and enforcement, although each might be taking a slightly different approach. Some have set up committees of technical partners from around the world, who meet and talk about issues to make sure there is consistent application and interpretation across the audit firm. There is a danger that in their zealous pursuit of consistent application the audit firm will end up developing rules that everyone has to follow, thereby effectively setting standards themselves. But, we are hoping they will refrain from doing that. Principles-based standards emphasize the need for judgment and professionalism even more than rules-based standards do, and we need to try to ensure they both play a role in financial reporting.

Companies are another group of key players. For them, change in financial reporting standards is always unwelcome. It is human nature to want to keep doing whatever one is currently doing. But, if we are going to achieve high quality global financial reporting, change is inevitable. My guess is there will be fewer bright-line rules and fewer safe havens for companies, which means they will need to use more judgment. The objective of financial reporting is to reflect the underlying economics, not to follow the letter of the rule.

Educators

U.S. educators, like many of you in this room, also have a key role to play in global financial reporting. I would like to share my thoughts with you about what U.S educators should be thinking about. My first recommendation is to teach the framework. I would not focus on teaching the rules in current standards, although they provide good examples. Focusing on the rules runs the risk of having your students' knowledge become obsolete. The conceptual framework is more enduring. It is like the U.S. Constitution. It changes. It evolves. It is a living document. But it changes much less frequently than standards do. So, it is important to teach the framework. My next recommendation is to teach the foundational concepts that underlie financial reporting. These include economics, finance theory, information economics, incentives, rational expectations, and portfolio pricing theory. These concepts will become even more important in financial reporting in the future as we more comprehensively implement the conceptual framework in standards. The framework makes clear that the focus of financial reporting is providing decision-useful information to investors in capital markets. These foundational concepts help us figure out what information investors need and the effect of the information on their decisions.

Educators also have to teach students how to make judgments. Financial reporting is replete with judgments. Understanding why financial reporting is what it is, i.e., teaching the framework, helps students learn how to make judgments. Doing anything else, such as simply teaching students existing rules and bookkeeping, runs the risk of attracting the wrong people to the profession. The accounting profession needs people who want to think and want to make judgments. The profession does not really want people who do not want to think and who simply want to follow rules and tick boxes.

Educators also have to educate students for a global world. You owe it to them. Students need to learn to adopt a global perspective. That means that we are going to have to change how we go about teaching international financial reporting. Cross-country differences in perspective and cross-country differences in financial reporting themselves certainly can be instructive, particularly to enhance our understanding of how we ended up where we are. But cross-country tours, if you will, of financial reporting are becoming obsolete. They are not obsolete yet, so such tours still have their place in curricula. But, fast-forward a few years. Then, it is not at all clear we should be teaching such tours. Globalization of financial reporting is happening very, very fast.

My dream is that eventually there will be no difference between teaching global financial reporting and teaching U.S. financial reporting. It will undoubtedly take a while to realize my dream, but I am confident that someday we will. To realize my dream, we need to take a lesson from the capital market and focus on the similarities around the world, not on the differences. Knowing the differences can be important, please do not misunderstand. We need to be informed about the differences in principle - for example, LIFO and asset revaluations - and about the differences in detail - for example in financial instruments, interest capitalization, and impairment. One needs to know about these differences to understand today's financial statements. But, you and your students should also know that these differences are likely to be short-lived. Thus, there should be no surprise when they go away.

Opportunities for Researchers

What about accounting researchers? I spend a considerable amount of my time doing research and it is near and dear to my heart. I believe research input is extremely valuable to standard setters. Academics like to debate whether academic research helps standard setting. Trust me, it does. First of all, we talk about research around the board table. The staff often asks, "What do we know from research?" about topics they are analyzing. I point them to particular research papers and they read them as best they can. They then sometimes ask me to interpret the inferences for them because they are not trained in research. However, they care about the research that relates to their topic and they find it helpful. Research helps identify issues that standard setters should be thinking about. Standard setters usually think they know what the underlying question is that needs to be resolved, but sometimes they really do not know what it is. Research helps standard setters identify the question they should be addressing, structure their thinking about the question, and, of course, provides evidence on the question. Research also provides an unbiased view to standard setters. Academics have no hidden agenda; they have no incentives to obtain any particular outcome of the standard setting process. This lack of self-interest is extremely valuable. Moreover, the concepts underlying financial reporting are comfortable for researchers. As I have noted, financial reporting is based on economics and the information needs of investors, and that is what a lot of financial reporting research is about.

The good news, and the bad news, is that there are many, many opportunities for research. When I write down a list of questions that standard setters do not know the answers to, it is almost embarrassing. Many of them are questions that you would have thought we would have figured out the answers to by now. But, we haven't. The list of questions stemming from the IASB's current agenda seems almost endless. That may not be great for standard setters who need to answer the questions, but it is great for researchers. Table 1 lists the topics on the IASB's agenda. They include revenue, financial statement presentation, leases, short-term convergence, postemployment benefits, fair value measurement, insurance, consolidations, non-financial liabilities, small and medium-sized entities (SMEs), and the conceptual framework. In the context of many agenda topics, the two words that you are likely to hear more and more are "fair value." Fair value has some issues, particularly relating to estimation, that need to be sorted out. But, it seems that in every project the boards tackle, using fair value as the measurement attribute at least needs to be considered as an alternative.

Consider the joint project on revenue. Revenue is a major project and it is quite controversial. You would think that by now accountants would know what revenue is. Yesterday in the joint board meeting when we were talking about the revenue project, one board member asked whether the discussion paper we issue in connection with the project would have a definition of revenue. The question took the staff aback, but the staff acknowledged it might be a good idea. One question the boards are grappling with is whether we should adopt a pure asset and liability approach, which would mean eliminating additional revenue recognition criteria such as completion of the earnings process and realizability. Such additional criteria take us away from a direct application of the framework and require us to define the criteria. I am not sure we have a clear definition of when the earnings process is complete. Time will tell how this will turn out. Another question the boards are grappling with is how to measure the liability for the entity's performance obligation to its customer. At present, the boards are considering two models - a fair value model and an allocated customer consideration model. We are considering two models because the boards do not agree on a single model. It is important to understand it is not that the two boards do not agree with each other. Neither board can agree on a single model - there are proponents and opponents of each model on both boards. By the way, this is not uncommon. We have discovered that most of the time it is not that the FASB is unanimous in concluding one way and the IASB is unanimous in concluding a different way. Rather, within the boards there are differences of opinion; individual board members can always find a board member on the other side of the Atlantic who thinks the same way.

The questions the boards are addressing in the financial statement presentation include the following, among others. What should the income statement look like? What should the statement of financial position look like? Should we classify assets and liabilities as short term and long term? Should we classify line items on all of the financial statements as operating and financing? These are very basic questions and we are debating the answers. The boards have just added to their agendas a project on leasing. The leasing project will consider an asset and liability approach to recognizing rights and obligations arising from a lease contract. The short-term conversion project is aimed at eliminating, in the short term, some of the differences between U.S. and international standards. However, at our joint meeting earlier this week, one of the FASB members suggested that we drop the "short term" part of the description of this project; nothing in standard setting seems to be short term. The post-employment benefits project is the modified joint project that I mentioned earlier when describing leapfrogging. I also described fair value measurement to you earlier.

Relating to our project on insurance contracts, when the IASB issues its discussion paper the FASB will also issue it with a wraparound invitation to comment. The IASB also has a project on non-financial liabilities. The international standard, IAS 37, is quite different from SFAS 5. IAS 37 requires entities to measure these liabilities using a measurement attribute that is a current value, similar to fair value. It is not exactly the same as fair value, but it is close. Relating to SMEs, the IASB is about ready to issue an exposure draft, probably before Christmas. The agenda is long and includes many fundamental topics, and the questions that we need to address in the projects are also fundamental and pervasive. There is much work to be done.

The joint conceptual framework project also is a rich source of research questions. As I am sure you know, the first two chapters of the revised framework are out for comment now. I believe there will be eight chapters in all. We have a long way to go. Research would be helpful, for example, to help us determine what the qualitative characteristics of accounting information should be. The framework identifies representational faithfulness and relevance as key, and describes other qualitative characteristics. It also identifies the objective of financial reporting as providing useful information to outside providers of capital. Are these appropriate?

Another way U.S. researchers fit into global financial reporting is to conduct research addressing issues of globalization itself. Much extant international research focuses on cross-country differences in accounting. Do different accounting treatments of a transaction provide the same information to the market or different information? If different, which treatment provides better information, however better is defined? What are the differences in institutional and legal environments, and how do these differences manifest in financial reporting? However, taking a global view suggests we should be focusing on global investors and global capital markets. We should be focusing on the similarities, not the differences. Of course, we still want to understand whether there are unique institutional features, for example, that should affect the accounting. Whether they do affect the accounting is one thing. But, the question is whether they should. Another question is whether global investors' information needs vary depending on where they are located. We do not yet know the answers to these questions.

International research, including that focusing on international differences, can inform global financial reporting issues. First, such research can provide an international perspective on global issues. There are different ways of thinking. Consider, for example, the debate about the use of historical cost versus fair value as a measurement attribute. This is a debate on both sides of the Atlantic and around the world. However, there are different dimensions to the debate, and different aspects of it are important to different people. Second, such research can address questions that are only addressable internationally. For example, if a researcher is interested in the question of remeasuring property, plant, and equipment to current value, i.e., asset revaluations, the researcher must look outside of the U.S. Asset revaluations are not permitted by U.S. accounting standards. If a researcher is interested in the question of measuring inventories at Last-in, First-out (LIFO), the researcher must look inside the U.S. LIFO is not widely used permitted by accounting standards anywhere else in the world. (1) Third, such research can use different institutional settings around the world to gain a deeper understanding of an issue. For example, presumably we can learn more about pension accounting by studying different pension arrangements around the world. Fourth, such research can identify country-specific features that global standard setters need to consider when writing global standards. We think of economics as being the global equalizer. That is, we assume that if we focus on ensuring financial statements reflect the underlying economics we have achieved our goal. However, some are concerned that this might not be the case. If it is not the case, it would be important to understand why.

What Have We Learned From Research?

We have already learned quite a bit from research. For example, research tells us that no single country has a monopoly on good answers. Many assert that the U.S. has the most comprehensive and highest quality financial reporting in the world. This could be true. But, many also would acknowledge that U.S. financial reporting is not perfect, and that for some transactions and events other countries have developed better accounting answers. The many studies focusing on the non-U.S. domestic to U.S. standards reconciliations of net income and shareholders' equity on Form 20-Fs for non-U.S. private issuers trading shares in U.S. capital markets provides supporting evidence for some of these differences (e.g., Hall, Hamao, and Harris 1992; Amir, Harris, and Venuti 1993; Niskanen, Kinnunen, and Kasanen 1993; Bandyopadhyay, Hanna, and Richardson 1994; Harris, Lang, and Moeller 1994; Barth and Clinch, 1996). Research also tells us that improved disclosure and financial statement transparency can reduce the cost of capital (see, e.g., Botosan 1997; Botosan and Plumlee 2002; Barth, Clinch, and Shibano 2003; Barth, Konchitchki, and Landsman 2007). For example, research shows that firms using IAS or U.S. standards have lower bid-ask spreads and higher share turnover than firms using German standards (Leuz and Verrecchia 2003). Research also tells us IAS are higher quality than non-U.S. domestic standards, where quality is measured using a variety of metrics common to accounting quality research, including some relating to earnings management (Barth, Landsman, and Lang 2007). This research also tells us that analyst's earnings forecast errors are lower for firms using IAS than for firms using non-U.S. domestic standards, which also can be interpreted as evidence of higher quality (Ashbaugh and Pincus 2001). Research also tells us that global harmonization can have beneficial capital market effects, such as decreasing cost of capital, increasing the ability of share prices to reflect information, increasing trading volume, and perhaps even decreasing home country investing bias that we know is prevalent around the world (Barth, Clinch, and Shibano 1999).

Research also tells us that informativeness of financial statements is linked to the legal system, shareholder protection, and the conformity of financial statements and tax reporting (e.g., Ball, Kothari, and Robin 2000; Hung 2001). It also tells us that cultures change slowly, not by fiat. Even if the IASB issues a standard and companies were required to follow it, there would be differences in how companies interpret the standard because of differences in their history and culture. So, even with global accounting standards we might not achieve global financial reporting. Financial reporting quality also depends on the incentives of managers, investors, and auditors that differ around the world (Ball, Robin, and Wu 2003). It also tells us that corporate governance plays a key role in determining financial reporting quality (Ashbaugh and Warfield 2003).

Research also tells us that standards are unable to address all situations and they often lag practice (Ball, Kothari, and Robin 2000; Ball, Robin, and Wu 2003). When local infrastructure is lacking, global standards might not even be optimal (Eccher and Healy 2003). Research also tells us that application of U.S. standards by non-U.S. companies does not result in accounting amounts that are comparable to those of U.S. companies. A study comparing accounting amounts based on U.S. standards reported by non-U.S. companies that trade American Depository Receipts (ADR) in the U.S. and those reporting by U.S. companies finds that amounts reported by U.S. companies generally are higher quality (Bradshaw and Miller 2006; Lang, Ready, and Wilson 2006). These findings make clear that accounting quality depends not only on accounting standards, but also how they are applied. Research using mathematical modeling tells us that fundamentally similar environments can end up in a different equilibrium with respect to accounting standards (Nagar and Petacchi 2005). But, the equilibrium can change dramatically with a relatively small shock to the system. This finding is quite intriguing because we observed differences in accounting standards around the world. Questions include why did we end up at these different equilibria and is there any hope of changing them to a common equilibrium? The insights from this research provide hope that we can.

Questions For Future Research

The good news for researchers is there are many, many, many open questions for research on globalization of financial reporting. I refer to these as motivating questions (see Barth 2006 for discussion of how research can relate to standard setting issues). These are the questions that motivate the research. Researchers like you will have to do the hard work of figuring out how to craft research questions that speak to the motivating questions. One open area of research relates to impediments to globalization. Several studies identify impediments to globalization. But, they provide almost no guidance on how to remove those impediments. Which institutions are the most critical to financial reporting? Are these transition problems as countries and companies adopt international standards, or are they more systemic? Is it even possible to write standards with global applicability? Clearly, the IASB thinks is it possible, and is trying to do it. But, no one has established that it can be done. Is a single set of global accounting standards even optimal? It sounds good. It seems right. But, we do not really know. It would help if research could provide insights into the answers to these questions.

How can we achieve globally consistent application and enforcement? Does this require more activity by securities regulators? Auditing firms? Educators? Voluntary action by firms? How do we set up institutions and incentive structures to ensure we obtain consistency and the desired interpretation and application? What is the role of the local information environment - such as analysts, the news media, press releases, rating agencies, market microstructure, and creditors? There is a fair bit of research on these features of the information environment in the U.S. Although this research does not answer all of these questions for the U.S., there is much less research addressing these issues outside of the U.S. Also, it is not clear how all of these features of the information environment interact with financial reporting, particularly global financial reporting.

Does global financial reporting actually reduce the cost of capital? We have some theoretical evidence that it can and the empirical evidence is beginning to emerge. However, there is not yet a lot of unassailable empirical evidence. Those who believe in the benefits of global financial reporting believe reduction of cost of capital is one of those benefits. But it would nice to see confirming evidence. Does global financial reporting actually facilitate the allocation of capital and cross-border trading? Again, believers in global financial reporting have confidence that it does. But we need empirical evidence to support or refute this confidence. Does global financial reporting reduce home country investing bias? Are global standards higher quality? The IASB aims to write high quality standards - have we done it?

Why don't all countries and companies adopt global standards? If global financial reporting has the benefits we believe it does, why haven't all countries and companies adopted them? Is it because the transaction costs required to change accounting systems are too high? Is it because political forces make countries unwilling to give up domestic standard setting? If so, why? What are those forces? Are there some unidentified factors that make global standards less than optimal? For example, do global standards fail to reflect companies' underlying economics in some situations? If so, why?

What about the role of politics? Most observers understand that the FASB and IASB come under political pressure from time to time. Such political pressure can influence the selection of the board and staff. It also can influence the boards' standard setting decisions. Pressure comes from comment letters, lobbying with governments, and governments overriding the standards after they are issued. The controversy in Europe regarding IAS 39, the financial instrument standard, was widely reported in the business press. It culminated in the European Commission (EC) carving out several paragraphs of the standard. Subsequently, the EC reinstated the paragraph permitting the fair value option, but the hedge accounting carve-outs remain. The Australian Accounting Standards Board eliminated some options available in IFRS. It believes that providing options in financial reporting standards impairs comparability. Recently, the Australians concluded it is more important to adopt IFRS as written by the IASB, thereby obtaining comparability around the world, than it is to ensure comparability within Australia. So, Australia is reinstating the options it eliminated. Do political influences from different countries offset or reinforce each other? Is political pressure good or is it bad? Does political pressure provide a healthy tension or does it compromise the quality of the outcome?

Can securities regulators help in achieving global financial reporting? What would be the effects of more timely reporting, enhanced disclosure, additional safeguards, increased auditor oversight, greater enforcement, or a uniform approach to securities regulation around the world? Can we predict these effects? Are there unintended consequences of such changes that can be anticipated? Addressing these questions will keep financial reporting researchers busy for a long, long time!

Even if globalization has clear benefits, it undoubtedly has costs as well. Change is always costly. Global financial reporting standards offer fewer safe harbors and bright-line rules. So, companies and others need to learn to live with ambiguity and become more comfortable with making financial reporting judgments. There also are costs associated with understanding and accepting different perspectives. Believers like me focus on the benefits, not the costs. Although the demand for globalization of financial reporting arises primarily from global capital markets, it has other benefits as well. Global financial reporting can facilitate mobility not only of capital but also of ideas and people. Students who learn the global financial reporting language will be able to use it around the world.

Are We There Yet?

The world is getting smaller. Figure 1 is a map of the world identifying countries that either have adopted IFRS or have said that they are working to converge their domestic standards to IFRS. The map is becoming more and more solidly colored in. This progress towards worldwide acceptance of IFRS does not mean the IASB does not have critics. The critics say the IASB does not understand Europe, or fill in the blank with any other region in the world, it is fixated on fair value, it is U.S. dominated, it is not listening, it is too theoretical, and its standards threaten the stability of �. And, this is only a partial list. However, these criticisms make me think the IASB is probably doing its job. Regardless, we keep our eye on the vision: A single set of high-quality standards used in the global capital markets.

Are we there yet? No, not yet. Many challenges remain. There are transition pains. There are many around the world who were unfamiliar with independent standard setting and an investor focus for financial reporting. They are struggling with the changes. But, they are learning. No change is universally popular, and revolutionary "big bang" change is very difficult. Evolutionary change is somewhat easier to implement and absorb.

We also have not yet fully resolved the issue of individual country modifications to the standards, which stand in the way of realizing the vision. As I mentioned earlier, Australia seems to be accepting the notion that global means global, but Europe has not fully accepted it yet. The fear of U.S. domination also remains. As I have explained, the U.S. is integral to the international process. However, outside the U.S., there is a concern that the U.S. will dominate not only our thinking about issues, but also the way standards are written. In particular, there is a concern that the U.S. preference for detailed rules will manifest in global standards. There also is a concern that the U.S. will export Sarbanes-Oxley. But, that is a topic for a different day. Inside the U.S., there is a concern that IFRS lack rigor. They are not tough enough to be high quality. They are not specific enough to ensure consistent application. Clearly, there is a tension. However, I think it is fair to say that the progress in the last five years has been breathtaking. Had you told me when the IASB took over from the IASC in April of 2001 that we would be where we are today - not only with the spread of IFRS application around the world, but also the close working relationship the IASB has with the FASB and the SEC - I would have told you that you were dreaming. It was my dream. But you would have been dreaming too. Neither of us is dreaming now. We have come a long, long way.

How does the U.S. fit in to global financial reporting? Centrally and everywhere. The U.S. is deeply involved in and will be affected by global financial reporting. If you take away only one message from my talk this evening, this is what I want it to be. Capital markets are demanding a single language of business. They are demanding that the single language of business not be developed solely in the U.S. It is just not a popular idea. "Made in the U.S." will not be accepted worldwide. So, we all need to prepare to participate and to contribute. I predict the demand for a single language of business will be met. The market forces are too great to stop. My advice to you is to join in, or risk getting left behind!

Figure 1

Table 1

International Accounting Standards Board Technical Agenda

J	Business combinations	M	Post employment benefits
J	Conceptual framework	M	Fair value measurement
J	Revenue	M	Insurance contracts
J	Financial statement presentation	M	**Consolidations**
J	**Leases**		

- ST Convergence
- Borrowing costs
- Segments
- Income taxes
- R+D

- Nonfinancial liabilities
- SMEs
- Joint ventures

J (M) denotes joint (modified joint) project with the Financial Accounting Standards Board

Footnote

(1) IFRS prohibits the use of LIFO. Although domestic standards of some countries, e.g. Canada do not prohibit the use of LIFO, it typically is used only by subsidiaries of U.S. parent companies.