
IMPLICATIONS OF IFRS ADOPTION ON THE ORGANIZATION AND HUMAN RESOURCE MANAGEMENT PRACTICES OF GLOBAL ACCOUNTING FIRMS

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ABSTRACT

Many industries have experienced a globalization process that has led to fundamental shifts in industry dynamics and changes to the basic structure of firms. However, the international accounting industry has largely remained a collection of inter-related but separate nationally-based industries. This nationally-based structure has been driven by the existence of country-specific accounting standards and professional licensing boards that are unique to each country. Various financial market regulators also prescribe financial reporting and other requirements for firms listed on specific equity exchanges. Cultural, economic, and legal factors all contributed to the development of country-specific accounting approaches.

Now, a number of factors are facilitating a globalization of the accounting industry. These factors include the recent development of international accounting standards, the trend towards listing equities on multiple exchanges, and increasing prevalence of electronic accounting information and communication. These trends will likely lead to changes in the structure and organization of accounting firms, changes in the nature of accounting work performed in certain countries, and a shift in accounting tasks to locations that can perform functions more efficiently.

INTRODUCTION

The twentieth century saw dramatic changes in the nature of national and global competition in many industries. In the past transportation costs, trade barriers, and communication limitations meant that most industries were organized on a national basis with minimal cross-border activity. Now, many industries have been transformed, and firms compete globally in industries where most national boundaries are transparent. These trends have been captured in research studies (Bartlett & Ghoshal, 1998), and popularized in the trade press (Friedman, 2005). While globalization happened faster in some industries than others, and competition evolved in unique ways as a result differing structural characteristics, few industries have been unaffected by globalization. One industry that has remained very much influenced by national boundaries is public accounting. The

recent development of international accounting standards, the trend towards listing equities on multiple exchanges, and the increasing prevalence of electronic accounting data, are among the factors that are now facilitating a globalization of the accounting industry. Although the largest accounting firms have operated across many countries for decades, in practice local partnerships have been semi-autonomous entities that focused on the domestic market while facilitating the audit, tax, and consulting needs of multinational companies. In many ways this was similar to how IBM, other computer companies, and software consulting firms operated prior to the development of the internet. In these industries, local sales, service, support, and software development teams worked closely with local companies to develop specific solutions for each client's unique needs, even if they were part of a multinational corporation. Similar to other industries, the accounting industry may experience changes in competition, organizational form, and distribution of work in the coming decade. More specifically, national offices are likely to become less autonomous, and certain tasks will be performed by employees or contractors who might be located anywhere in the world.

HOW GLOBAL IS THE PUBLIC ACCOUNTING INDUSTRY?

Large companies operating in multiple countries have responded to the increasing flatness of the global economy in many ways (Friedman, 2005). In the world of financial reporting, however, a variety of regulatory forces seem to have constrained responses by large public accounting firms. While the largest public accounting firms, known as the "big four," are global organizations, they are organized as networks of national affiliates rather than as truly integrated global firms. One reason for this organizational form has been the national regulatory environments within which public accounting firms operate. Historically, national accounting standards, auditing standards, and security regulations made it difficult or impossible for public accountants from one country to have the appropriate expertise and/or mandated certifications to effectively function in other countries. Hence the structure of the worldwide accounting industry was one where there were a number of individual nationally-based industries, each with its own unique characteristics, competitors, and regulatory structure. As their clients (corporations) expanded internationally, however, accounting firms began to affiliate with independent accounting firms in other countries. Gradually these firms came to operate under similar "brand names," and evolved into network structures of interdependent, yet fairly autonomous entities.

Nevertheless, there are signs that public accounting firms are now shifting their organizations and human resource management approaches. For some time, U.S. corporations have outsourced a number of functions to lower cost environments such as India. Work that is commonly outsourced offshore includes service work such as customer service, bookkeeping, information systems management, and accounting. There is also evidence that public accounting firms are also outsourcing work offshore. Most of the work being outsourced by public accounting firms is lower-level work requiring limited judgment. Smaller firms are most often outsourcing bookkeeping work,

while large firms such as Ernst & Young are outsourcing tax compliance work (Boomer, 2005; Guda, 2009; Houlder, 2007; Daugherty & Dickens, 2009). The increasing reliance on electronic data for all financial transactions, rather than paper trails and written ledger books, has facilitated the shift of some activities to offshore locations.

Offshore outsourcing of truly professional services, including legal and auditing services, however has been limited. Although some evidence exists about outsourcing low-level audit work, and two of the big four firms reportedly have started pilot programs to test offshore performance of audit procedures, currently relatively little audit work appears to be outsourced (Daugherty & Dickens, 2009). A number of factors make outsourcing audit work problematic. First, most audit work requires at least some judgment, and this type of work is known to be more difficult to effectively outsource. Second, auditing standards and other regulatory requirements make offshore outsourcing of audit work problematic. For example, U.S. audit standards require appropriate supervision of individuals performing audit work. Indicators of supervision quality may include education, experience, and certification. Since it is difficult to find U.S.-licensed CPAs in other countries, it can be challenging to meet this standard when outsourcing audit work to other countries. It is interesting to note, however, that country-specific rules don't seem to be an impediment to outsourcing. Although the U.S. tax code is quite specific to the United States, tax preparation is one of the most outsourced activities of U.S. public accounting firms. The professional nature of auditing work can affect offshore outsourcing. While some dimensions of audit work could likely be fragmented and outsourced, other dimensions are more advisory in nature and depend on relationships and client service. Also, the profession may resist the de-professionalization of public accountants that would accompany fragmentation of their work and offshore outsourcing (Sako, 2009).

STATUS OF IFRS ADOPTION

Historically, nations developed their own financial accounting standards. Culture, legal, governmental, and economic factors influenced the way accounting standards developed in different countries, and as a result direct comparison of financial statements was problematic. As business and finance became more global, the idea of one common international set of financial accounting standards became more appealing. The quest to develop a set of international financial accounting standards that would be globally accepted has been a relatively long one. While contemplated earlier (Mueller, 1963), the goal was formally institutionalized in 1973 with the creation of the International Accounting Standards Committee Foundation (IASC). Thirty-five years later, a comprehensive set of accounting standards, International Financial Reporting Standards (IFRS) was developed and are now required or permitted by more than 100 countries (IASB, 2010). While IFRS was earlier adopted by developing countries, the European Union mandated adoption of IFRS by EU-listed public companies in 2005. This step precipitously augmented the stature of IFRS, as it meant nearly

a third of the world economy would be preparing financial statements in accordance with IFRS (Kotlyar, 2008). The drive for IFRS came from many sources, not the least of which was multinational firms that wanted to list their equity on multiple exchanges and obtain financing worldwide.

In the United States, efforts have been underway for some time to converge U.S. financial accounting standards (GAAP) with IFRS. The 2002 “Norwalk Agreement” formalized a commitment to this objective (FASB, 2010). Since this time, the U.S. standards setter, the Financial Accounting Standards Board (FASB), has been working with its IFRS counterpart, the International Accounting Standards Board (IASB), on joint standard setting projects. While considerable progress was made toward convergence, the Securities and Exchange Commission (SEC) took steps that ultimately may lead to a leap from a commitment to converge U.S. and IFRS standards to the wholesale adoption of IFRS by U.S. public companies. In 2007, the SEC issued a final rule allowing foreign registrants to report under IFRS without reconciliation to U.S. GAAP (SEC, 2007). One reason for this may have been to facilitate foreign firms listing on U.S. exchanges in order to preserve the “market share” of New York in the global equity market. Regardless of the SEC’s motivation, this was a significant step. In essence it allowed foreign companies a reporting option (i.e., IFRS) that was not available to U.S. companies. This disparity in reporting options, however, created a further impetus towards a single set of standards. In November 2008 the SEC issued its proposed rule titled “Roadmap for the Potential Use of Financial Statements Prepared in Accordance with IFRS by U.S. Issuers” (SEC, 2008). This proposed rule articulates the process the SEC will use to evaluate whether to mandate adoption of IFRS by all U.S. public companies as early as 2014 (although earlier adoption might be allowed for certain companies). In this roadmap, the SEC articulates its motivation for proposing a process by which U.S. companies would be required to adopt IFRS as follows:

As capital markets become increasingly global, U.S. investors have a corresponding increase in international investment opportunities. In this environment, we believe that U.S. investors would benefit from an enhanced ability to compare financial information of U.S. companies with that of non-U.S. companies. The Commission has long expressed its support for a single set of high-quality global accounting standards as an important means of enhancing comparability. We believe that IFRS has the potential to best provide the common platform on which companies can report and investors can compare financial information (SEC, 2008).

There is some debate among academics, practitioners, and other stakeholders regarding the pros and cons of IFRS adoption, but major U.S. corporations and the big four public accounting firms generally support this move. While anything can happen, all indications suggest that the question is “when” rather than “if” the U.S. will fully adopt IFRS.

IMPLICATIONS OF U.S. ADOPTION OF IFRS ON THE PRACTICE OF PUBLIC ACCOUNTING

The adoption of IFRS is building momentum. If the U.S. adopts IFRS, effectively there will be one global set of accounting standards for most of the world's economy. Many, including the SEC, have commented on the potential this would have for facilitating comparison of financial statements and efficiency in capital allocation (SEC, 2008). Others have recognized that U.S. adoption of IFRS and the emergence of global accounting standards will be a catalyst for global change with respect to regulatory frameworks, contracting, and corporate communications (Kotlyar, 2008). There has been little discussion, however, of the effect global accounting standards might have on the organization and management of public accounting firms, and the practice of public accounting.

The immediate consequences of global IFRS adoption relate to creation of a common set of accounting standards. Accountants around the world would be trained to understand the same standards. In a world of one common set of accounting standards, and potentially one common professional certification, factors underlying the current organization of public accounting firms and the way work is performed would change. It would be much easier for staff of a global public accounting firm to work trans-nationally, and much easier to meet regulatory standards regarding supervision when audit work was performed in different countries. This notion, while not widely articulated in the U.S., was at least present in considerations regarding the EU's mandate for listed companies to adopt IFRS. The EU planned to open a single market for financial services, as articulated under its Financial Services Action Plan, and common accounting standards were a necessary precondition for achieving this goal (Kotlyar, 2008). Additionally, the momentum toward global adoption of IFRS most likely is related to the pilot programs being introduced by some of the big four public accounting firms to test offshore outsourcing of some audit procedures. As globalization of accounting standards progresses and spurs more global integration of related regulation, it is likely that audit work will be performed more globally. Ernst & Young clearly articulates the importance of staff mobility in its discussion of its Career Development Framework (see Appendix 1). While Ernst & Young discusses this as a competitive advantage of its firm (E&Y, 2009), increasing global competition for audit jobs and downward pressure on salaries are possible consequences of a more global financial reporting system. Ernst & Young does not address this point in its promotional materials regarding its Career Development Framework.

More globally integrated audit work is almost inevitable as global accounting standards and financial regulations are adopted. This will be facilitated by the movement away from paper invoices and ledger books that would need to be audited "on site," since most accounting data are now electronic and could be audited and reconciled from anywhere in the world where an auditor could access the data. The logic of the current organizational form of the big four may also be reconsidered. A myriad of factors, including the implications of global practice on liability, will

affect the organizational form ultimately adopted by public accounting firms. Ernst & Young has already altered the structure of its operations in response to globalization (see Appendix 1), even if it retains elements of its prior structure for legal purposes. Global accounting, auditing, and financial reporting regulations may make a more truly global public accounting firm possible.

CONCLUSION

It is clear that globalization of accounting standards and financial reporting practices will have implications for investors and public corporations. But there will also be implications for how, where and by whom audit work will be performed. It is reasonable to consider that the practice of auditing could follow a trajectory similar to that seen in the practice of information systems development and consulting, where much of the development work now takes place in countries with a large number of skilled, but lower wage, programmers. This potential shift of work and change in organizational structure needs to enter the discourse surrounding U.S. adoption of IFRS in a more meaningful fashion. While the big four firms are taking actions that reflect cognizance of these issues, their understanding of, and planning for, these changes have not been clearly articulated with regard to adoption of IFRS. The IASB and the big four public accounting firms are mounting education programs to ramp up for the U.S. transition to IFRS. But the implications of the U.S. adoption of IFRS for employment and education run much deeper than the need to rapidly integrate IFRS into college curricula. If public accounting firms can move staff more easily and even outsource audit procedures, career paths within public accounting will change. The public accounting positions that remain in the U.S. will be quite different than the ones that currently exist, suggesting a need for different recruiting, training, and retention strategies. While more judgment-intensive and client relationship-oriented work might remain domestically staffed in the near term, the question of how staff will develop judgment becomes significant. If lower level audit work can be outsourced, how will staff be trained and develop expertise? In the description of its structure, PwC clearly articulates the importance of experience at the engagement level for developing professional competence:

The unit of organisation most critical to our success is also its smallest and most fluid: the client engagement team. Much of the decision-making authority relating to how client needs are met rests with engagement teams. The team also has primary responsibility for building and expanding client relationships. And the team is where much of our people's professional development occurs and PwC's culture is passed to younger professionals. As a consequence, each piece of the PwC network shares a single, overriding aim: to help engagement teams connect with clients, win work, and mentor the next generation of leaders (PwC, 2010).

Ernst & Young openly suggests that staff mobility across national boundaries will be central to career development, "We see mobility as the key to providing our people with the experiences

they expect to build their careers and is therefore an important part of our EYU framework” (E&Y, 2009). Regardless of public accounting firms’ individual responses to the changing business and financial reporting landscape, the implications for the organization of public accounting firms, the staffing of audit work, and the development of professionals are significant and need to be part of the discourse surrounding the possible U.S. adoption of IFRS.

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APPENDIX 1: ERNST AND YOUNG'S CAREER DEVELOPMENT FRAMEWORK

From: http://199.52.9.11/Global_Review_2008/Index.html

This year marked the global launch of EYU, our career development framework. Through EYU, our Service Lines operate in ways that provide our people with the right experiences, learning and coaching to help them grow and achieve their potential. It brings consistency, clarity and transparency to the way we develop all our people globally and reflects the mutual commitment we have to supporting our people, and our people have to owning their career.

We provide our people with some of the most challenging, exciting and rewarding experiences available anywhere through a range of international, cross-Service-Line and cross-functional assignments. We have increased our focus and investment on mobility assignments, and our US\$1 billion, four-year expansion effort in key markets will help to provide even greater mobility opportunities for our people.

We see mobility as the key to providing our people with the experiences they expect to build their careers and is therefore an important part of our EYU framework. More than half the graduates joining us today say they chose us because they want to embark on an international career. And our clients increasingly require our support across a number of markets.

We are pushing hard to give our people global experiences to help shape their perspectives and enable their personal and professional growth. Mobility is one of our global priorities. It helps foster our inclusive culture, and promotes global assignments and working on cross-cultural teams.

The integration of our business across our Americas, EMEIA and Far East Areas has helped to promote inclusiveness across our diverse cultures. We can now more easily mobilize our people and provide them with greater opportunities to build rich careers, working with a greater range of accounts, specialty practices, industry sectors and geographies.

EYU also provides our people with a structured learning curriculum that offers globally consistent content to help our people develop their skills and become well-rounded professionals. And we provide our people with continual support to ensure they know how to apply their learning in their day-to-day role, to build their competencies and skills and accelerate their careers with us. But it is only by supporting our people in the broadest sense that we can deliver on our promise of being an inclusive and diverse organization.

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