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The Role of American Culture in the Convergence Process of International and United States Financial Accounting Principles

Umarbek U. Rabbimov

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The Role of American Culture in the Convergence Process of International and United States Financial Accounting Principles

Abstract
The aim of this study is to analyze the role of American culture in the process of the International Financial Reporting Standards and U.S. Generally Accepted Accounting Principles convergence.

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The Role of American Culture in the Convergence Process of International and United States Financial Accounting Principles

By

Umarbek U. Rabbimov

A Senior Thesis Submitted to the

Eastern Michigan University

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Section 1: Introduction

The world has never been as globalized as it is today. The economic, social, and
political lives of people have changed greatly with increases in globalization. There are
numerous examples of this interconnectedness across the world. This globalization
affects all facets of business. For example, there are 965 foreign companies registered
with the U.S. Securities and Exchange Commission (U.S. Securities and Exchange
Commission, 2011). There are 18 countries that are now members of the European
Union. The Euro, their joint currency, is used by 333 million citizens of the European
Union (European Commission, 2014). Deloitte Touche Tohmatsu Limited is a public
accounting firm present in more than 150 countries with over 200,000 employees
(Deloitte, 2014). There are countless such examples that illustrate the scope and the
impact of globalization in the business world. The field of accounting is not an exception
to this process of globalization. Today's vibrant, international business environment
requires the knowledge of two different accounting standards for American Certified
Public Accountants (CPAs). The first, U.S. Generally Accepted Accounting Principles
(U.S. GAAP) is the accounting standard required for all publicly traded companies in the
United States. The second, International Financial Reporting Standards is considered a
global standard required or permitted by 124 countries1 all over the world for their
respective capital markets. CPAs frequently apply IFRS as they perform accounting
services for U.S. subsidiaries of foreign companies, foreign subsidiaries of U.S.
companies, and for foreign companies that are listed on U.S. capital markets. The two

1Some of the countries that require or permit IFRS are the United Kingdom, Australia, Ireland, New
Zealand and Canada. A full listing of countries that have adopted IFRS can be accessed at
http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx
different sets of accounting standards make it challenging for accountants to collaborate and cooperate together. U.S. GAAP and IFRS remain two distinct standards up to this day.

The purpose of this paper is to discuss the differences that exist between IFRS and U.S. GAAP while exploring why, from a cultural perspective, the U.S. has not adopted IFRS while many other similar countries have. I discuss the cultural similarities between the U.S., Canada, New Zealand, Australia, Ireland and the U.K. In addition, I explore differences that help to explain why the U.S. has not adopted IFRS while similar countries have adopted IFRS. Those countries have fully embraced reporting under IFRS as the sole accounting standard for publicly traded companies in their respective countries.

U.S. GAAP and IFRS have two distinct standard setting boards: the Financial Accounting Standards Board (FASB) is responsible for making reporting rules for U.S. GAAP while the International Accounting Standards Board (IASB) makes accounting rules for IFRS. There are different primary users. U.S. GAAP is focused on the reporting needs for capital markets in the United States. IFRS is meant to be a reporting standard applicable to firms across many different countries. As a result, their standards board is made up of members from Japan, Korea, Canada, the U.S., Netherlands, the U.K., France, Germany, Sweden, Australia, Brazil, South Africa, and China (IFRS Foundation, 2014).

There are also differences between these two standards themselves. However, the standard setters for U.S. GAAP and IFRS have come together in a convergence process designed to make the two sets of standards more similar. This convergence process goes
back to a joint meeting in Norwalk, Connecticut between FASB and IASB in September 2002, to narrow the differences and to make the standards as compatible as possible (FASB, 2002). Since this agreement, the two standard setting bodies have come a long way. IASB and FASB presented an update on accounting convergence to the Financial Stability Board (FSB), an institution that organize the duties of national and international standard setting bodies at the international level, on April 5, 2012. According to the update, most of the short term projects such as revisions on requirements of accounting for inventories, research and development and borrowing costs have already been completed (Hoogervorst & Seidman, 2012). The report also stated that the focus of the two boards has been adjusted to address the top ten long-term projects. According to the joint update note, most of the long term projects have been successfully completed which is a vital sign of progress towards a greater convergence between IFRS and U.S. GAAP. Table 1 below summarizes the completed projects. Even though there have been successes in completing these projects, the U.S. convergence process has been a much slower endeavor compared to other countries’ acceptance of IFRS.

Table 1: Completed FASB & IASB Short-term and Long-term Projects

<table>
<thead>
<tr>
<th>Project</th>
<th>Milestone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share-based payments</td>
<td>Convergence completed in 2004.</td>
</tr>
<tr>
<td>Non-monetary assets</td>
<td>FASB amended the treatment of certain non-cash transactions by mandating the recognition at fair market value unless the exchange does not economic substance.</td>
</tr>
<tr>
<td>Inventory accounting</td>
<td>FASB agreed on the accounting of surplus freight and spoilage.</td>
</tr>
<tr>
<td>Accounting changes</td>
<td>FASB required application of the treatment of voluntary changes in accounting policy retrospectively as the result of convergence.</td>
</tr>
<tr>
<td>Borrowing costs</td>
<td>IASB modified IAS 23 Borrowing Costs in 2007 to better align with FASB.</td>
</tr>
<tr>
<td>Joint Venture</td>
<td>IASB established a standard in May 2011 for the financial reporting by entities to a joint agreement.</td>
</tr>
</tbody>
</table>
Long-term Projects

<table>
<thead>
<tr>
<th>Business Combination</th>
<th>The 2008 convergence resulted in certain accounting and non-controlling requirements for business combinations.</th>
</tr>
</thead>
<tbody>
<tr>
<td>De-recognition</td>
<td>FASB and IASB introduced amendments to substantially align the disclosure requisites.</td>
</tr>
<tr>
<td>Consolidated financial statements</td>
<td>With IASB and FASB issuing two standards in May 2011 and clarifications in regards to principles vs. agents in 2011 respectively, the project was completed.</td>
</tr>
<tr>
<td>Financial statements presentation – other comprehensive income</td>
<td>The 2011 changes to the presentation of other comprehensive income of IFRS and U.S. GAAP completed the project.</td>
</tr>
</tbody>
</table>

Source: Hoogervorst, H., & Seidman, L. (2012). *IASB and FASB Update Report to the FSB Plenary on Accounting Convergence.* FASB.

Most other countries have outright adopted IFRS instead of converging. For example, all EU countries mandated IFRS for their publicly traded companies as of January 2005. These countries have adopted IFRS on a large scale while replacing their local GAAPs with IFRS for use on their capital markets. There was no convergence process; it was a mass adoption of IFRS across multiple countries replacing one standard (their national GAAPs) with another (IFRS). Other countries that have converged have not had such a long process. For example, in 2008, Turkey adopted IFRS for all companies whose stocks are publicly traded (IFRS Foundation, 2013).

There have been agreements on many standards between U.S. GAAP and IFRS in the convergence process, but vast differences remain that continue to differentiate the two standards. Even things like language create a barrier for true comparability between these two standards. For example, U.S. GAAP and IFRS give different benchmarks for classifying something as an operational lease or a financial lease and the wording that is used becomes important for interpretation. IFRS classifies something as a financial lease if the lease term is for a “major part” of the borrowed asset’s economic life. U.S. GAAP
gives what is a considered a bright line for decision-making because U.S. GAAP requires that a lease be classified as a financial lease if the lease lasts 75 percent of the asset's life (Doupnik & Perera, 2012). There is a specific percentage given instead of saying an undefined “major part.” Such differences present unique challenges throughout the convergence process.

To explore this topic, I confront specific issues in the U.S. GAAP-IFRS convergence process along with the effect of culture on the process. Section II discusses possible reasons for the failure of the U.S. to fully adopt IFRS while other culturally similar countries have adopted IFRS. Section III describes the differences that remain between IFRS and U.S. GAAP even though this convergence process began in 2002. Additionally, this section explores role of culture in explaining those differences. Finally, Section IV concludes this paper and discusses avenues for future research. The paper contributes to the current literature on IFRS and U.S. GAAP by analyzing culture and hypothesizing how that contributes to the lack of adoption of IFRS by the United States even as the rest of the world continues to adopt it as a global accounting standard.
Section II: Failure of U.S. Adoption of IFRS

Culture is an important issue to address when it comes to highlighting the failure of acceptance of IFRS in the U.S. and I will discuss the effect it has had on the convergence process. This section will provide some explanations for the failure of the U.S. to fully embrace IFRS by quantifying culture through certain proxies. Initially, I will share some insight about the lack of explanatory power of Hofstede’s dimensions in explaining the role of culture in the convergence process. I then discuss certain aspects of American culture that could be holding back the United States from fully embracing IFRS by identifying variables of interest that are measures of culture that may shed some light in understanding the failure of acceptance of IFRS in the U.S. Specifically, I identify the globalization aspect of the culture measured by the KOF Index of Globalization, the degree of justice within a society measured through the lenses of rule of law indices by the World Justice Project, and identify the predominant values of a culture indexed by the World Values Survey.

Culture has numerous definitions from several scholars. Hofstede, in his book “Culture’s Consequences: International Differences in Work-Related Values” (1984), defines culture as “the collective programming of the mind which distinguishes the members of one human group from one another”. Inspired from this definition, Gray (1988) expands upon Hofstede’s definition by stating that collectively held norms and values in a societal level form a culture. Based on these definitions, it can be claimed that there are certain values that countries uphold at the collective level that distinguish the culture of one country from another. Furthermore, it is suggested that the culture influences the society through governmental and non-governmental institutions. Stulz and
Williamson (2003) claim that culture affects the development of finance and its institutions through at least three channels: “predominance of certain values”, “effects on institutions”, and “resource allocations”. To put the ideas of these scholars together, it appears that there are certain predominant values of countries which shape financial institutions and hence, should shape accounting behavior. Empirical work supports this. Ding, Jeanjean, and Stolowy (2005) find that the extent of harmonization between national GAAP and International Accounting Standards (IAS) \(^2\) varies among those with different cultural dimensions. Additionally, Nobes (1998) states culture has an influential impact on the development of accounting system. Hope, Kang, Thomas, and Yoo (2008) propose the notion that one of the determinants of the quality of financial reporting is culture. Given the impact of culture on business, it is reasonable to assume culture has an impact on the difference in accounting practices between U.S. GAAP and IFRS and the lack of adoption of IFRS in the United States.

The first cultural measures I look at are Hofstede’s seven cultural dimensions. The reason for specifically exploring these variables first is that Gray (1988) uses Hofstede’s first four dimensions, power distance, individualism, masculinity, uncertainty avoidance, to establish a link between culture and accounting reporting behavior. He hypothesized that those cultural dimensions influence the development of accounting worldwide. The first four dimensions were presented in Hofstede’s book (1980), “Culture’s Consequences: comparing values, behaviors, institutions, and organizations across nations”. He quantified culture by surveying 116,000 IBM employees between 1967 and

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\(^2\)The International Accounting Standards Committee (IASC) was established in 1973 with the goal of formulating International Accounting Standards (IAS). The IASC issued 26 IASs between 1973 and 2001 with this objective. However, due to certain problems, IASB took over the IASC on April, 2001. IAS formed the basis for development of IFRS.
1973 across multiple cultures. He then extended his work in 2001 by adding long-orientation which was found from the 1985 Chinese Values Survey which included 23 countries (Hofstede, 2001). His work was once again extended, this time with co-authors (Hofstede, Hofstede, and Minkov, 2010) who added an analysis of two more dimensions from the World Values Survey to measure national cultures: pragmatism and indulgence. All seven dimensions are defined as follows:

**Power Distance (PD)** refers to the notion that not all individuals of societies are equal and represents the attitude of the culture towards the unfairness among its members. The numerical value of PD illustrates the level of expectation and acceptance the less powerful members of a society poses in regards to unequal distribution of power within a country (Hofstede, 1980).

**Individualism versus Collectivism (IDV)** presents the extent to which members of a culture feel interdependent with each other by analyzing their self-conception in terms of “I” or “We”. It is observed that people are only supposed to look after themselves and their direct family in individualist societies, whereas, in collectivist societies, people associate themselves with certain groups that provide care for each other in return for loyalty and respect. The numerical value of IDV represents such comparison (Hofstede 1980).

**Masculinity versus Femininity (MAS)** provides a comparison between a society’s ambition for competition, accomplishment and for being the winner or the best which is indicated by a high or masculine score and a feminine score which represents culture’s primary values such as caring for others, immersing with others and good quality of life. The index of MAS
quantifies the preference of willingness to be the winner and the desire to do what is enjoyable (Hofstede 1980).

Uncertainty Avoidance (UAI) refers to the perception of cultures in regards to the notion that the future is ambiguous. As the result of such uncertainty and anxiety associated with it, societies have adopted certain mechanisms of dealing with them. The UAI index reflects the level of threatened feelings such ambiguity causes and beliefs and norms targeted to avoid these feelings with a society (Hofstede, 1980).

Long-Term Orientation (LTO) is mainly based on the ideologies of Chinese philosopher Kong Ze (Confucius) which opposes long-term to short term aspects of life. More specifically, long-term orientation in life promotes future-oriented lifestyle by emphasizing “perseverance and prudence”. On the other hand, short-term orientation encourages past- and present-oriented lifestyle by highlighting certain values such individual stability and recognition of customs and traditions (Hofstede, 2001).

Pragmatism (PGTM) represents people’s belief to the notion that a lot of surrounding present and past events and issues do not have explanations. With their desires to certain explanations, normative oriented societies tend to explain as much as they can. Cultures with pragmatic minds, majority people do not present as much need or desire for interpretation of surrounding events. Pragmatic cultures strive for virtuous life and hold beliefs that understanding the complexity of life is beyond the bounds of possibility (Hofstede et al., 2010).

Indulgence versus Restraint (INDLG) offers a unique comparison of two distinct natures of societies. One is indulgence which represents societies with certain level of desire for freely
enjoyment of principal human needs associated with joyful and fun life. In contrast, restraint reflects a society’s belief that such kinds of desires require limitations and regulations by stringent rules and norms (Hofstede et al., 2010).

Hofstede has provided quantifiable data for each of the dimensions. These dimensions are widely used in academic business fields for research to compare cultural values of one country to another to understand their different approaches to similar situations (Hope, 2003; Salter & Niswander, 1995; Ahrens & Chapman, 2006; Gray & Vint, 1995). Hofstede’s book (1984) has been cited over 32,000 times according to Google Scholar. This shows the scope of application of his dimensions among scholars in a variety of disciplines. However, these dimensions are not sufficient in explaining the existing differences between IFRS and U.S. GAAP when all other Anglo-American countries except the U.S. have fully converged with IFRS. Anglo-American countries and those influenced by the Anglo-American tradition, stem from a British-traditional legal system, and are also commonly referred to as common-law countries (LaPorta, Lopez-de-Silanes, Shleifer, & Vishny, 1997; LaPorta, Lopez-de-Silanes, Shleifer & Vishny, 1998). The distinctive feature of a common-law legal tradition is that laws are made by judiciary system and are consequently transformed by legislative piece such as laws or ordinances as opposed to code (civil law) where laws are originally, derived from the Roman law and feature

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3 La Porta et al. (1997, 1998) use a sample of 49 countries to identify the origin of their legal systems and their effect on the development of their respective capital markets.
characteristics of the intellectual community and a legislator-made civil law

tradition.

Most interestingly, Hofstede’s dimensions for all English speaking, common-law
countries, including the U.S., are similar (Borker, 2013). Table 2 further illustrates the
point by showing the Hofstede dimensions for six English speaking, common-law
countries, Australia, Ireland, New Zealand, Canada, United Kingdom and United States.

Hofstede scores range from 0 to 100.

<table>
<thead>
<tr>
<th>Country</th>
<th>PD</th>
<th>IDV</th>
<th>MAS</th>
<th>UAI</th>
<th>LTO</th>
<th>PGT</th>
<th>INDLG</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>27</td>
<td>99</td>
<td>62</td>
<td>41</td>
<td>31</td>
<td>22</td>
<td>71</td>
</tr>
<tr>
<td>Canada</td>
<td>30</td>
<td>87</td>
<td>52</td>
<td>38</td>
<td>23</td>
<td>27</td>
<td>68</td>
</tr>
<tr>
<td>Ireland</td>
<td>18</td>
<td>75</td>
<td>70</td>
<td>26</td>
<td>43</td>
<td>22</td>
<td>65</td>
</tr>
<tr>
<td>New Zealand</td>
<td>12</td>
<td>86</td>
<td>59</td>
<td>39</td>
<td>30</td>
<td>28</td>
<td>75</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>26</td>
<td>98</td>
<td>68</td>
<td>26</td>
<td>25</td>
<td>52</td>
<td>69</td>
</tr>
<tr>
<td>Mean</td>
<td>22.6</td>
<td>89</td>
<td>62.2</td>
<td>34</td>
<td>30.4</td>
<td>30.2</td>
<td>69.6</td>
</tr>
<tr>
<td>Median</td>
<td>26</td>
<td>87</td>
<td>62</td>
<td>38</td>
<td>30</td>
<td>27</td>
<td>69</td>
</tr>
<tr>
<td>United States</td>
<td>31</td>
<td>100</td>
<td>63</td>
<td>37</td>
<td>29</td>
<td>21</td>
<td>68</td>
</tr>
</tbody>
</table>

PD, power distance, measures the attitude of people to unfairness and inequalities within the culture.
IND, individualism, measures the degree to which people care for themselves and for their direct
families. MAS, masculinity, measure degree of significance on competition, prosperity, and
accomplishment as opposed to caring for others. UAI, uncertainty avoidance, reflects the level of
threatened feelings people hold due to unknown situations and have created confidence and
organizations that avert them. LTO, long-term orientation, scores the preference of people in regards to
future-oriented and past- or present-oriented lifestyle. PGTM, pragmatism, measures the degree of
people’s belief that truth depends much on situation, context and time. INDLG, indulgence provides
comparison between unleashing desire for better life and controlling the desires with rules and
regulations. All values come from http://geert-hofstede.com/dimensions.html.

As Table 2 shows, for the most part, the United States does not differ greatly from
the other common-law countries in terms of Hofstede’s dimensions. For example, the
average masculinity score for the other five English speaking common-law countries is

La Porta et al. (1997, 1998) further distinguish code law countries by classifying their historical
development based on French, German, and Scandinavian legal tradition.

Long-Term orientation Index Values are only available for 23 countries.
while the score is 63 for the United States. The U.S. has a score of 68 for indulgence while the other countries have an average score of 69.6. The average level of power distance for the other countries is 22.6 which is driven by a very low score for New Zealand. The median score for the countries corrects for that and reveals a score of 26 compared to 31 for the United States. Furthermore, comparing the indices for uncertainty avoidance, the median score for the other five countries is 38 whereas the U.S. has a score of 37. The median score for long-term orientation of the other five countries, 30, is one point different from the U.S. with a score of 38. Pragmatism has a median score of 27 for the five nations which is relatively similar to the U.S. with the score 21. The only Hofstede score with a somewhat large difference between the U.S. and the other five countries is for individualism. The U.S. has a score of 100 while the other five countries have an average of 87. However, looking at the individual level reveals that Australia and the U.K. have almost the same scores, 99 and 98 respectively. One might argue that a five unit difference in power distance, 13 unit difference in individualism and a six unit difference in pragmatism is sufficient to distinguish the U.S. from those five nations. In this regard, it is vital to understand the sense of scale in comparing one country to another on Hofstede's scale. Table 3 below illustrates six randomly selected countries that are culturally different from the English speaking, common-law countries. From the table, one can see that countries that are culturally different from English speaking, common-law countries have scores that are substantially far apart from the initially sampled nations. For example, the median score of these random countries is 71 for power distance or 37.5 for individualism which is noticeably different from the English
speaking nations. There are 45 units and 49.5 units of differences respectively within the two groups of samples.

Table 3: Hofstede variables comparing some other random countries

<table>
<thead>
<tr>
<th>Country</th>
<th>PD</th>
<th>IDV</th>
<th>MAS</th>
<th>UAI</th>
<th>LTO</th>
<th>PGTm</th>
<th>INDLG</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>81</td>
<td>30</td>
<td>69</td>
<td>82</td>
<td>-</td>
<td>24</td>
<td>97</td>
</tr>
<tr>
<td>Brazil</td>
<td>69</td>
<td>38</td>
<td>49</td>
<td>76</td>
<td>65</td>
<td>44</td>
<td>59</td>
</tr>
<tr>
<td>Croatia</td>
<td>73</td>
<td>33</td>
<td>40</td>
<td>80</td>
<td>-</td>
<td>58</td>
<td>33</td>
</tr>
<tr>
<td>Russia</td>
<td>93</td>
<td>39</td>
<td>36</td>
<td>95</td>
<td>-</td>
<td>81</td>
<td>20</td>
</tr>
<tr>
<td>Turkey</td>
<td>66</td>
<td>37</td>
<td>45</td>
<td>85</td>
<td>-</td>
<td>46</td>
<td>49</td>
</tr>
<tr>
<td>Germany</td>
<td>35</td>
<td>67</td>
<td>66</td>
<td>65</td>
<td>31</td>
<td>83</td>
<td>40</td>
</tr>
<tr>
<td>Mean</td>
<td>69.5</td>
<td>40.7</td>
<td>50.8</td>
<td>80.5</td>
<td>48</td>
<td>56</td>
<td>49.7</td>
</tr>
<tr>
<td>Median</td>
<td>71</td>
<td>37.5</td>
<td>47</td>
<td>81</td>
<td>48</td>
<td>52</td>
<td>44.5</td>
</tr>
</tbody>
</table>

PD, power distance, measures the attitude of people to unfairness and inequalities within the culture. IND, individualism, measures the degree to which people care for themselves and for their direct families. MAS, masculinity, measure degree of significance on competition, prosperity, and accomplishment as opposed to caring for others. UAI, uncertainty avoidance, reflects the level of threatened feelings people hold due to unknown situations and have created confidence and organizations that avert them. LTO, long-term orientation, scores the preference of people in regards to future-oriented and past- or present-oriented lifestyle. PGTM, pragmatism, measures the degree of people's belief that truth depends much on situation, context and time. INDLG, indulgence provides comparison between unleashing desire for better life and controlling the desires with rules and regulations. All values come from http://geert-hofstede.com/dimensions.html.

Understanding the lack of Hofstede's cultural values in explaining the role of culture is important in accounting because there have been mixed empirical results on tying Hofstede to differences in reported accounting behavior (Salter & Niswander, 1995). Moreover, Gemon and Wallace (1995) identify some issues such as lack of variety of respondents to Hofstede's survey. They describe cultural studies in international accounting research as, "trapped by paradigm myopia by its reliance on the framework suggested by Hofstede". At the same time, the U.S. is the only country that has not adopted IFRS for financial reporting purposes among all English speaking, common-law countries. Australia, Ireland, and the U.K. all adopted IFRS in 2005. New Zealand mandated the use of IFRS from January of 2007 and Canada converged with IFRS in
2011 (IFRS Foundation, 2013). Therefore, it is critical to not to limit the scope of the
study to Hofstede’s dimensions but to explore culture’s influence through other avenues
of identifying proxies for culture. In search of other dimensions, I have identified three
possible sources that can provide proxies for culture and help to explain the lack of
adoption of IFRS in the United States.

The first set of dimensions is derived from the KOF Index of Globalization. KOF
(a German word of "Konjunkturforschungsstelle") is a business cycle research institute.
The institution is a governmental think tank run by the country of Switzerland and their
main role is two-fold: one, as a moderator between a general public such as politicians,
social workers and the research community, and two, as a leading platform for
economists, especially within Switzerland (KOF, 2014). The KOF Index of Globalization
was initially computed in 2002 and now computes globalization indices for 207 countries
and geographic regions. Every year, the index is updated to capture the most recent trend
on globalization annually. They view globalization as “a process that erodes national
boundaries, integrates national economies, cultures, technologies and governance and
produces complex relations of mutual interdependence” (KOF, 2013a). The institute
presents one general, aggregated globalization index. Furthermore, it has provided three
variables that comprise their globalization index based on economic, social and political
factors. Each dimension is quantified and can be looked at separately, or combined, into
the globalization index.

Economic globalization (Economic Glob) is defined as continuous stream of consumer
goods and products, financial capital and services along with information and viewpoints
that follow market exchanges between nations. The index consists of two sub-indexes,
actual flows and restrictions. Actual flows represent information on trade, foreign direct and portfolio investments and income payments to international workforce. All the data is collected from several known sources such as The World Bank and UNCTAD STAT\(^6\).

"Restrictions" refers to limitations on exchange of commerce and capital using undisclosed import or export barriers, excessive tariff rates, and foreign trade taxes. The data is collected based on reports of numerous economic institutions such as the International Monetary Fund (IMF) and World Economic Forum (KOF, 2013a).

**Social Globalization (Social Glob)** is the index that expresses the expansion of intelligence, ideologies, pictures and people worldwide. KOF quantifies the globalization of social life in three categories. The first index represents "personal contacts" which is designed to illustrate the direct and indirect exchanges of communications among people residing in various countries. This data is aggregated from several sources such as international telecommunication traffic headed by International Telecommunication Union, the number of tourists a country hosts and some other statistics derived from the World Bank, the UNESCO\(^7\), and the United Nations Commodity Trade Statistics. The next variable captures "information flows" by collecting data about the possible flow of new concepts, ideologies and images. They compile the number of internet users, the proportion of households with a television set, and the quantity of international newspapers sold. The final sub-variable measures cultural proximity of other countries to the U.S. They include data on the number of traded books (imported and exported), the numbers of McDonald’s in a country, and the number of Ikea stores located in a country (KOF, 2013a).

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\(^7\) UNESCO stands for United Nations Educational, Scientific and Cultural Organizations. For more information, refer to [http://en.unesco.org/](http://en.unesco.org/)
**Political globalization (PolitGlob)** refers to the spread of nations' rules and regulations around the world. To adequately represent the spread, the institute combines the number of consulates, as well as high commissions in addition to the number of participation of a country in international and United Nations led missions and signed agreements between two or more nations since 1945. All of these statistics comes from the Central Intelligence Agency World Factbook, the Europa World Yearbook, the United Nations Department of Peacekeeping Operations, and the United Nations Treaties Collection (KOF, 2013a).

The KOF indexes for English speaking, common-law countries have been aggregated in Table 3. The application of the KOF Index of Globalization in explaining the existing differences between the decisions of FASB and IASB is appropriate due to the fact that one nation's culture is affected by the globalization process. For example, Lieber and Weisberg (2002) argue that globalization and modern values are transmitted to nations through culture in its difference kinds of forms. Thus, dimensions of globalization needs to be accounted for when discussing the role of culture in the ongoing convergence process. Specifically, the level of globalization of United States compared to other English speaking, common-law countries will provide some critical insight about the failure of adopting IFRS by the U.S.
Table 4: KOF variables comparing English Speaking, Common-law Countries

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>81.59</td>
<td>76.41</td>
<td>72.79</td>
<td>80.04</td>
<td>79.82</td>
<td>71.88</td>
<td>76.04</td>
<td>91.32</td>
<td>91.29</td>
</tr>
<tr>
<td>Canada</td>
<td>85.38</td>
<td>75.77</td>
<td>71.79</td>
<td>79.76</td>
<td>88.59</td>
<td>79.64</td>
<td>92.52</td>
<td>93.92</td>
<td>94.13</td>
</tr>
<tr>
<td>Ireland</td>
<td>91.79</td>
<td>93.95</td>
<td>99.08</td>
<td>88.82</td>
<td>90.79</td>
<td>89.06</td>
<td>93.19</td>
<td>89.93</td>
<td>90.22</td>
</tr>
<tr>
<td>New Zealand</td>
<td>78.22</td>
<td>80.55</td>
<td>73.65</td>
<td>87.44</td>
<td>72.82</td>
<td>78.81</td>
<td>86.75</td>
<td>50.3</td>
<td>82.65</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>85.39</td>
<td>78.01</td>
<td>65.74</td>
<td>90.28</td>
<td>85.19</td>
<td>75.85</td>
<td>87.49</td>
<td>92.82</td>
<td>95.93</td>
</tr>
</tbody>
</table>

Glob Index: Global Index combines the economic, social and political aspects of globalization. Economic Glo: Economic globalization is an index that takes into account stream of products and goods, financial capital and services along with knowledge and opinion that follow market exchanges. Actual Flows: presents information on trade, FDI and portfolio investment. Restrictions refers to limitations on exchange of trades and capital using obscure import and export barriers, excessive tariff rates, and foreign commerce tax. Social Glo: Social globalization refers to the diffusion of intelligence, ideologies, pictures and humans. Pers Contact: Personal Contact is an index that shows direct and indirect communications among people residing in various countries. Info Flows: Information flows measures the potential flow of images and ideas. Cult Prox: Cultural proximity mostly refers to the similarity of one country to the U.S. Polit Glo: Political Globalization refers to the spread of government rules and regulatory policies. All values come from the KOF index (2013b) from http://globalization.kof.ethz.ch/media/filer_public/2013/03/25/rankings_2013.pdf.

The higher numbers in this table refers to higher degree of preference for a certain dimension of globalization. For example, the numeric value of the economic globalization index for the U.S. is 60.33, while it is 80.94 for the other English-speaking, common-law countries. This means that on average, the other countries are more economically globalized than the U.S. It is also apparent that every other individual country in the table is more economically globalized than the U.S. More specifically, the overall globalization index of the United States, which is comprised of economic, political, and social globalizations is the lowest among any other countries in the table. Therefore, I posit that the degree of globalization of countries plays an important role in
the lack of adoption of IFRS in the U.S. compared to countries that are culturally similar according to Hofstede. Other culturally similar countries are more globalized thus, IFRS with its objective of a worldwide accounting standard, better matches with their globalized needs. The United States scores the lowest compared to the other nations in the general measure of globalization. This suggests that there is no strong urge in the U.S. to adopt international standards due to its lower degree of global integration.

Another variable that is important when understanding the role of culture in accounting is rule of law because it has an impact on the cultural behavior of nations. Licht, Goldschmidt, and Schwartz (2007) argue that the relations of culture to governance norms concerning rule of law, non-corruption, and accountability are substantial. Therefore, it is appropriate to examine rule of law in the context of culture. LaPorta et al. (1997) apply the idea of rule of law in a comparison between countries and find that rule of law is one of the indicators that help to describe the scope and size of a country’s capital market. By sampling 49 countries, they find that “the legal environment – as described by both legal rules and their enforcement – matter for the size and extent of a country’s capital markets” (La Porta et al, 1997). Furthermore, they argue that potential investors provide more capital in exchange for stocks and securities in the presence of a good legal environment which protects them against fraudulent activities of entrepreneurs. As a result, the scope of capital markets expands significantly where there is a stronger legal environment. LaPorta et al. (1997, 1998) are both frequently cited in the accounting and finance literature to help explain capital market differences across the

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*The World Justice Project defines rule of law as an environment which ensures obedience to the law by anyone, including government officials and where principal rights are protected by law and justice is done to all.*
Thus, LaPorta's variables for rule of law are essential in international studies of accounting and finance. When compiling the data on the six English speaking, common-law countries, it shows that the United States once again does not differ noticeably from the other similar nations. One can see from the table below, their rule of law measurement of the United States is equal to the median score of other five nations.

Table 5: LaPorta (1997) variables comparing English Speaking, Common-law Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Rule of Law</th>
<th>Anti-director Rights</th>
<th>Creditor Rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>10.00</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Canada</td>
<td>10.00</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Ireland</td>
<td>7.80</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>New Zealand</td>
<td>10.00</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8.57</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Mean</td>
<td>9.3</td>
<td>3.8</td>
<td>2</td>
</tr>
<tr>
<td>Median</td>
<td>10.00</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>United States</td>
<td>10.00</td>
<td>5</td>
<td>1</td>
</tr>
</tbody>
</table>

"Rule of Law" is a measure of law and order tradition in a country. "Anti-director rights" is an index that cumulates scores for shareholder rights by adding one when legitimate stakeholder rights are present. "Creditor Rights" is an indication of creditor rights. Similarly, it is calculated by adding one up to five when appropriate rights for creditors are established. All values come from LaPorta et al. (1997).

The World Justice Project (WJP) has variables that can serve as more in-depth extensions of LaPorta's rule of law characteristics and can help us understand why the U.S. has failed to embrace IFRS. The World Justice Project is a self-regulated organization that is devoted to promoting rule of law around the world by seeking to inspire state reforms by advancing and coordinating practical programs, and by educating the general public about the foundational significance of rule of law. The organization presents a quantitative assessment of the scope of countries' practical observations of rule
of law. The assessment consists of eight categories of dimensions that measure certain aspects of rule of law:

**Constraints on Government Powers (LimGovPow)** refers to a society where any level of state officials is held responsible and accountable for their actions under the law. In order to ensure such responsibility, societies have established a mechanism that prevents abuse of government and restricts the overexpansion of the power. The numerical value of LimGovPow shows the effectiveness of such mechanism (World Justice Project, 2014).

**Corruption (AbsCorrup)** represents the extent to which public authority and government officials use power for personal favors. A society without corruption is one of the bright indications of practical rule of law. The phenomena of rule of law reject any forms of corruption. The index of AbsCorrup quantifies the absence of corruption in countries around the world (World Justice Project, 2014).

**Order and Security (OrdSec)** is one of the primary duties of any government. Effective safety ensuring system guarantees preservations of human life and property which is a key aspect of a society governed by rule of law. The consequences of disorder and insecurity are unthinkable. First of all, they damage the psychological state of society and hold the society back from accomplishing full practice of basic human rights such promoting freedom and liberty. The numerical value of the index is comprised of three categories: “absence of crime”, “absence of civil conflict”, and lastly “absence of violence as a socially acceptable means to redress personal grievances” (World Justice Project, 2014).

**Fundamental Rights (FundRight(s))** is another aspect that rule-of-law-abiding societies need to ensure for their members. The principal human rights are highlighted in the United Nations’ Universal Declaration of Human Rights as “the right to equal treatment and the absence of discrimination, the right to life and security of the person, the right to the due
process of the law, the freedom of opinion and expression, the freedom of belief and religion, the absence of any arbitrary interference of privacy, the freedom of assembly and association, and the protection of fundamental labor rights” (World Justice Project, 2014).

Open Government (OpenGov) calls for active participation, open communication, and interactive collaboration between the government and its civilians. Additionally, open government refers to clearly publicized rules and regulations, easily accessible administrative meetings for general public attendance, conveniently available official information on the blueprints of rules and regulations. The numerical value of the index indicates the level of openness of governments (World Justice Project, 2014).

Regulatory Enforcement (RegEnforce) is the backbone of any effective rule of law in governed societies. Competent regulatory enforcing system ensures proper installation and application of laws and regulations as well as diminishes the ability of public officials to use their authoritative powers for their own favors. Furthermore, such enforcement creates an environment where administrative proceedings are directed with respect to the due process of law (World Justice Project, 2014).

Civil Justice (CivilJust) reflects the financial affordability, easy accessibility, fairness and competency of the civil justice system. Accessibility ensures overall familiarity of the solutions for civilian issues and affordability refers to inexpensive legal guidance and representation without any extra and unreasonable fees and barriers. Fairness ensures equal grounds in the system without any differentiation in terms of economic and social status of either involved party and without inappropriate pressure or influence of government officials or particular individuals. Lastly, civil justice system within a rule-of-law abiding society presents an alternate approach to dealing with civilian concerns while avoiding requiring people to use an alternative system without their permission (World Justice Project, 2014).
**Criminal Justice (CrimJust)** is an impartial and objective mechanism in which wrongdoers of a society are brought to justice. A properly functioning criminal justice system is able to carry out investigations and judgments against the actions of potential criminals while securing their rights and privileges in a timely and effective way (World Justice Project, 2014).

<table>
<thead>
<tr>
<th>Country</th>
<th>LimGovPow</th>
<th>AbsCorrup</th>
<th>OrdSec</th>
<th>FundRights</th>
<th>OpenGov</th>
<th>RegEnforce</th>
<th>CivilJust</th>
<th>CrimJust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>0.88</td>
<td>0.90</td>
<td>0.86</td>
<td>0.84</td>
<td>0.84</td>
<td>0.83</td>
<td>0.72</td>
<td>0.72</td>
</tr>
<tr>
<td>Canada</td>
<td>0.78</td>
<td>0.81</td>
<td>0.88</td>
<td>0.78</td>
<td>0.84</td>
<td>0.79</td>
<td>0.72</td>
<td>0.75</td>
</tr>
<tr>
<td>Ireland</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>New Zealand</td>
<td>0.87</td>
<td>0.92</td>
<td>0.87</td>
<td>0.86</td>
<td>0.84</td>
<td>0.82</td>
<td>0.76</td>
<td>0.79</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.79</td>
<td>0.80</td>
<td>0.84</td>
<td>0.78</td>
<td>0.78</td>
<td>0.79</td>
<td>0.72</td>
<td>0.75</td>
</tr>
<tr>
<td>Mean</td>
<td>0.83</td>
<td>0.86</td>
<td>0.86</td>
<td>0.82</td>
<td>0.83</td>
<td>0.81</td>
<td>0.73</td>
<td>0.75</td>
</tr>
<tr>
<td>Median</td>
<td>0.83</td>
<td>0.86</td>
<td>0.87</td>
<td>0.81</td>
<td>0.84</td>
<td>0.81</td>
<td>0.72</td>
<td>0.75</td>
</tr>
<tr>
<td>United States</td>
<td>0.77</td>
<td>0.78</td>
<td>0.83</td>
<td>0.73</td>
<td>0.77</td>
<td>0.70</td>
<td>0.65</td>
<td>0.65</td>
</tr>
</tbody>
</table>

LimGovPow, Limited Government Power assures that every single branch of government maintains an equal authoritative power by imposing checks and balances upon each other. AbsCorrup, Absence of Corruption is defined as the absence of use of public power for private gain. OrdSec, Order and Security refer the ability of a state to prevent crime and violence of every sort, including political violence and vigilant justice. FundRights, Fundamental Rights refer to the level of guarantee to the rights embodied in the Universal Declaration of Human Rights. OpenGov, Open Government refers to the level of engagement, access, participation, and collaboration between the government and its citizens. RegEnforce, Regulatory Enforcement refers to the degree that rules are upheld and properly enforced by authorities. CivilJust, Civil Justice requires that judicial institutions be accessible, affordable, effective, impartial, and culturally competent. CrimJust, Criminal Justice refers to a state's capability to investigate and adjudicate criminal offences effectively, impartially, and without improper influence, while ensuring that the rights of suspects and victims are protected. The World Justice Project rule of law measures can be found at [http://worldjusticeproject.org/rule-of-law-index](http://worldjusticeproject.org/rule-of-law-index).

Table 4 above summarizes all eight variables of rule of law for four of the English speaking, common-law countries (data for Ireland is not available) plus the United States for comparison. The highest possible index is 1.00 and the lowest possible index is 0.00. This means that whichever country is close 1.00 is the highest ranking in terms of that
specific aspect of rule of law. For example, Australia has score of 0.88 on limited
government power which is the closest to 1.00 and the highest among other countries in
the table. This means that Australia enjoys the highest levels of limitations on
government powers.

Most interestingly, the United States ranks the lowest in regards to every single
dimension of rule of law. This suggests that the United States embraces the idea of rule of
law to a lesser extent compared to the other four nations. As noted above, rule of law
plays a crucial role in the evolution of culture and furthermore, the variables of rule of
law can serve as one of the explanatory factors in the ongoing convergence process
between FASB and IASB. It is critical to understand that it is not the numerical value of
the indices that are causing the difference between the U.S. and other nations; it is the
degree of preference towards certain behavior or value of rule of law that is causing such
difference. For example, the general public of the United States believe to a lesser extent
that the government and its officials are subject to and held accountable under the law
compared to the beliefs of the other five nations. These differences in the perception of
rule of law have serious implications to the overall process of convergence. Specifically,
I posit that the United States is not fully embracing IFRS due to the fact that the
American public feels less confident in regards to the ability of their country to prevent
crime and violence, the use of public power for private gain, and lastly, the ability to uphold
and properly enforce the rules and regulations. I propose that such feelings of uncertainty
and distrust coupled with a relatively new accounting standard, IFRS, create barriers for
the U.S. to transition to IFRS.
Up to this point, I have discussed two possible measures of culture that can explain the differences that exist between the U.S. and countries similar to the U.S. that have adopted IFRS: the KOF Index of Globalization and the World Justice Project Rule of Law Index. Both can serve as explanatory factors in providing some insight regarding the lack of convergence between IFRS and U.S. GAAP. Besides these two cultural measures, it is important to take into account one more potential source of cultural differences that can help explain the role of cultural in the convergence process. The World Values Survey (WVS), a worldwide network of social scientists studying changing values and their impact on social and political life, presents six variables that measure what people want out of life and what they believe. The WVS, in collaboration with the European Values Study, carries out representative national surveys in 97 societies containing almost 90 percent of the world’s population (World Values Survey, 2014).

Overall, the WVS analyzes the impact of global cultural change on economic development, innovation, quality of life and democracy. Their four primary dimensions are:

**Patriotism (Patriot)** indicates the level of nationalistic pride by analyzing the member of societies’ preference in regards to their prouder to be citizens of their counties, their willingness to stand for their nation, and lastly, their belief that the locals should be privileged over foreigners (Morse & Shive, 2011).

**Traditional versus Secular-rational values dimension (TradRati)** provides a comparison between secular-rational societies and traditional societies. Secular-rational cultures do not view a religion as one of the vital aspects of life and do not reject the notions of abortion and suicide. Additionally, such societies view the bonds between
parents and children less important and do not tie themselves to certain traditional or family oriented norms and standards. On the other hand, traditional societies regard religion as an important pillar of humanity and call for strong maintenance of relationships between parents and children, and strict adherence to historically established family customs and values. Furthermore, traditional cultures refuse the ideas of euthanasia, abortion, suicide and divorce. Along with that, traditional societies maintain high levels of nationalistic pride (Inglehart & Welzel, 2005).

**Survival versus Self-expression values (SurvSelf)** is a contrast between the societies that value physical and financial stability and security and the societies that prefer personal healthy life style, freedom of expressing oneself, and good conditions of life. Self-expressive societies regard to daily survival as pre-guaranteed characteristics of life and do not worry about it much. Hence, they prioritize improving political, economic and social freedom of their members. In contrast, survival oriented societies focus on surviving from daily security threats and financial burdens (Inglehart & Welzel, 2005).

**Subjective well-being index (SWB Index)** is comprised of two widely utilized indicators, happiness and satisfaction. In a high SWB Index, happiness encompasses a much broader meaning by emphasizing greater happiness in all, political, economic and social aspects of life. Such happiness is measured by analyzing societies’ happiness in different realms of life. The second sub-index, life satisfaction indicates the overall satisfaction of people from their daily activities which was assessed by understanding satisfactory feelings of people from their duties and responsibilities from life (Inglehart, Foa, Petersom, & Welzel, 2008).

The World Values Survey is directly involved in analyzing cultural values and their impact on evolvement of culture over the period of time. The WVS has conducted
five waves of surveys in the years 1981, 1990, 1995, 2000, and 2006. Table 5 presents the WVS indexes for the six English-speaking, common-law countries. The scores in the table represent the averages from all waves of surveys available for a given country. For example, there are only three out of five waves of survey data available for Australia and five out five is available for the United States.

Table 5: World Values Survey indexes comparing English Speaking, Common-law Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Patriot</th>
<th>TradRati</th>
<th>SurvSelf</th>
<th>SWBIndex</th>
<th>Happy</th>
<th>LifeSat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>3.69</td>
<td>-0.10</td>
<td>1.62</td>
<td>3.36</td>
<td>1.69</td>
<td>7.57</td>
</tr>
<tr>
<td>Canada</td>
<td>3.56</td>
<td>-0.22</td>
<td>1.50</td>
<td>3.54</td>
<td>1.71</td>
<td>7.81</td>
</tr>
<tr>
<td>Ireland</td>
<td>3.69</td>
<td>-0.98</td>
<td>0.92</td>
<td>3.88</td>
<td>1.63</td>
<td>7.96</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3.61</td>
<td>0.10</td>
<td>1.82</td>
<td>3.60</td>
<td>1.68</td>
<td>7.80</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3.37</td>
<td>0.05</td>
<td>1.26</td>
<td>3.37</td>
<td>1.69</td>
<td>7.54</td>
</tr>
</tbody>
</table>

Mean 3.58 -0.23 1.42 3.55 1.68 7.74
Median 3.61 -0.10 1.50 3.54 1.69 7.80

United States 3.73 -0.75 1.40 3.48 1.68 7.67

Patriotism measures respondents' proundness to be nationals, willingness to fight for their country. TradRati, Traditional vs. Secular-rational, measure preference of societies to religion and family oriented traditions and values as opposed to more secular and individualistic values. SurvSelf, Survival vs. Self-expression, indicates primary cultural preference to financial and physical safety over personal well-being, freedom of expressing oneself and good conditions of life. SWBIndex, Subjective well-being, is an index which is comprised of two sub-indices, happiness and overall life satisfaction, which refers to more extensive feelings of happiness through increasing free choice in all aspects of life as well as maximizing the level of satisfaction people have with their life, respectively. All the scores are then averaged from all waves available for a given country. Data presented here comes from http://www.worldvaluessurvey.org/.
From the table above, it can be seen that the first two variables show differences between the U.S. and the other common law countries. The index of patriotism for the U.S. is the highest among all the other countries which means the United States is a more patriotic nation. Such a higher ranking has certain implications for overall policymaking decisions in the areas of economics and politics. The impact of patriotism on economic decisions is influential because it creates economic transactional obstacles, a lack of attainable diversification benefits, information asymmetries, and familiarity bias (Morse & Shive, 2011). Therefore, the index of patriotism may assist in understanding the major disagreements between FASB and IASB. I suggest that patriotic feelings about U.S. GAAP within the American people and U.S. trained accountants are one of the reasons that the U.S. has failed to converge with IFRS like the other English speaking, common-law countries. As discussed earlier, IFRS is not an American idea; it is an international accounting standard and is governed by an international community which is against the nationalistic outlook of American culture. Furthermore, there is a noteworthy difference in traditional versus secular-rational values between the U.S. and the other English speaking, common-law countries. Such differences may play an important explanatory factor in identifying the rationale behind the lack of progress in the convergence process of U.S. GAAP and IFRS. The index for traditional/secular-rational values range between +2.0, the most secular and -2.0, the most traditional. Therefore, a score of -0.75 suggests that the U.S. is more traditional and has a higher sense of nationalistic pride as opposed to the other English speaking, common-law countries with lower scores. This extends the earlier suggestion that the more traditional and nationalistic nature of American culture holds the convergence process between U.S. GAAP and IFRS back. The U.S. is similar
on the other counties on the other dimensions. However, patriotism and traditional vs.
secular values give us two possibilities that show how the U.S. differs from similar
counties that have adopted IFRS to help explain the lack of IFRS acceptance in the
United States.

Overall, a thorough discussion has been provided in terms of the lack of
explanatory power of Hofstede’s cultural dimensions, (power distance, individualism,
masculinity, uncertainty avoidance, long-term orientation, pragmatism, and indulgence)
in regards to the existing disagreements between FASB and IASB and the lack of
adoption of IFRS in the United States while culturally similar countries have adopted
IFRS. Since the six English-speaking, common-law countries are very similar on the
Hofstede dimensions, it is not enough to adequately explain why the U.S. has not adopted
IFRS and why there are still significant differences between IFRS and U.S. GAAP. I
have presented three potential alternative measures of culture with detailed explanations
of each dimension within those measures that explain the lack of adoption of IFRS by the
U.S. More specifically, the variables from the KOF Index of Globalization, the World
Justice Project and the World Values Survey measure some aspect of culture that may
have stronger explanatory power in explaining the role of American culture in the
convergence process of International and United States financial accounting principles.
The global index of KOF, each aspects of rule of law from the World Justice Project,
along with patriotism and traditional/secular-rational indices of World Value Survey
provide cultural insights to explain the lack of adoption of IFRS in the U.S. Next, I will
explore the differences between IFRS and U.S. GAAP and discuss the potential cultural
reasons for the existence of those differences. Thus, section III will shed some light into some major differences and the impact of culture on these differences.
Section III: Differences Between U.S. GAAP and IFRS

U.S. Generally Accepted Accounting Principles, as discussed earlier in this paper, are designed for the financial reporting needs of all publicly traded entities within the boundaries of the United States. International Financial Reporting Standards, as their title suggests, are geared towards the financial reporting needs of many countries. The U.S. capital markets are different from the rest of the world. The U.S. has the largest market capitalization for all listed companies based on 2012 data from The World Bank. Having the largest financial market consequently causes U.S. GAAP to be different from IFRS because of a greater need for financial reporting which leads to stronger demand for transparent reporting (Ball, 2001). Therefore, it is important to understand some of the differences between the two standards. Some scholars, such as Hail, Leuz and Wysocki (2010), object to this by stating that instead of incorrectly focusing the arguments on IFRS adoption in the United States or on the differences in the standards, the reporting incentives of the two standards should be examined more in depth. While acknowledging the critical response, it is still important to fully understand the differences between the two standards because those differences are the ones that hinder comparability across firms, and influence operating, investing and financing activities of businesses in general.

There are many individual differences between specific IFRS and U.S. GAAP standards. In addition, there are two high priority projects as of September 1, 2013 that are necessary to address between U.S. GAAP and IFRS in regards to their scope and urgency to converge the two standards. These two projects address accounting for financial instruments and insurance contracts and IASB and FASB are working together to eliminate those differences as soon as possible (Hoogervorst & Seidman, 2012). The
The table below broadly summarizes differences between U.S. GAAP and IFRS in regards financial instruments and insurance contracts. Each difference will be discussed in more detail later in this section. First, I discuss general differences between U.S. GAAP and IFRS on topics other than financial instruments and insurance contracts and then the two major differences will be analyzed in the sub-sections below.

Table 6: Key differences between U.S. GAAP and IFRS

<table>
<thead>
<tr>
<th>Difference</th>
<th>Treatment Under U.S. GAAP</th>
<th>Treatment under IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Instruments</td>
<td>• Industry-specialized guidance.</td>
<td>• One standard for classification of financial instruments.</td>
</tr>
<tr>
<td></td>
<td>• Requires two-step impairment process.</td>
<td>• Provides one step impairment model.</td>
</tr>
<tr>
<td></td>
<td>• Management assertion is preferred.</td>
<td>• Requires an objective evidence for impairment.</td>
</tr>
<tr>
<td></td>
<td>• &quot;Current Expected Credit Loss&quot; approach for impairment.</td>
<td>• &quot;Three bucket&quot; model of impairment.</td>
</tr>
<tr>
<td></td>
<td>• FASB presents two different measurement approaches: BBA &amp; PAA.</td>
<td>• IASB issues only one approach, BBA with having PAA as a simplified method.</td>
</tr>
<tr>
<td></td>
<td>• Includes costs associated only with successful efforts.</td>
<td>• Accounts for both unsuccessful and successful efforts.</td>
</tr>
<tr>
<td></td>
<td>• Recognizes the right-to-recover costs as asset.</td>
<td>• Rejects the recognition of the right-to-recover cost as asset.</td>
</tr>
<tr>
<td></td>
<td>• Dismisses the explicit risk adjustment as part of insurance measurement.</td>
<td>• Adjusts for explicit risk as part of measurement for insurance.</td>
</tr>
<tr>
<td>Insurance Contracts</td>
<td></td>
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</table>

**General Differences**

Understanding of the role of culture in the convergence process can be accomplished by analyzing some of the general differences. One of those differences is in the area of inventory. IFRS does not allow the application of Last-In-First-Out (LIFO) when measuring the value of inventories. LIFO is a cost allocation method which
assumes that the most recently purchased or produced inventories are sold or consumed first. In the United States, LIFO is permitted and in fact, it is one of the most utilized methods. There are tax advantages of LIFO because it increases the cost of goods sold, thereby lowering taxable income. Therefore, when inventory is valued using LIFO, when the item is sold the costs associated with those goods are higher than other valuation methods which ultimately lowers net income and hence, the amount of taxable income. In the U.S., if a company uses LIFO for tax purposes, they must also use it for financial purposes. IFRS does not allow the use of LIFO. Therefore, this is a difference with far reaching consequences. If the U.S. were to adopt IFRS, this would necessitate a change in the tax code and there would need to be a decision made if LIFO could still be used for tax purposes. In addition to that difference, there is also a difference in accounting for continues measurements of inventories. IFRS requires inventories to be continuously measured at the lower of purchased cost or net realizable amount which is an estimation of future economic benefits from the inventories. However, inventories are measure at the lower of cost or market cost (price in the market) under U.S. GAAP (Ernst & Young, 2011). The underlying reasons for the two differences in the standards can be culturally explained through the variables of patriotism and traditional/ secular rational values of World Values Survey. LIFO along with "lower of cost or market" method has been employed in the U.S. for many years. The United States, as described by WVS, is the most patriotic and traditional culture compared to the other English speaking, common-law nations. This suggests that American culture does not want to give up traditionally

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9 Ernst and Young will henceforth be referred to as E&Y.
used methods of inventory accounting which is not allowing FASB to fully converge with IASB.

Furthermore, there is a substantial difference in the subsequent measurements of properties, plants, and equipment (PPE) of an entity. IFRS allows two ways to report PPE assets on the balance sheet: the cost or the revaluation model. The cost model is similar to U.S. GAAP which requires reporting the assets at purchased (historical) cost after accounting for accumulated depreciation. The revaluation model mandates the revaluation of the assets at the fair value. The revaluation model is prohibited under U.S. GAAP. Under the latter model, assets are re-evaluated on a regular basis\(^{10}\) and can be written up or down whereas under the cost model, it is only written down if something indicates that an impairment may have occurred. World Justice Project’s Rule of Law index can provide a cultural reason for the U.S. GAAP preference of only writing down the assets. Managers, in the hope of attracting more investors, can misrepresent the values of their assets if they are allowed to write them upward. However, American investors do not view their civil system as protective, fair or just as the other English speaking, common-law nations and thus, the application of the cost model protects investors from a less effective civil justice system. In addition, the lack of strong belief in the civil system of the United States also causes FASB to disallow the reversal of previously recorded impairment losses. The reversal of impairment losses can also be explained as increasing the value of assets based on the changes in the events that caused the initial impairment losses (Doupnik & Perera, 2012). The disallowance of reversals prevents entities from

\(^{10}\)Regular basis is defined as yearly for assets that are considered volatile whereas revaluations can occur every 3-5 years for those in non-volatile classes. Once an asset is reviewed for revaluation, all other assets in the same class must also be revalued (BDO International, 2014).
increasing the value of their assets which might lead to a misrepresentation or getting caught in a valuation bubble, and in turn, it protects investors from a less effective civil justice system.

Another disagreement exists in the area of internally created intangible assets such as patents. IFRS calls for a distinction between research and development costs. The distinction requires considerable management judgment to establish the difference between research and development. Research is reported as an expense on the income statement and the development is capitalized in an asset on the balance sheet. U.S. GAAP does not require management to make any distinctions between the two elements of the internally created assets because it requires all of them to be recorded in the income statement as expenses in the period in which they were incurred. This difference can also be explained through a cultural perspective. Regulatory enforcement of the WJP index ranked the U.S. the lowest compared to the other five nations in regards to proper installation and application of rule and regulations. This may explain why FASB does not want to allow management to make too much judgment and distort the financial information.

There are differences that remain in the guidelines for employee benefits. One of the main differences can be observed in the accounting of past service costs. Part service costs are costs associated with the improvements of benefits needed to be paid to active vested or non-vested and inactive or retired employees. Vested employees are the one who already have a right for the benefits and non-vested ones are those who do not have the right yet to those benefits. IFRS requires past service costs associated with active

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11 U.S. GAAP does make an exception for software development, but outside of that specific exception, U.S. GAAP calls for immediate expensing of research and development costs.
vested and retired employees to be expensed immediately but the ones related to non-
vested employees to be divided over the time period until the benefits are activated for
them and partially recorded in each period (Doupnik & Perera, 2012). In contrast, U.S.
GAAP does not differentiate the recording of expenditures related to vested and non-
vested employees. It simply requires those expenses to be recorded over the remaining
total working period. For retired employees, U.S. GAAP reports expenses over the
remaining expected lives of those workers. These differences can also be explained
through the rule of law index of WJP. The overall rule of law variables indicate that the
Unites States values the importance of rules and regulations less compared to the other
five English speaking, common-law nations, thus investors in the U.S. would like to see
conservative and less-risker approach in the financial information to protect themselves.
The accounting method of U.S. GAAP in regards to employee benefits provides the
needed protection by mandating companies to record the expenses accordingly over a
certain time period. Furthermore, more extensive guidance of U.S. GAAP for medical
insurances with its clear cut rules further protects investors from the lack of rule of law.

Another difference can be seen in regards to joint business practices of entities.
IFRS offers specific definitions. For example, IFRS specifically defines joint venture as
an arrangement in which all involved parties have rights to the net assets of the
arrangement (KPMG, 2013). Unlike IFRS, U.S. GAAP does not provide any specific
definitions of joint arrangements. This difference can be culturally explained through the
KOF Index of Globalization. Australia, Ireland, Canada, the U.K and New Zealand are
more globalized thus, require specific definitions to ensure unity and comparability in
accounting practices. On the other hand, the U.S. is not as globally integrated as those
nations; hence, U.S. GAAP, without specific definitions of joint agreements is sufficient to serve the needs of U.S. financial markets.

Besides all the noted differences above, there are several more differences that are obstacles for the two boards to fully converge their respective accounting standards. Those differences can be observed in each element of accounting policies and procedures ranging from presentation of statement of cash flows to reporting income taxes and from recognition of revenue to interim financial reporting requirements. I propose that unique characteristics of American culture have an impact on each of the difference in some way. Detailed explanations of the role of American culture on each of these differences are beyond the scope of this paper. However, more in-depth analysis of two major differences between U.S. GAAP and IFRS with extended discussion of the role of American culture will be accomplished in the following sub-sections.

**Impairment of Financial Instruments**

A financial instrument is a legal contract between two entities that creates an asset for one entity and liability or equity for the other. Generally, financial instruments are classified as equity or debt. An equity instrument is evidence of legal ownership of a company issued to shareholders. A debt instrument is a loan made by an investor to the owner of the asset. Both FASB and IASB have several similarities in their guidance for the accounting of financial instruments. They both require the classification of financial assets into distinct categories in order to determine their proper measurements, provide explanations of the time and manner of recognition and de-recognition, and mandate disclosure of important information regarding such assets. At the same time, numerous
differences exist. The two standard setting bodies have been working together since late 2004 on a joint project that is intended to address the differences in the recognition and measurement of financial instruments. Once the project is finalized (which is expected in the second quarter of 2014) the proposed standard will replace all of FASB’s and IASB’s financial instrument guidance. The scope of accounting for financial assets is very broad and complex. Therefore, for this paper, I will concentrate on the issue with the most differences, the impairment\textsuperscript{12} of financial instruments. Such a focus allows for more concentration on the differences and a thorough discussion of the role of American culture in these differences.

FASB and IASB have distinct models for the impairment of financial instruments which may result in different causes and criteria for impairment. One of the main reasons for the distinction between the models is due to different classification methods of financial instruments. More specifically, IFRS currently has one generalized and non-industry specified standard which mandates the classification of financial assets in four different categories: “investments held for trading (HFT)\textsuperscript{13}”, “held-to-maturity investments (HTM)\textsuperscript{14}”, “available-for-sale (AFS)\textsuperscript{15}”, and “loans and receivables (LR)\textsuperscript{16}” (PricewaterhouseCoopers, 2013a\textsuperscript{17}). However, U.S. GAAP provides very broad, complex, and industry-specialized guidance in terms of financial assets classifications.

\textsuperscript{12}Impairment means a reduction in the value of an asset if the asset's fair market value is less than the cost of the asset.
\textsuperscript{13}Held-for-trading (HFT) investments are purchased with the intention of selling them within some period of time.
\textsuperscript{14}Held-to-maturity (HTM) securities are those that a firm has the ability and intent to hold until its maturity.
\textsuperscript{15}Available-for-sale assets (AFS) are securities that are purchased with the intent of selling before it reaches maturity, or selling prior to a lengthy time period in the event the security does not have a maturity.
\textsuperscript{16}Loans and Receivables (LR) are financial assets with predetermined payments from one to entity to the other.
\textsuperscript{17}PricewaterhouseCoopers will henceforth be referred to as PwC.
based on varying legal forms of assets. For example, an instrument that is accounted for at amortized cost is non-secured debt instrument whereas a debt with a legal form of security is not amortized. The only difference between the two is their legal forms.

One of the key differences between IFRS and U.S. GAAP has to do with the impairment of available-for-sale (AFS) and held-to-maturity (HTM) debt securities. Under U.S. GAAP, impairments of AFS and HTM debt instruments are assessed if the fair value, a rational and unbiased estimate of the potential market value of the asset, is less than the cost or recorded book value. If this is true, then identification of whether the impairment is temporary or not is required. FASB has provided a two-step model for determining whether impairment should be considered temporary or not which involves an entities' subjective assessments. Subjective assessment refers to the intention and ability of the management team of a company to keep the instrument. The first step of the model requires two conditions. The first condition asks the management to properly assess that the intention of selling the AFS or HTM debt is present. In the second condition, it is required that the management ensures the presence of financial circumstances which require the sale of debt before reclaiming its purchase cost. Once the management establishes the intention and condition that necessitate the sale of debt, then the impairment is not temporary and must be applied on the debt. The resulting impairment loss will affect the balance sheet and income statement. The loss in the debt amount due to changes in the fair value is offset against the income causing it to decrease. The balance sheet will also show a decrease in the value of the asset due to the impairment loss.

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\textsuperscript{18}Book value is a value at which an asset is carried on a balance sheet.
On the contrary, if there is neither a need nor a willingness to sell the instrument, then the second step of the process is applied. In this case, if management expects to collect the entire amount of the purchase price of the security upon its sale, then there is no need for impairment. Otherwise, the impairment will be assessed and the loss amount is the difference between the present value of expected cash flows from the financial asset and its fair value. Similarly, the impairment loss affects the balance sheet and income statement. The value of the debt investment will be decreased on the balance sheet and net income will decline due to the impairment loss.

IFRS treats impairments differently for these items. Available-for-sale debt securities, along with held-to-maturity debt instruments, are impaired and the losses are recorded only if certain objective evidence is present as opposed to the U.S. GAAP specifically requiring assessment for impairment if the fair value is less than the cost. IFRS users consider specific factors in evaluating the objective evidence of impairment such as considerable financial hardship, high possibility of bankruptcy, and sudden loss of active market. Additionally, impairment is measured in the case of breach of contract, and significant decline in the expected future cash flow (PwC, 2013a). It is important to note that the presence of only a single piece of evidence is not sufficient for impairment under IFRS. In other words, the absence of an active market for the entity’s AFS or HTM securities is not, by itself, acceptable evidence for impairment. In order to properly recognize the need for impairment, an entity needs to present more than one objective piece of evidence in order to properly recognize the need for impairment. The resulting loss from the impairment, the difference between the fair value and post-impaired cost, is recorded in the other comprehensive income statement which is in the equity section of
the balance sheet. Overall, IFRS, with its objective evidence driven impairment approach, focuses on the events that may cause the loss. U.S. GAAP takes the intention of the security holders, such as their intent to sell or hold, into consideration. As previously mentioned, if U.S. GAAP users do not expect the recovery of the cost of the asset, then the impairment is assessed whereas IFRS allows the impairment only in the presence of objective evidence. I believe the main reason for such distinction can be explained through the KOF Index of Globalization. Table 4 shows that the other five English speaking, common-law nations are more socially and economically integrated compared to the U.S. This suggests that those nations prefer more objective evidence driven accounting procedures to ensure greater levels of comparability within their globalized cultural setting. IFRS, with its objective of providing unified and comparable accounting standards, meets the needs of those nations by requiring the presence of objective events. Such a requirement ensures comparability across all entities whereas subjectivity involved with U.S. GAAP may not provide the same level of comparability that IFRS requires. In addition, American culture does not value globalization as much which implies that there is not a need for a more unified and comparable standard for the impairment of financial assets. Thus, the U.S. prefers its own GAAP due to its flexible accounting procedures.

In terms of impairment of available-for-sale equity instruments, U.S. GAAP presents a slightly different method which requires careful consideration of certain elements to determine if the impairment is permanent in nature or not. The overall guidance for the impairment of financial assets does not allow the reversal of previously recognized impairment losses. Thus, it is important to clarify that the losses are
permanent. Once an amount is written down, it cannot subsequently be written back up if the value increases. The extent and duration of the decline in the market value, financial and operational situations of an entity, and their willingness and capability to maintain the asset until its market value recovery are factors that may assist in identifying if an impairment loss is necessary. The loss causes the asset to decrease in value, which will in turn negatively affect the balance sheet (PwC, 2013a). In contrast, IFRS requires similar objective evidences of impairment as debt investments with two additional events that prompt the need for impairment. The first event is a significant and continued decrease in the fair value, and the second one requires serious harmful changes in the business environment, which is very similar to U.S. GAAP guidance. However, the impairment losses caused due to these events do not affect the balance sheet of an entity; the reductions are recorded in the current income statement (PwC, 2013c).

There are several key differences remaining between the two standards that prompt the need for impairment and affect the recognition of the loss amounts. Instead of eliminating these differences, the two standard setting bodies deviated from each other causing the greatest obstacle in meaningful convergence process between the two in the area of impairment of financial assets. In a major departure from IASB, FASB has publicly decided at its December 18th, 2013 meeting to maintain its “full lifetime expected credit loss” model in regards to the impairment of financial instruments whereas IASB expressed commitments to continue with their “three-bucket” approach (PwC, 2013c). The FASB model of “full lifetime expected credit loss” is an approach that mandates businesses to record an allowance for its estimations of all possible credit losses on financial assets that are held. On the other hand, the “three-bucket” model of
IASB is a very complicated approach which divides financial assets into three separate buckets based on diminishing levels of credit quality. Deloitte’s (2012) IFRS Project Insights explains the “three-bucket” model in general sense, by stating that all financial assets would start in Bucket 1 at initial recognition regardless of their level of credit quality and depending on the level of credit quality deterioration and the type of financial asset, it will move to the Bucket 2 or 3. With the decision to keep its model, FASB has eliminated the possibility of convergence between the two boards in measurement of impairment losses. In the meantime, we can expect converged guidance on the measurement and recognition of financial assets by the second quarter of 2014 but there is no clear convergence path to unified guidance on impairment of financial assets.

This major divergence for financial assets has certain cultural reasons. I propose that patriotism and traditional/secular-rational variables of the World Values Survey can provide cultural explanation to the underlying difference. As mentioned above, WVS refers to the United States as more patriotic and more traditional nation compared to other English speaking, common-law nations. Such stronger nationalistic feelings along with an emphasis on conservative traditions of American culture suggest that the accounting professionals in the United States would like to keep their own way of accounting for financial assets. Adopting IFRS would require accounting professionals to give up their standard and use the one IFRS presents. FASB indicates the complexity of the IFRS model as the technical reason for not adopting the model. However, the cultural reason of patriotism and the conservative outlook of the American culture embedded in the traditional/secular-rational variable can help explain the adherence to the current way of dealing with impairment. Additionally, U.S. GAAP does not allow the reversal of
recorded impairment losses of AFS and HTM securities while IFRS allows writing debt securities upward. Disallowance of reversals is one of the differences that can be explained by the World Justice Project's Rule of Law index. As indicated by the index, regulatory enforcement in the United States does not ensure the installation and application of rules and standards as properly and adequately as the other five nations do. Therefore, the adherence to FASB may be a substitution mechanism in the face of weaker regulator enforcement. This may imply that reversal of impairment losses may not be properly reversed which in turn can cause investors to worry about the reliability of accounting information. To avoid such issues, FASB does not support the IASB policy of allowing reversions upwards.

**Insurance Contracts**

FASB and IASB are both highly committed to developing a mutual and comprehensive standard that addresses all the aspects of insurance contracts. In hopes of accomplishing this commitment, there has been a lot of progress made in the process of convergence between the two boards. However, there are a number of critical disagreements that still exist that drive significant differences in reporting behavior between the two accounting standards when it comes to insurance contracts.

One of the primary disagreements between the boards is their differences in the measurement model of insurance contracts. IASB presents a “building block measurement (BBA)” which is an approach that allocates the current, discounted and weighted average of all future cash flows of insurance contracts in respective financial statements. For example, the model requires the reporting of unearned revenue from the
insurance contract in the income statement as they become earned. Additionally, the BBA model is encompasses the ideas of “the fulfillment of cash flows” and “contractual service margins”. The fulfillment of cash flows consists of the risk adjustment which shows the level of correction that the insurer requires bearing because of the uncertainty of the future cash outflows. IFRS requires each risk adjustment to be determined separately from the premium and re-measured during each reporting period. Based on the level of the risk, the premium amount will also be impacted. For example, if there is high risk of the insured event happening, then higher amount of risk will be added to the premium. Initially, the measurement of risk adjustments involved three specific methods, but later in its Revised Exposure Draft of 2013, IASB has set out a single set of characteristics the risk adjustments should meet such as explicit presence of the risk (E&Y, 2013). Another issue that arises is that the contractual service margins or the profit from the contract prompt unearned profit from the very first day of the insurance contract. The amount of the margin represents an excess of the present value of all future cash inflows over the present value of all future cash outflows plus the risk adjustment. IFRS does not mandate the locking of the service margin at the time of acquiring the contract; rather it requires the periodic update of the value of the margin to properly represent any changes that current and previous estimation of cash flows have. PwC (2013b) in their report, Practical Guide to IFRS, expresses their concern regarding the adjustments of the margin stating that such adjustments add more complexity to the accounting of the insurance contracts. Along with accounting for unearned revenue and

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19 The fulfillment of cash flows refers to the future expected cash flows which are determined by discounting due to the time value of money and applying explicit risk adjustments.
20 Contractual service margin refers to the amount of profit from the insurance contract.
risk adjustments, the BBA model of IFRS requires disclosure of the liability that results from the insurance contracts in the notes of financial statements. In order to simplify the accounting for the liabilities, IFRS also establishes “premium allocation approach” (PAA) which does not require discounting the cash flows if the liabilities are covered within one year or less (E&Y, 2013). In summary, it is important to note that IFRS has provided two-margin (contractual service margin and explicit risk adjustment) measurement of insurance contracts with its building block approach (BBA) and the premium allocation approach (PAA) which is a simplified method of BBA.

On the other spectrum of the convergence process, FASB has developed a new standard that applies to wide range of insurance contracts and uses two unique models: the premium allocation approach (PAA) and the building block approach (BBA) (E&Y, 2013). While the two models are named similarly to the ones used by IFRS, they differ noticeably from each other. Under the PPA, an insurance providing entity recognizes the insurance contract liability with the present value of all premiums of insurance. As time goes by and if any part of the contract is fulfilled, an entity is to reduce the liability amount accordingly. When the event that was insured happens, the company must recognize a liability at the present value of the expected cash outflows from the incurred insurance claims. It is important to make a distinction that IFRS with the PAA approach limits the duration of the expected cash outflows to one year or less and does not require the present value of the cash outflows. U.S. GAAP does not have such limitations but with its PAA model, it measures the insurance liabilities without adjusting for an explicit risk. In other words, U.S. GAAP does not account for uncertainty of future cash flow under the PAA model. This is also a major difference between FASB and IASB. As
mentioned above, IASB accounts for an explicit risk adjustment due the possibility of paying more than collected profit whereas FASB does not.

The second measurement model of FASB is called the “building block approach” which incorporates three elements of the insurance contracts: “unbiased future cash flows”, “discounted cash flows” and “a margin” (Benjamin, Bolton, DiLeo, Gomes, & Sojkowski, 2013) “Unbiased future cash flows” is similar to IFRS’s approach of calculating future cash flows on the weighted average basis. Furthermore, “the discounted cash flow” element of BBA is also very similar to IFRS in the way that they both require the calculation of the present value of all future expected cash flows. However, one of the main differences lay in the idea of “a margin”. IFRS and U.S. GAAP both agree on the role of the margin which is a representation of the unearned profit from the contract. As discussed earlier, IFRS presents a two-margin method to measure the unearned revenue and liability from the insurance contracts, whereas U.S. GAAP advances the idea of single margin with its BBA approach. FASB views a single margin without any risk adjustments as a proper representation of the profit at stake. This is also implies that the insurer would not have to re-measure the single margin to recapture previously recognized margin. In other words, the expected profit upon inception of the contract would be recorded as a ‘margin’ liability under the FASB BBA approach and earned over the future coverage and settlement periods. Under this approach, FASB has also abandoned the IASB’s approach of including an explicit risk adjustment which is another major divergence from bringing the two standards together.

PwC (2013d) explains the decision of FASB by explaining the concerns of U.S. constituents. Many, including a majority of the FASB board members, are concerned that
estimating an explicit risk adjustments may decrease the reliability and comparability of the insurance contract liabilities across the board. The concern is mainly based upon the fact that there is no universally accepted technique for calculating the adjustment with requires continuous update. Even if a certain method is developed, there would still be certain levels of subjectivity involved, such as identifying the probability of the risk happening or not. The opponents of the explicit risk adjustments dislike the involvement of additional subjectivity that is already subjective estimate (PwC, 2013d). Given these concerns, differences, and divergences, it is important to note that there are a lot of critical hurdles that still exist in the path to fully converge accounting practices in the area of insurance contracts.

The unique characteristics of American culture can provide some reasonable explanations for the existing differences between the two boards. More specifically, the differences in the accounting of insurance contracts can be explained through the criminal and civil justice dimensions of World Justice Project Rule of Law index. Due to lower numerical values of criminal and civil justice variables, I suggest that American people believe less in the fairness and impartiality of criminal justice system compared to the other five nations. The effect of such perception can be observed through the lens of FASB by not allowing the application of risk adjustments in both methods. Such disallowance calls for more cautious and preservative approach of measuring insurance contracts without any adjustments. Additionally, removal of risk adjustment compensates for the perceived lack of impartiality and fairness in the criminal and civil justice system of the United States.
The differences in the measurement models can also be explained by the cultural values that I have identified in this paper. As mentioned earlier, IASB allows the BBA model while FASB allows either the BBA (which differs from the IASB BBA model) or the PAA model. I suggest a following proposal to explain the reason for the difference. It is critical for IFRS to provide one uniform standard due to its objective of providing unified and comparable accounting standards. This prevents the issues of inconsistency and incomparability of standards caused due to the flexible application of multiple standards in the insurance contracts. In addition, the application of two methods of FASB can be culturally explained through the general globalization index of the KOF Index of Globalization. The index shows that the United States puts a smaller emphasis on the notion of globalization; hence, it does not feel the need for uniform accounting principle for insurance contracts. However, the other English speaking, common-law nations are more globalized according the KOF index which establishes the grounds for fully embracing IFRS with its unified standards in the insurance contracts.

Differences exist between the standards in smaller (general differences) and to larger extents (in the case of insurance contracts and financial instruments). Cultural variables outside the realm of Hofstede can be used to help explain why these differences persevere. Other countries that are similar to the U.S. have decided to adopt IFRS while the U.S. continues to push the convergence date back. Therefore, it is important to acknowledge and study the role that culture plays in this convergence process.
Section IV: Conclusion

Both the Financial Accounting Standards Board and the International Accounting Standards Board have publicly expressed their commitment in 2002 to converge their two accounting standards, U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards, respectively. It has been more than a decade since the start of the convergence process and during this time period, a lot of progress has been made. Numerous standards of both boards have been converged to better serve the accounting needs of the globalized world. Despite such progress, there are several differences that still exist between the two standards. This paper has explored cultural reasons of the differences through three proxies for culture. More specifically, through the application of KOF Index of Globalization, World Justice Project Rule of Law Index and World Values Survey, this paper has established the influence of American culture in the decade-long convergence process. In order to establish the effect of culture on the process, I compare the United States to five other English speaking, common-law countries, Australia, Ireland, Canada, New Zealand, and the United Kingdom. First, Hofstede's cultural variables are examined to understand the lack of explanatory power the variables have to explain the lack of IFRS adoption in the U.S. As Table 2 shows, the United States is very similar to the other five nations in regards to Hofstede's variables. However, the other nations have already adopted IFRS whereas the U.S. has not. This triggers the need for some other way of cultural explanations of the U.S. failure to adopt IFRS. The very first proxy for culture that provides some insight into the lack of convergence in the U.S. is KOF Index of Globalization. KOF, a Swiss economic think tank, has provided indices that measure the level of globalization in countries. According
to the index, the United States is less globally integrated nation compared to the other five countries. Lower levels of globalization provide cultural explanation for not adopting IFRS in the U.S. along with some explanation on the remaining differences between the two standards. More specifically, I propose that lower degrees of globalization in the U.S. do not create the need for IFRS whereas other English speaking, common-law nations are better matched with IFRS. The objective of IFRS is to establish a unified global accounting standard which suits the globalized culture of those nations. The KOF Index of Globalization also provides some cultural explanation in regards to the differences between the two standards. For example, difference between the two primary projects, financial assets and insurance contracts, can be explained through the analysis of their overall globalization variable. The other English speaking, common-law nations have adopted IFRS because its accounting rules and procedures establish a more unified and comparable accounting practice that better serves the needs of more globalized nations whereas, U.S. GAAP is preferred among accounting professionals in the U.S. due to its management-assertion oriented principles coupled with the U.S.'s lesser need for globalization.

The second set of proxies for culture is derived from the World Justice Project Rule of Law Index. The WJP Rule of Law Index assesses the level of application of rule of law in all aspects of life. According to the index, the United States embraces rule of law to a lesser extend compared to the other English speaking, common-law nations. Lower levels of adherence and application of rule of law leads the accounting professionals of the U.S. to feel less secure and less confident in regards to proper implementation and application of IFRS in the United States. The lack of strong rule of
law in the regulatory enforcement, criminal and civil justice systems of the country prevents FASB from fully adopting IFRS. Additionally, the WJP Rule of Law Index provides some cultural insight in regards to some differences between the standards. Specifically, a less effective criminal and civil justice system compared to the other English speaking, common-law nations explains the application of different accounting methods for the same purpose. U.S. GAAP provides more restricted accounting methods in some aspects of accounting such as PPE, and employee benefits to protect investors from such systems. For example, there is only one method of PPE recognition allowed under U.S. GAAP (the cost method), whereas IFRS allows two distinct methods (the cost and the revaluation methods). I propose that WJP Rule of Index also explains differences in the two major convergence projects. Disallowing reversals of impairments of financial assets along with removal of risk adjustments are some of the compensating methods of FASB, I believe, to secure investor confidence in the United States in the face of a justice system perceived to be more biased.

The third cultural source that presents some insight about the role of American culture in the convergence process is the World Values Survey. According to the WVS, American culture is the most patriotic and traditional compared to all other English speaking, common-law nations. I suggest that the highly patriotic and traditional culture of the U.S. has been a barrier to the full adoption of IFRS in the United States. The American people patriotically adhere to U.S. GAAP as one of their biggest achievements in business. Full convergence with IFRS would cause the U.S. to stop using the GAAP they created. This would be an admittance that another GAAP has superseded U.S. GAAP as the perceived highest quality accounting standard. As a result, there is the
psychological burden of not wanting to give up their national GAAP. The WVS also culturally explains several differences between U.S. GAAP and IFRS. For example, the more patriotic culture of the U.S. prevents it from abandoning LIFO treatment for inventories and the traditional culture of the U.S. encourages FASB to prefer the “current expected credit loss” method of accounting over IASB’s method of “three bucket”. The absence of such patriotic and traditional culture would make the U.S. much more like the other English-speaking, common-law countries that have all adopted IFRS, and therefore, possibly more willing to adopt IFRS. The U.S. continues to hold on to their national GAAP, U.S. GAAP.

One reason could be that U.S. GAAP is already seen as a high-quality GAAP so it does not make sense to go through a difficult conversion process to go from one high-quality GAAP to another. However, many countries that have converted to IFRS, like the U.K. and Germany, were also perceived to have high quality national GAAPs prior to IFRS. The explanation of culture, therefore, becomes a strong lens in which to view the lack of acceptance of IFRS in the United States. I believe that all three cultural variables, KOF Index of Globalization, WJP Rule of Law Index and WVS have a very strong cultural influence in the convergence process of the two accounting standards. My future work outside the focus of this paper will statistically test the level of influence each variable has on the process. With such operational testing, I hope to present new ways of quantifying culture and new ways of cultural perspective for future accounting literature works.
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