

Difficulties of applying IFRS in continental Europe from the perspective of codification

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Received 2012-09-11

Abstract

The implementation of the Accounting Standards Codification (hereinafter: “Codification”) in July 2009 resulted in significant changes to the structure of the US GAAP. The Codification collects all existing US GAAPs in a single codified structure, being conceptually different from previous standard-based accounting structures typical to the IFRS, and to accounting structures applied in the UK and Canada. The paper presents the structure of the Codification and compares it to the traditional continental statutory accounting systems. The results show that the continental accounting systems are similar to the Codification in structure and highlight a possible reason why these countries have difficulties in implementation of the standard-based IFRS regulations. I demonstrate in the paper the links difficult to traverse, resulting from the currently diversified standard-based structure of the IFRS. This novel approach underlines this fact and supports it by a SWOT analysis on the possibility of codification of IFRS. Considering the merits and demerits of the analysis, the introduction of a codification approach similar to the Codification is proposed.

Keywords

IFRS · US GAAP · Codification · framework accounting · global standards

1 Introduction

Two significant accounting frameworks exist simultaneously that outline accounting and financial reporting obligations with views more or less differing from one another: the Generally Accepted Accounting Principles of the United States (US GAAP¹) and the International Financial Reporting Standards and their Interpretations (IFRS). The IFRS² has developed increasing emphasis in global accountancy and it is apparent that the IFRS may develop into global standards of accounting. According to the latest announcements of IASB and the releases of SEC, IFRS will become the global standard for companies listed on the stock exchange worldwide. Therefore, the comparison of IFRS and US GAAP is important in order to combine the best solutions in developing a single system. The global convergence of the accounting standards is progressing at an increasing speed today. Approximately, 110 countries allow or require the application of the IFRS all over the world, and even more countries announce adoption of IFRS or adjust national accounting rules to IFRS. Therefore, the IASB has increasing legitimacy (Choi, Frost & Meek [5]; Herz [10]; Meek & Thomas [18]; Roberts, Weetman & Gordon [22]). The IASB³ and the FASB⁴, in cooperation has published a working program⁵ in recent years with the purpose to progress by 2009 in a direction to achieve convergence between the IFRS and US GAAP. The aim is approached through mutual recognition, mapping and harmonizing differences between the two accounting frameworks.

Businesses may face a large number of accounting regulations and acts at national level, despite the fact that options for businesses on the stock markets in the world are limited. In addition to the development of the convergence program and the efforts for developing a global accounting system, the US GAAP underwent considerable changes in 2009 (O. Ford, Thomas, C. [19]; Pounder [21]). Companies listed on the US stock exchange are expected to gradually report under the IFRS commencing 2011,

¹ Generally Accepted Accounting Principles of United States

² International Accounting Standards (IAS), International Financial Reporting Standards (IFRS)

³ International Accounting Standards Board

⁴ Financial Accounting Standards Board

⁵ The so called convergence program

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thus turning the IFRS into global standards for accounting⁶.

Nevertheless, the IFRS regulated financial statements of companies listed on the stock markets, many countries have not yet accepted the IFRS for national and mandatory accounting standards. The causes for any resistance are generally due to the different features of the accounting requirements, such as local taxation matters, as well as the architecture of the IFRS (i.e. framework structure) which is examined later in this paper. Although approaches of the accounting standards in the UK, North-America and in continental Europe are different, one of the most considerable representatives of North-American accounting – the FASB – has introduced a structure very similar in concept to what has been traditionally reflected in the continental European view, the Codification (O. Ford, Thomas, C. [19]; Pounder [21]).

The paper discusses the reasons that resulted in difficulties to the US GAAP application and reasons that necessitated the Codification process in 2009 and why such progress is timely for the IFRSs as well. Both the IFRS and the US GAAP have evolved on a framework basis traditional to UK and North-American accounting systems (Alexander and Archer [2]; D'Arcy [7] and Lewis and Salter [17], Callao, S., Ferrer, C., Jarne, J.I. and Lainez, J.A. [6]. The complete literature of the IFRS and the US GAAP are relatively exhausting, further, the sequential numbering of standards does not particularly refer to balance sheet line items or any sequence of task to be performed in the reporting process. Therefore, in addition to core technical knowledge on specific topics, advanced skills are required to be able to cover all relevant literature related to recognition and measurement issues, in the maze of available accounting references, within a limited time frame.

To a certain extent, it is true that within each standard the titles do refer to the financial statement component and accounting tasks. However, the relatively detailed table of contents still does not provide clear guidance as to whether standards cover a particular issue in question. Special attention has to be paid to interrelations between the standards because the standards and related interpretations deal with one or more key subjects with the objective to cover the scope comprehensively (topic approach). Therefore, both the IFRS and the US GAAP need thorough and advanced knowledge of standards in order to find answers to questions that relate to specific components of the financial statements.

In our experience, the application of the framework structure triggers major resistance particularly in the Central European countries with typical Continental European accounting traditions. To be specific, within states where continental European accounting regulations develop accounting requirements under statutory rules in a consistent structure, and the users of the accounting rules in each country have become familiar with the logic and architecture over the past decades. Therefore, we con-

sider it important to examine the difficulties central European countries encounter with the introduction of the IFRS and find out their experience after becoming familiar with the framework features and what continental Europeans' thoughts are about the possible future introduction of the IFRS.

On 1 July 2009 substantive changes took place in the US accounting scene in order to simplify the use of generally accepted accounting principles (GAAP)⁷. Such changes took place by transforming existing GAAPs into a single codified reference literature. As a result of the above changes, users today enjoy access to the US GAAP in a user-friendly format.

2 The Accounting Standards Codification

The official US GAAP literature contained an extremely high amount of different standards, guidelines and interpretations. The number of references exceeded two thousand before the Codification took place. Only standards issued by the FASB amounted to 168, excluding opinions, statement of positions and guidelines, issued by other various standard setting bodies over the past fifty years or more. The statement of financial accounting standard (SFAS) 162 organized the existing network of authoritative US GAAP literature into a hierarchy forming four separate levels. Yet, most critics focused on the lack of consistency and concise approach in the framework based US GAAP.

In addition, the number of financial reporting guidelines have significantly increased in recent years and exceeded two-thousand in numbers, which caused even more difficulties to US GAAP users. Even prior to this, the public, together with the FASAC⁸, had indicated problems of confusion. In consequence, the FASB evaluated the emerging problems and deficiencies experienced in the framework, and in order to eliminate confusion, examined whether the existing authoritative US GAAP was worth simplifying and codifying as part of a separate project known as the Accounting Standards Codification.

2.1 Development of the Accounting Standards Codification

The US GAAP is essentially a framework based accounting system similar to the IAS/IFRS structures. When studying the topics, special attention has to be paid to the interrelations between the standards, as standards and related interpretations concentrate on one or more specific topics, with the objective to process specific topics comprehensively. This means that not every topic is covered by a single standard, while more than one standard can cover specific topics that constitute one unit of accounting matter.

⁷ The Accounting Standards Codification introduced on July 1, 2009 revised the earlier framework based reference literature, including over two thousand authoritative points of guidance, into a single codified reference structure. The new structure, similarly to the structure of accounting acts in Central European countries, resulted in a consistent, and easy to overview reference. The Codification is the single authoritative US GAAP reference, superseding earlier literature prior to July 1, 2009.

⁸ Financial Accounting Standards Advisory Council

⁶ <http://www.sec.gov/spotlight/ifrsroadmap.htm>

Further, the sequential numbering of standards, similar to the IFRS, does not necessarily correspond to the sequence of financial statements; nor to the expected sequence of tasks in the financial reporting process. In many instances, the framework structure has confused new users of the US GAAP. However, the same can also be said for seasoned, experienced professionals. Recognizing the problems of the framework based accounting system, the FASB project team invited a representative sample of opinion poll companies and experts to survey users via questionnaires.

In order to simplify accounting research and monitoring activities for users, the FASB reedited the over two thousand existing US GAAPs, including a number of separate reference literature having caused difficulties in application.

The Accounting Standards Codification (ASC or “Codification”) project was announced on January 15 2008 with the objective to bring the existing US GAAP literature based on various sources into a single codified reference source of standards, interpretations, opinions and other guidance. The Codification process was a result of a four-year work in total, and was carried out by a team of over two hundred experts from different organizations.

The structure of the Codification differs significantly from the former US GAAP arrangement. The primary purpose of the FASB was to simplify access to all authoritative literature in the US GAAP hierarchy. Therefore, all existing standards relevant to predefined topics had to be collected into a unique reference covering each specific topic; hence developing a concise, easy to review structure. The Codification did not result in new GAAPs. Instead, the Codification developed a new edition of existing GAAPs organized under approximately 90 different topics.

Following the Codification no further standards are to be issued, instead, the Codification remains subject to revision through Accounting Standards Updates (ASUs) including appropriate explanations for any changes in the Codification. That is, the ASUs represent the single channel for communication of changes in the Codification.

The newly issued standards will have the following time system codes: Accounting Standards Update 20YY-XX, where “YY” represent the year of issue and “XX” the code of the new standard. The new standards will include the relevant guidance in a consistent structure with ASC requirements.

2.2 Architecture of the Accounting Standards Codification

The primary purpose of the Codification is to locate earlier very different standards into a codified structure, to harmonize any contradiction and to eliminate repetition of information. After the revision, all standards were assigned to a lead structure easy to comprehend and navigate in a consistent manner.

The ASC uses the above structure by subject to build up the references. Consequently, the new reference numbers have become completely independent from the reference numbers of the former standards.

Tab. 1. Lead structure of Codification [1] (Source: www.asc.fasb.org)

General Principles
Presentation
Assets
Liabilities
Equity
Revenue
Expenses
Broad Transactions
Industry

Apparently, the references of the former US GAAP literature have been completely transformed. Each topic is structured in the following model:

XXX-YY-ZZ, where *XXX* = topic, *YY* = subtopic, *ZZ* = section, *PP* = subsection

Accordingly, the new references take the following pattern: FASB ASC XXX-YY-ZZ-PP. In the instance of FASB ASC 740, the topic of income taxes superseding standard is No. SFAS 109. It considerably simplifies the search process and monitoring of changes and references because every aspect is grouped into sections and subsections subordinated to a topic or subtopic (Andor, Rózsa [3], in progress). Therefore, users are able to unambiguously locate standards dealing with a particular area, for example, any reference concerning property, plant and equipments is assigned subtopic “Property, plant and equipments”.

3 Architecture of the IFRS literature

Having reviewed the codification efforts made with US GAAP standards, the following paragraphs will describe the existing features and structure of another considerable representative of global accountancy, the IFRS.

The IFRS comprise three authoritative components: (1) the Framework; (2) standards and related (3) interpretations. In addition to titles, all standards and interpretations are coded by abbreviations that stand for “International Accounting Standards” or “International Financial Reporting Standards” or the name of the interpretation committee (SIC/IFRIC). Finally, each standard coding ends with a serial number referring to the chronological history of issue. Serial numbers are missing from the sequence if part of a standard has been superseded or reedited in a new standard because of significant changes in standards, other than simple modifications.

Again, the interrelations between standards are important because the standards and related interpretations may focus on several key topics, with the objective to process topics in a comprehensive manner. Still, standards are not developed for each topic separately under the IFRS either. The standards draw attention to the interrelations between corresponding standards

in two ways. On the one hand, standards define the scope of each standard and references in the interpretations. On the other hand, standards further refer to specific topics dealt with by other standards.

The IASB has implemented significant development to date and further projects are expected in order to make the IFRS a global standard of accounting. Therefore, a number of standards have been modified and/or superseded, and several new standards and interpretations were issued in the past years. However, standards should not change as frequently in order to facilitate successful adoption of IFRSs and allow users, such as auditors and other finance professionals to interpret the requirements and information on a consistent basis (Soderstrom, Jialin Sun [23]).

Clearly the level of diversity of IFRSs is not as high as that of US GAAPs as the number of standard setters is lower by tradition resulting in lower number of IASs/IFRSs in issue. Despite the lower amount of IASB standards compared to the US GAAPs, the IFRS is still difficult to overview in its current stage given the continuous revisions and wide range of cross references between standards and related interpretations. The above conditions give reason to assess whether the codification of the IFRS is worth the effort in light of the US GAAP experience prior to Codification, especially if further IFRSs are expected to be issued in future⁹.

In order to assess the complexity of the reference structure the following diagram illustrates the network of cross references between the IASB standards. For simplicity and clarity, the diagram excludes references related to limitation in scope and any cross reference to related interpretations.

Chart 1¹⁰ below indicates that despite the exclusion of certain cross references, the number of cross references between the standards is still significant. In consequence, the assessment, as to whether the development of an IFRS codification is worth the effort, has won support.

The chart contains all standards in force and the positive correlation between standards only. It is clear that the number of references between standards is significant and to study a topic requires a comprehensive knowledge of all standards.

In summary, the number of references by standard is relatively high, although still manageable in its current stage. Nevertheless, the continuous revision of standards and issue of new standards may shift the system into a confusing direction in the forthcoming years. Therefore, it is imperative that codification efforts take place as early as possible, as today the current preventive structure would allow a more rational implementation of a codification than in future years.

⁹<http://www.ifrs.org/Current-Projects/IASB-Projects/Pages/IASB-Work-Plan.aspx>

¹⁰ Links to the IAS 1 standard are marked with grey since, beyond the minimum expected contents, the standard is in relation with all standards requiring the publication in each part of the statements.

4 The possibility of codifying IFRS

In the Central European region, each country applies an accounting law edited in a consistent and correlated structure. As such, in these countries, the framework based IFRS represents an overall challenge for the accounting profession to overcome the differences. The Accounting Standards Codification challenges considering the viability of a codified structure, instead of consolidating all the existing standards into a new set of cleared-out standards. If the framework and standard based approach was taken for best practice, a good solution would have been to reissue the former standards, reaching a number of two thousand, previously issued by several standard setters into a new set of standards in a single edition without further overlaps or conflicting information. If the standard-based approach was the best approach, the FASB would have considered to edit a new list of standards, similar to the IFRS, and consolidate the former standards into that edition given that the US GAAP traditionally represents concepts common in the UK GAAP and IFRS, where framework and standards based accounting applies. Based on the US GAAP experience, it is clear that changes in the system and in the environment necessitated a codified accounting system suitable for easy review and maintenance of existing accounting standards.

Following the IFRS Codification, a decline is expected in opponents against IFRS implementation as a transparent and familiar structure replaces the existing list of IFRSs which is explained in the SWOT analysis later. Obviously, the codification would not dissolve the dilemma of a taxation-based accounting, because for the countries, taxation is one of the most significant arguments against the introduction of IFRS.

The analysis below presents the strengths, weaknesses, opportunities and threats related to the transformation of IFRS into a codified structure in Tab. 2.

Strengths

The codified structure is traditionally accepted, known and used in the continental Europe. By having a codified structure, countries can easily compare, link and reconcile national accounting systems to the global, codified regulations. The codified structure enables transparency of systems and underpins the users and regulators in the maintenance of the system.

Weaknesses

The codified structure is a cultural and tradition-oriented question. Despite the fact that continental European countries prefer codified structures, the Anglo-Saxon accounting systems are standard-based systems, which would be reluctant to change it to a codified one. Another weakness may be to freeze a structure for a long term. Being inflexible with the changes of the accounting environment, if the structure is “frozen”, relevant issues may be left out or simply not dealt with.

	IAS 1	IAS 2	IAS 7	IAS 8	IAS 10	IAS 11	IAS 12	IAS 16	IAS 17	IAS 18	IAS 19	IAS 20	IAS 21	IAS 23	IAS 24	IAS 26	IAS 27	IAS 28	IAS 29	IAS 31	IAS 32	IAS 33	IAS 34	IAS 36	IAS 37	IAS 38	IAS 39	IAS 40	IAS 41	IFRS 1	IFRS 2	IFRS 3	IFRS 4	IFRS 5	IFRS 6	IFRS 7	IFRS 8						
IAS 1	-	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1					
IAS 2		-	1	1	1	1	1			1														1															1				
IAS 7			-	1									1										1																	1			
IAS 8				-	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1			
IAS 10					-		1																	1	1															1			
IAS 11						-					1														1	1																	
IAS 12							-	1	1	1	1	1	1	1	1										1	1	1	1													1		
IAS 16								-	1				1	1	1										1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1		
IAS 17									-	1																1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1		
IAS 18										-						1										1																1	
IAS 19											-						1									1																1	
IAS 20												-						1								1	1																
IAS 21													-						1								1															1	
IAS 23														-						1							1	1														1	
IAS 24															-	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1		
IAS 26																-											1	1															1
IAS 27																	-	1								1	1															1	
IAS 28																		-	1							1	1															1	
IAS 29																			-	1							1															1	
IAS 31																				-	1						1															1	
IAS 32																					-	1					1															1	
IAS 33																						-	1				1															1	
IAS 34																							-	1			1	1														1	
IAS 36																										1																	1
IAS 37																										1																	1
IAS 38																										1																	1
IAS 39																										1																	1
IAS 40																										1																	1
IAS 41																										1																	1
IFRS 1																											1																1
IFRS 2																											1																1
IFRS 3																											1																1
IFRS 4																											1																1
IFRS 5																											1																1
IFRS 6																											1																1
IFRS 7																											1																1
IFRS 8																												1															1

Fig. 1. Other standards in relation with each standard (The standards, being in force as of 1 January 2010 have been included in the network of relations, i.e. the IFRS 9 effective after 1 January 2013 is not included.) [3]

Tab. 2. SWOT analysis of the IFRS Codification

Strengths:

- easier to compare with other systems (US GAAP or other national rules)
- consistent systems are common
- increased transparency
- easier review of changes in the accounting rules

Weaknesses:

- resistance to transition from the standards common to the UK and North-America systems
- inflexible structure built on existing standards

Opportunities:

- instead of uniform world standards: uniform global accounting law
- global system of references
- support to the American transition

Threats:

- reaction to changes in the world is less flexible in a fixed structure (e.g. accounting of new types of revenues) after getting accustomed

Opportunities

The world is converging to create one global accounting manual, global standards. Instead of global standards, the content can be codified into global, generally accepted structure, to set up the global codified accounting regulation. The global accounting regulation enables worldwide references, reconciliations to national systems, a common language for accountants. Additionally, the conversion from in the U.S. from US GAAP to IFRS is supported by a known, and generally accepted structure (which is not equal to the Codification structure).

Threats

Setting up a codified structure may risk the inflexibility and comfort. The world is changing rapidly, so the accounting transactions and issues. The codified structure must be challenged regularly, to react on issues in time.

Analysis of the result of the SWOT analysis

In the continental European region, accounting regulation has never been a framework based. Accounting laws of consistent structure have always been issued with the well-proven practice of comprehensive overview. Reviews and updates of the accounting regulations, as well as, the changes in rules have been integrated within consistent legislative systems, such as accounting laws in fashion similar to the current practice applied by the Accounting Standards Codification. Performing research, reference and monitoring procedures is much easier for users in a legislative or codified environment than performing the same in a framework based accounting system.

The accounting laws in a number of countries define the structure of the chart of accounts, a subject outside the scope of IFRS (see e.g. Jaruga, Szychta [15]). Therefore, lifting any mandatory requirements would lead to a lack of reference, adversely affecting the comfort of local professionals.

The system of the Accounting Standards Codification in its structure is closer in concept to the continental European national accounting systems, for example, the Hungarian accounting law (Andor, Tóth [4]). Therefore, the ASC is deemed to be more acceptable than the framework based IFRS.

Because statutory financial statements prepared in compliance with national accounting laws serve taxation purposes, some countries oppose the introduction of the IFRS, as pointed out by several researchers in earlier studies (Haller [9]; Hoogerdoorn [12]; Holeckova [11]; Lamb, Nobes & Roberts [16]). In 1995, Guenther and Hussein [8, p. 132] drew attention to the national tax systems expected to being the primary obstacle against any IFRS adoption efforts in the accounting systems.

The popularity of IFRS professional trainings indicate mixed views in the countries, as training in accounting, in general, has no history in any of the countries. For example, obtaining a basic accounting technician certificate requires no preliminary IFRS knowledge (Ormos, Veress [20]).

On the basis of the example in the US, the initiation of the IFRS codification is a timely matter. Considering the merits and demerits of codifying IFRS, the introduction of a codification approach similar to the ASC should be taken into account.

5 Conclusion

Today, we witness global transformations that will substantially rearrange commonly accepted regulations of accountancy in the future. The IFRS is expected to become mandatory for listed companies in the US leading the IFRS to global accounting standards. Therefore, investigating and scrutinizing the benefits, disadvantages, difficulties, and facilitating factors for introducing the IFRS is important. In this article, we have not examined the accounting differences between the IFRS and US GAAP, rather, we focused on the possible demand for IFRS codification from the perspective of practicing accountants working for Central European entities.

Standard setters in the US have set 2015 as a conversion date for listed companies to report under the IFRS. Consequently, the accounting profession is looking forward to welcoming an exciting period; a period in which it will become clear which global accounting system will be the predominant one used around the world. It is very important from the perspective of developing global accounting standards that the selected accounting regulation is applicable and plausible not only from technical perspectives, including recognition, measurement, presentation and disclosure assertions, but also from user perspectives to make standards friendly for everyone.

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