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THE LORD OF GLOBAL STANDARDS: THE TWIN TOWERS

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ABSTRACT

The article is a satire on Tolkien's *Lord of the Rings*. It provides, in a humorous style, an analysis of the *rules vs. principles* approach debate to international accounting harmonization. Although the debate is often referred to in the literature, explanations of the actual nature and dimensions of the controversy are weak. By placing the debate in a mythical but familiar setting, the authors are able to explain in simple terms the nature of the controversy, its political dimensions and the potential relevance for developing countries. By representing countries and their roles with individual characteristics from the *Lord of the Rings*, the article offers a fresh perspective in a highly readable style.

Keywords:

IASB, FASB, international accounting, harmonization, rules vs. principles approach

THE LORD OF GLOBAL STANDARDS: THE TWIN TOWERS¹

Scene: The Great Debating Table²

The intense light shone on the participants at the Great Debating Table but could not dispel totally the darkness at the margin where Gollum and others of a lesser status stood watching. The Lord of the Principles raised his shield on which the word “*TRANSPARENCY*” was emblazoned. ‘It is evident’ he thundered, ‘that stock options represent a true cost and therefore must be expensed against income.’

‘He truly is a fearsome figure’, exclaimed Gollum to his master, the Director of Accounting Standards for the Shires. Gollum’s large eyes glowed excitedly in the semi-darkness. ‘Is it true that each and every kingdom on Middle Earth will follow him?’ His master gave a small laugh. ‘It is not him that they follow but the principles which will ensure that all dealings we perform are fair.’

‘Is it true’, frowned Gollum, ‘that a long, long time ago, the Lord of the Principles, even before he became Lord, pronounced that our treasures would remain precious to us but that they could also rust and decay.’

‘Yes, he advocates that the dilution of asset values should be shown in financial reporting of transactions. This method is known as impairment and that is now a standard in his own land.’

‘So it is the Lord’s principle.’

‘No,’ said his master, ‘it is a principle he recognised a long time ago and now all of us in Middle Earth recognise it.’

‘I do not know whether I should recognise it,’ pouted Gollum, his scrawny hand scratching his chin in a perplexed manner, - ‘and do hobbits and elves have to recognise it too?’

‘Ahh,’ chuckled his master, ‘of course, all men, hobbits, elves, dwarves, orcs and ents have to recognise it. See over there on the far side of the table is fair Mary. She comes from the same land as that of the Lord of the Principles – the Land of Albion - and is of his persuasion. Those men who group around her are Albion’s neighbours. They will all follow the Lord of the Principles in the auspicious year 2005.’³

‘You mean that all inhabitants of Middle Earth will abide by the Principles in all their dealings?’ enquired Gollum haltingly, not quite understanding the ramifications of these dictums known as “Principles”.

‘Not all inhabitants,’ replied his master patiently, ‘only those who publicly collect together and consolidate in their transactions.’

‘And what about the others? Will they follow the Lord of the Rules instead?’

‘No, they will follow the ways that they have always followed.’

Gollum pondered for some time and said, ‘It is important for us to respect our Fathers and to follow in their ways.’⁴ He added doubtfully, ‘What do we do if the principles are in opposition to our traditions?’

You ask too many questions of me, Gollum. Hush, do you see that group approaching the table – they are men from the tribe of IOCSOO.’

‘Does the Lord of the Principles have to pay homage to them?’

‘Not pay homage, Gollum, but they are helping him in his task for the great quest and he is mindful to meet their needs.’

‘I seem to remember,’ said Gollum, ‘that in the Palace of the Lord of the Principles, before he came to power, there were many there who were mindful of the needs of others like myself who are in the Lands of Development.’⁵

Before the Director of the Accounting Standards of the Shires could respond, the Lord of the Rules started to speak. Gollum retreated further into the darkness. He started to mutter incessantly. ‘Rules or Principles, which are better? Do I want Principles or Rules? If we do away with the Lord of the Rules, we only need to worry about Principles. If we do away with the Lord of the Principles, we only need to worry about Rules.’

‘Master,’ he said ruefully, ‘what is the difference between Rules and Principles?’

‘It is quite simple. A principle will tell you generally what is the right thing to do and then you must judge what to do in specific circumstances. A rule will tell you what to do in specific circumstances.’

‘I see,’ beamed Gollum, ‘principles are like a compass which show you the direction and rules are like maps which show you exactly how to get there.’ After a few moments of reflection, he added, ‘I prefer maps.’

‘It is not like that, Gollum. Maps can be wrong or if you are in uncharted territory or if you have no map, you will need a compass. Also, you cannot make precise maps for every part of Middle Earth.

‘Stop, master!’ cried Gollum flabbergasted. ‘You are confusing me!’ He tugged at his master’s arm. ‘Who is the other lady sitting in the middle? The one with the shield bearing a symbol of a red leaf with pointed five-toothed lobes on a white background? Hmm...looks like she’s from the Land of *Acer Rubrum*. Why does she listen to the Lord of the Principles but smile at the Lord of the Rules!’

‘There are some who remain cautious⁶, Gollum. There are also many who are decided but find the perils that confront them of considerable magnitude.⁷ But the two great Lords are now debating their differences. Listen, the Lord of the Rules is just finishing his speech.’

‘...and the dark clouds of Enron in Mordor may have cast shadows on our land but we are dispelling these with the efforts of the noble princes - Sorbanes and Axley⁸ - so that once again we have transparency.’ The Lord of the Rules raised his voice and sceptre triumphantly.

Excitedly, Gollum whispered in a trance-like manner. ‘I understand now, the Lord of the Rules is going to agree to follow the Lord of the Principles, yes, yes ...’

‘No, Gollum,’ his master retorted, ‘the two Lords are going to discuss serious issues of concern together. They have jointly issued a memorandum of understanding known as the ‘Narwolk Agreement’⁹ in ...’

‘But one Lord must win’ cut in Gollum, his wide, round eyes unblinking.

‘It’s not like that. Stop, where are you going?’

‘I cannot wait until they have finished,’ Gollum hissed. ‘They do not need me and I must go catch fish now. When they have finished, they will tell me what principles I must follow and I will pretend it is a rule. I will also remember that if I do not consolidate, I will remain of little importance and the great tribe of IOCSOO will not even see me.’

Gollum was getting greener and agitated. His other ‘friend’ inside him was getting louder. He could feel a headache creeping up on him and images of his ‘friend’ coaxing him to adopt the ‘Rules’ began to cloud his vision like a cataract. ‘Gollummmmm, you must not break away from centuries of tradition...’ The voice began to pound on him like a sledgehammer.

Before his master could reply, Gollum disappeared into the darkness mumbling. ‘Should we have Rules or should we have Principles.’ At the Great Debating Table, the two Lords shook hands and there were shouts of praise. But the glittering crown of the Lord of Global Standards still rested on the table, yet to be claimed.

Notes

¹ The Twin Towers are intended to represent the two schools of thought: “Principles” and “Rules”.

² With acknowledgements to J.R.R. Tolkien. Although it may be tempting to identify characters with living individuals, the purpose is to represent particular institutions, groups and schools of thought. Gollum, who observes the Debate from a distance, represents the developing countries at the Great Debating Table.

³ From 2005, listed companies in the European Union that publish consolidated accounts will be required to follow IFRSs. In Australia, all reporting entities will be required to comply with Australian equivalents of IFRSs.

⁴ The importance of cultural differences was pioneered by Hofstede (1980) and Gray (1988) has extended the work to accounting values.

⁵ The authors are obligated to the late Professor R.S. Olusegun Wallace for reminding them that one of the original aims of the IASC was to assist standard-setting in developing countries with particular attention to the specific issues that confront these countries.

⁶ Canada, or at least the Certified General Accountants, espouses globalization and philosophically embraces the notion of IFRSs (Buckstein, 1999). However, the reality is that if IFRSs are applied in Canada, companies which conduct any form of business with the US may have to prepare two sets of accounts – one using the international standards and the other using FASB standards (Canadian Securities Administrators, 2000). Thus, although Canada appears to

lean towards internationalization, it is contended that the country will not fully converge its standards unless there is direction from the US (Cheney, 2000). A report issued by CICA (1998) espoused harmonization with FASB standards but at the same time increased its involvement with IASB and other international groups. This sentiment is confirmed by a CGA discussion paper (Lenihan and Hume, 2003). The report (which consists of a discussion group of individuals from a variety of backgrounds) showed that although there is increasing support for IFRSs, there is reluctance to alienate the FASB since the US is Canada's largest trading partner. The latest CGA discussion paper (Simunic, 2003) espoused the adoption of International Auditing Standards (ISAs) as the domestic auditing standards for use in Canada. However, it cautioned that while the potential net benefits of adopting ISAs are compelling, it is argued that the current rules of the US Securities and Exchange Commission may pose an impediment to a speedy adoption of ISAs in Canada. The Accounting Standards Board (2005) of Canada demonstrates this even-handed approach by claiming that Canadian GAAP will converge with IFRSs over the next five years but accepts US GAAP is an acceptable alternative in its strategy paper.

⁷ Street (2002, p. 89) argues that 'for many countries, convergence with IFRSs will be a monumental task'.

⁸ The repercussions of the recent corporate scandals (in particular the Enron and Worldcom fiascos) spurred the US Congress to enact the Sarbanes-Oxley Act or SOx on financial regulation of public corporations. The Act was signed by President Bush on July 30, 2002 and came into full effect a month later. The legislation covers a substantial amount of ground and requires CEOs and CFOs to personally certify that their companies' accounts are fairly presented in all material respects. Misrepresentation could lead to fines of up to US\$5m and up to 20 years in jail.

⁹ In October 2002, the IASB and FASB jointly issued a memorandum of understanding, marking a significant step toward formalizing their commitment to the convergence of US and international accounting standards. The two Boards had reached agreement on the terms in the

memorandum of understanding at their joint meeting in Norwalk, Connecticut, USA. For that reason, the memorandum of understanding is sometimes referred to as the "Norwalk Agreement". A comment on these developments can be found in Hussey and Ong (2005).

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