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Exploring the History and Trends of Accounting in Canada and the United States

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Abstract

During my years at University at Albany, I have studied accounting that is based on the United States regulation, GAAP. As I am from British Columbia, Canada, that uses a different standard, IFRS, I wanted to take this opportunity to research the differences between GAAP and IFRS. The purpose of this research paper is to explore the history of accounting in both countries and compare their differences in education, license requirements, fraud scandals, and their solutions. I will also examine the new revenue recognition, the convergence of IFRS and GAAP, and some of the professionals' opinions on the trend of combining the two regulations.

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History of accounting

The first accountant to ever set foot in the United States of America was for the purpose of Christopher Columbus' 1492 expedition. As Columbus' voyages were financed by the Queen Isabella of Spain, she required the accountant to travel with his crew to record all expenditures. When Christopher Columbus landed in America while seeking a faster route to India, he also discovered the gold, silver, and other resources. As he claimed America for the Spanish Monarchy, he brought back his finds and the accountant was required to report all the resources.

Accounting extended in the US culture when the Founding Fathers established the US Treasury as the economy grew. They recognized the importance of transparency and accountability of financials and created the position of Auditor General in 1776. Seven years later, Department of Treasury disclosed a financial document reminiscent of today's balance sheet that displayed country's surplus of $850,000. In 1801, Albert Gallatin became responsible for the law that required Annual Reports by the Secretary of Treasury. This was to assure treasury's accountability to congress by reviewing the department's annual report that contains revenues, expenditures, debts, and loans. In the following year, 1802, he submitted the first annual report and worked as a Secretary of Treasury for 13 years until 1814 (Bennett, 2015).

The United States was also heavily influenced by British accountants. British accountants frequently travelled to the United States to audit corporations in industries such as railroads and breweries where their British clients have invested in. British immigrants also impacted accounting in the United States as they were the first to establish one of the "Big Four" accounting firms in America. They were later joined by Scottish immigrant accountants in creating accounting associations in the United States (King, Case, & Senecker, 2017).

The need for American accountants increased in the late 1800s with the rise of corporate businesses. In the 1870s, it was very common for investors to visit the corporate offices to verify the financial statements. This was due to the fact that there were only a few manufacturing firms exceeding ten million dollars in assets. However, with the growth of corporates, accountants' roles extended as they were needed to detect fraudulent accounting activities, discover inaccurate transactions, and present their opinions of whether or not the financial statements are fair in accordance to the American reporting framework, Generally Accepted Accounting Principles.

The origin of Canadian accounting has its roots in the financial centres of Toronto and Montreal. Their services started mainly for bankruptcies in the 1840s but became more prominent as economy grew and stocks became more common. Number of bookkeepers also increased after the World War I as many companies were created with the economy boom and the need for bookkeepers for the entities naturally increased. The role of tax accountants was created in 1917. The Canadian government enacted the Income Tax Act which required businesses to keep accounting records as well as to file tax returns.

Canadian accounting principles were influenced by both Great Britain and the United States. It originally followed closely to the English as they were the first generation of immigrants in Canada. However, in the late 1930s, Canada had increasing businesses with the United States. Therefore, accounting was more heavily influenced by the United States as many US based companies operated their subsidiaries in Canada. This convergence also resulted from the pressure of U.S. Securities and Exchange Commission (SEC) and other accounting regulation setters in the US that emphasized that both countries' accounting regulations should be closely related and interact.

In 1946, the Canadian Institute of Chartered Accountants began creating their own nation's bulletins on accounting regulations. These statements were combined into a loose-leaf binder, the Canadian Institute of chartered Accountant's Handbook, two years later. National Policy Statement No. 27 was issued by the Canadian Securities Administrators which favoured the adoption of US regulations, Generally Accepted Accounting Principles, over in the Canadian Handbook in 1972. Later in 1975, under the Canada Business Corporation Act, all corporations and businesses were legally required to follow the US adopted regulations, GAAP.

Education and Regulations

Education in accounting first started in the colonial times for the United States. Eager students worked under local merchants as apprentices to learn bookkeeping and commerce. Each merchant taught their own method of bookkeeping and interpretation of the accounting principles. As economy began to develop with bigger transactions, independent teachers started offering accounting classes. This unregulated teaching continued in the 1900s until many felt the need for recognition in the field and also standardized coursework with the growing number of bookkeepers. This was also due to the Industrial Revolution where there was a new demand in accounting as capital markets along with auditing and accounting expanded dramatically. In 1883, University of Pennsylvania was the first college to offer accounting courses. Thirteen years later, around 40 universities in the United States carried accounting classes in their education. However, even then, suitable textbooks for accounting classes were difficult to find and many believed that there has to be unity in the teaching the accounting principles (Chatfield & Vangermeersch, 1996).

Then in 1929, Great Depression resulted as the stock market crashed. The Congress has enacted the Securities Act of 1933 and 1934 which created the Securities and Exchange Commission. This act required companies to record accurate books, transactions, and specified maintenance of internal accounting control. This also required companies to file financial statements with accordance to GAAP, Generally Accepted Accounting Principles. The purpose of creation of GAAP was to provide investors with confident and transparent documentations and to enable the United States' economy to flourish. Lawrence Summers, a former Treasury Secretary, explained the idea of GAAP as the most important innovations that shape our economy and capital markets.

The very first approach in educating Canadians on accounting started in the late 1840s. Texts on bookkeeping were imported from Irish schools and were first used by Egerton Ryerson. Accounting books written by Canadian accountants were introduced in the 1860s. More than a decade and after the war, University of Saskatchewan became the first college to offer accounting classes in 1917. University of Saskatchewan was also the first to offer a major in accounting. In 1920, the accounting association, Institute of Chartered Accountants of Ontario joined education in accounting as they reached out to Queen's University to develop corresponding programs. In 1970, the association made bachelor degree a mandatory to obtain accounting licenses (Chatfield & Vangermeersch, 1996).

Historically, Canada adopted the US GAAP and exercised their own version, Canadian GAAP. Then IFRS was created and many countries joined to adopt the new regulation. Canada also joined the movement and required that all public entities to exercise IFRS. As IFRS may be complicated for private, not-for-profit, and small businesses, they were given the option to exercise simplified GAAP (S. Lee, personal communication, January 2018).

License Requirements

In the United States, the requirement to be a qualified Certified Public Accountant, CPA, differ by states although the general qualifications are very similar. In the State of New York, the requirements to obtain the CPA license is to earn a bachelor’s degree or higher from a program that meets the 150 semester hour requirement, a year of full-time experience, and pass the uniform CPA exam. Recently, there have been changes on the structure of the CPA exams to test the ability to analyze and evaluate rather than applying and memorizing.

Canada has made dramatic changes to their accounting licenses in 2011 as they combined numerous accounting credentials into one. Previously, there were three accounting licenses; Chartered Accountants (CAs), Certified Management Accountants (CMAs), and Certified General Accountants (CGAs). Chartered Accountants played the role of external auditors, Certified Management Accountants as internal managerial accountant, and Certified General Accountants as general clerks.

The requirements for each accounting credentials were different and are shown in the table below:

	Chartered Accountants	Certified Management Accountants	Certified General Accountants
Education	Bachelor's in accounting	Bachelor's in related discipline (ex. commerce)	Bachelor's in any major
Experience	30months of experience in external audit firm	Suitable work experience	Two or three years at the managerial level
Exam	Uniform Final Evaluation (three day exam)	Entrance exam	Entrance exam

Similar to the United States, although the general requirements were similar, every province had different specifications and standards such as prerequisites needed to write the Uniform Final Evaluation exam. The level of recognition for the three credentials also differed as the difficulty of obtaining each license was different. CA was the most valuable, then CMAs, and the CGAs. It was most difficult to become a Chartered Accountant although Certified Management Accountants were the most unique. CGA was the biggest accounting body with the highest number of accountants.

Some of the problems raised with having three accounting bodies were that they were competitive of each other in trying to recruit more people into their bodies while providing very similar services. Many clients who did not understand the three accounting bodies in depth was unable to easily differentiate the three. Therefore, each of the accounting bodies spent their finances to market why they were different of each other. In this competitive environment, each accounting body also fought to have more rights to exercise accounting functions. For example, CGA Ontario petitioned and won court cases to also provide some assurance services. Such acts worsened to differentiate each other as their ability to practice different functions of accounting were mixed up. Therefore, they raised the option to combine the three credentials into one body. At first, there were a lot of disagreements from CAs as they thought it was unfair to have the same license when they had the most difficult exam and longest process to obtain CA letters. However, many accountants agreed that in the long run, it was better for the accounting body (S. Lee, personal communication, January 2018). In October 1, 2014, CPA was created to unite the three accounting credentials. CPA is synonymous to USA's CPA (Certified Public Accountant) but stands for Chartered Professional Accountants and Comptables Professionnels Agréés in French.

Accounting fraud scandals

One of the biggest accounting frauds in the United States can be named to be the Enron Scandal. In October 2001, the Enron Scandal made headlines around the world as an accounting fraud led to the bankruptcy of the Enron Corporation and dissolution of the Arthur Anderson LLP. Enron Corporation was an American energy company that was based in Houston, Texas. The company's operating activities were the sale of electricity, natural gas, pulp, and paper. It was audited by one of the big five accounting firms at the time, Arthur Anderson LLP (Li, 2010).

Enron Corporation was also well known for its unique trading business and stocks. At its peak, their stock price was over $90 which gave the company the market value of nearly $70 billion. However, shortly after their manipulation was discovered, their stock price hit the bottom as it traded for less than a $1. Thousands of their employees were immensely impacted as they were fired and lost their retirement funds that they have invested in Enron (Giroux, 2008).

Few of many factors that led to Enron's bankruptcy was unethical management and audit manipulations. The management and the CEO manipulated their financials to meet the quarterly earnings forecasts in order to receive compensations. Arthur Anderson LLP also reported audit failures especially when restating the earnings in the 3rd quarter 10-Q. They hid huge debts that Enron Corporations had by using special-purpose entities and did not report them on the balance sheets. The most unethical activity that led to the downfall of Arthur Anderson LLP's reputation was when the company's employees destroyed the documents and correspondence related to the Enron Corporation. In addition to the Enron Scandal, some of other biggest accounting scandals in the United States include the WorldCom Scandal, Tyco Scandal, and HealthSouth Scandal.

Unlike the United States, I found it difficult to research for extensive accounting scandals in Canada. The theme was also consistent from my interviews with two Canadian CPAs, S. Lee and B. Fong as they struggled to recognize well-known accounting scandals in Canada. S. Lee described that this is due to Canada's very conservative nature of accounting regulations and used the 2007 Subprime Loans as an example. 2007 Subprime Loans in the United States was when a massive number of mortgage loans were given to the subprime borrowers without adequate documentations. These unreliable loans were than repackaged through special-purpose entities and sold as bonds. As a result, many executives were fired as huge losses were taken at major financial institutions. In the meantime, Canada required three qualifications, securities, cash flows, and credit, to issue loans and through careful consideration and actions, they were able to avoid consequences caused by the Subprime Loan.

Unified Solution and Convergence of IFRS and GAAP

While the Subprime Loan and the Enron Scandal did not have much effect on its neighbouring country, Canada, I found it very interesting that it had adopted SOX from the United States. SOX, which stands for Sarbanes–Oxley Act was enacted in order to prevent further accounting frauds such as the Enron and WorldCom Scandals and prevent damages to the public and investors. The act contains eleven sections that demands emphasis on auditor independence, corporate responsibilities, and enhanced financial disclosures.

The Canadian version of SOX, C-SOX, or also called the Bill 198 share very similar concepts although there are couple differences. One of the main differences is that while the US SOX required external auditors to provide an opinion on the company's internal control, C-SOX does not require companies to submit an external auditor attestation on internal controls. Another difference is the deadline dates. For the United States, the filing deadline for compliance was November, 2004. Canada had a deadline that was nearly two year later, in 2006, as Canada wanted to observe the impact of SOX (Admin., 2010).

Accountants from both countries agree that while SOX and C-SOX was not a perfect fix, it was necessary and effective. After Enron, the accounting industry took a huge hit on their image and loss of trust by investors. SOX and C-SOX put a great pressure on management in enhancing control framework and therefore many companies expanded their internal audit and greater level of accountability. This allowed accountants to issue audits with opinions that are independent and for clients to rely on them with confidence (B. Fong & G. Kruglov, personal communication, January 2018).

Sarbanes-Oxley Act is not the only recent regulations that both countries, Canada and the United States, have adopted. There is a trend of combining and coordinating the IFRS and GAAP regulations. The most recent example is the change in the Revenue Recognition Principles. On May 28, 2014, IASB (International Accounting Standards Board) and FASB (Financial Accounting Standard Board) announced the convergence of Revenue Recognition Principle from contracts with customers (Klimek & Welsh, 2014). Before the convergence, the IFRS and GAAP differed in standards, requirements, and methods of recognizing revenue. IFRS lacked details in requirement while GAAP was overly complicated.

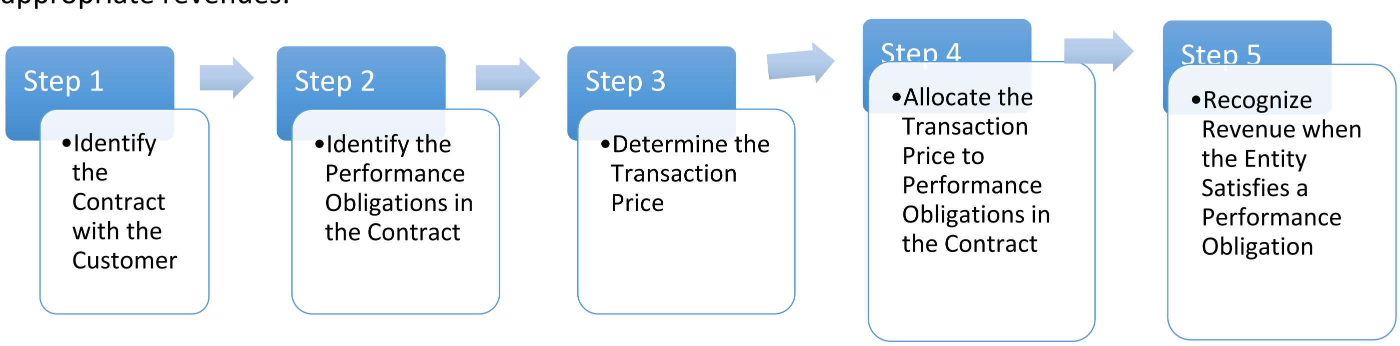
The following were the differences in revenue recognition between GAAP and IFRS:

	GAAP	IFRS
Revenue recognition standard	- Recognized when revenue is realized or realizable and earned	- Recognized when it is probable of future economic benefit - Benefit can be measured reliably - Revenue normally must be earned before it can be recognized.
Revenue definition	- "inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's	- "the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity

	ongoing major or central operations."	participants."
Deferred transactions	- Discounting is not required for revenue recognition	- Recognition of revenue is determined by discounting
Long-term contracts	- Approves completed contract method	- Approves zero profit method
Software arrangements	- Specific guidelines for recognizing revenue in software arrangements can be found on ASC 985-605	- There are no specific guidelines for recognizing revenue in software
Construction contracts	- Completed-contract method is used when percentage-of-completion method is inadequate due to doubtful estimates - Customers **must** approve the scope and price of change orders before revenue can be recognized.	- Revenue is recognized when provided that costs are recoverable when percentage-of-completion method is inadequate due to doubtful estimates - Related revenue can be recognized when it is **probable** that customers will approve the scope and price of change orders.

(Bohusova & Nerudova, 2009)

The new revenue recognition principles enforced 5 steps that help accountants derive to appropriate revenues:



(AICPA, 2016)

The new revenue recognition is named ASC 606 in the US and IFRS 15 in Canada. This change will help recognize revenue and profit more accurately in exchange to the goods and services the companies provided. It will also enhance disclosures about revenues that is complicated especially service revenue and contract modification and cut down complicated procedures for certain revenues. They reasoned that the adjustment will not only help report revenue effectively but also allow the investors to conveniently compare financial statements when making decisions.

Professionals from both countries explained that companies are becoming less domestic and more globally focused. Therefore, they both agree with convergence of IFRS and GAAP is beneficial in the long run. The downside may be that some professionals do not like change and recording revenue in a different way when they might have recorded it a certain way for many years. Another concern is that many countries are different from each other and one method may not necessary display their revenue or financials very accurately. However, GAAP and IFRS, both are effective models and while you may lose some quality, we will gain in uniformity and consistency (B. Fong & G. Kruglov, personal communication, January 2018). Clients will be able to read financial statements from different countries and have the same basis of understanding and recognizing revenue the same way.

Conclusion

Undoubtedly, the neighbouring countries, Canada and the United States share many similarities in terms of their accounting history, education, regulations, and license requirements. Both countries' accounting origin was highly influenced by the British and accounting naturally expanded as the economy flourished. Regulations were created, added, and altered due to many audit failures and bankruptcies. Some of the differences are that while both practiced GAAP, Canada now exercises IFRS as their accounting regulation. United States also has more examples of accounting fraud scandals. Regardless, it is important to learn from other's mistakes and to adopt new regulations that will help accountants to audit financials with more independence and transparency. This honours thesis helped me to gain more knowledge about the basis of accounting in both countries and as an accounting student and a future CPA, I have learned the importance of understanding both GAAP and IFRS.

Interview Report

Interviewee's Background.

Through this Honours research paper, I had the opportunity to conduct interviews with three CPAs. Two of the interviewees are Canadian CPAs, Sam S. Lee and Benjamin Fong. Sam S. Lee works at LeeJung LLP located in Burnaby, British Columbia as a partner. Benjamin Fong works as an assurance services manager at Ernst & Young LLP in downtown Vancouver. George Kruglov is a US CPA and he works as an audit senior manager in investment management at Deloitte & Touche LLP located in New York, NY.

Narrative of the Interview

I interviewed Sam S. Lee and Benjamin Fong in person when I visited home during winter break, December to January 2018. Questions were sent via email with George Kruglov. Their responses following the questions are not direct quotations but my interpretation of the interviews according to my voice recordings, emails, and notes during the interview.

1. What are the differences between CA, CMA, CGA (Chartered Accountants, Certified Management Accountants, and Certified General Accountants) and what are their individual purpose?

Benjamin Fong – Before convergence, CA worked as external auditors at firms to conduct reviews and audits and CMA played the role of managerial accountants to do internal analysis for companies. CGA worked as general clerks and helped to enter more people in the accounting field as it had the least requirements to acquire the license. The hierarchy for three accounting licenses from the most difficult to acquire and most recognized to least is CA, CMA, and CGA.

2. What was the reason to combine the three accounting bodies into one?

Benjamin Fong – The three accounting bodies converged into one, Chartered Professional Accountant, because they were very competitive of each other to try to recruit people into their bodies while providing very similar services and spent a lot of money marketing that the three accounting bodies were different from each other. For example, CGA Ontario petitioned and won court cases to also provide some assurance services. However, despite the effort, a client who doesn't understand the accounting field would view CA, CMA, and CGA the same and wouldn't be able to differentiate. There was some pushback as CA who has the toughest requirements thought it was unfair and as CGA had the biggest body. But now, we can conclude that it was definitely better in the long run.

3. What accounting regulations does Canada use?

Benjamin Fong – There was a time when we used Canadian GAAP. When IFRS was created and many countries started to exercise it, Canada also joined the movement. As IFRS is complicated for small businesses, simplified Generally Accepted Accounting Principles is allowed for small private businesses.

Sam S. Lee – All public entities are required to exercise IFRS in Canada. However, private and not-for-profit companies have the option to choose between IFRS and GAAP.

4. Were there any big accounting scandals in Canada?

Benjamin Fong – I haven't seen very many that really hit the news. Some of them would be Sino-Forest Scandal and KPMG offshore tax issues. However, they are more international, Chinese fraud issue and scandals related to tax.

Sam S. Lee – I don't think we have had any big accounting scandals. The accounting regulation in Canada is very conservative. Even when the United States had the Subprime Mortgage Crisis in 2007, Canada did not take a huge hit as it required qualifications to issue loans. There were three requirements which were securities, cash flows, and credit.

5. After Enron, Canada also adopted their version of SOX, C-SOX. Do you think this was necessary/ effective for another country to adopt this rule as they did not encounter problems similar to the Enron scandal?

Benjamin Fong – I would say that it was necessary and has been helpful because the accounting industry took a huge hit on their image from the scandal. Since there are many accounting companies, such as the Big Four, that operate globally, this would affect their clients' trust and their ability to stay independent. C-SOX helped to issue audit with opinions that are independent so that there is no undue influence by your clients and users and investors are able to rely on them with confidence.

George Kruglov – Ultimately, while SOX in it of itself was not a perfect fix for the issues that brought about Enron, it did put greater pressure on management to enhance the underlying control framework. As a result, companies have expanded their internal audit and SOX Office functions, which has served to create more checks and balances at many of the organization. It has also brought about the PCAOB, which while it has made the audit profession better as a result by enforcing a greater level of accountability. In the end, fraud doesn't know territorial boundaries, so if something happened in the US it is just as probably of occurring in Canada, simply there are fewer companies of such prominence as a result fewer incidents as well publicized, but human nature is human nature.

6. What is your perspective on the trend of combining IFRS and GAAP? Do you think that the positives outweigh the negatives?

Benjamin Fong – It's a good thing for the users. So that way, as the world gets more globalized, clients want to be able to read statements from any country and still have the same basis of understanding and recognizing revenue the same way. There are some concerns, for example, a tax accountant might prefer to have a certain standard. Also, some countries, when they encounter a situation have applied a certain way for many years. For someone to come in and say all of a sudden, you have to record it another way may be difficult and confusing. It would be an easier transition if the accountants understand both IFRS and GAAP.

George Kruglov – In the long run, having a more uniform global accounting standard is beneficial as the world becomes more integrated and companies become less domestic and more globally focused. The increased comparability over time will be essential, but in the meantime, to get there you have to go through the thing the accounting professions sometimes dislikes and that is "change". While the underlying thinking is somewhat different between GAAP and IFRS, at the end of the day, both are effective models. The ultimate goal is greater uniformity and if you have to lose some proscriptive guidance in your standards to get there, that's worth it in the long run.

7. With more regulations uniting globally, do you think that the financials will become less accurate (as the standards won't be quite specific to each country/ industry)? Do you think that this will ever backfire on the concept of helping investors compare financials?

George Kruglov – In the end the answer to this is really time will tell, but what is being missed in the discussion is that with regards to the actual users of the companies' filings they are focusing less and less these days on the actual financial statements themselves and placing more emphasis on non-GAAP measures disclosed by management in the press releases, MD&A and other investor presentation. It is these non-GAAP measures that are really driving most analysts' valuations models and as a result are becoming much more impactful on how end users of the financial statements evaluate the performance of the companies. That is why recently, about a year ago the SEC made a very strong push to try to regain control over these non-GAAP measures by putting forth more prescriptive guidance governing the nature of such disclosures. But at the end of the day these disclosures are outside of the IFRS/GAAP framework, so regardless what happens with GAAP/IFRS management through non-GAAP measures still has a less regulated avenue to get their story to investors in a manner that is not beholden to these stringent regulations.

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