Chapter 4 International accounting





Upon completing this chapter readers should:

- appreciate that there are important differences between the accounting policies and practices adopted in different countries, although such differences are decreasing across time as various countries elect to adopt standards released by the International Accounting Standards Board;
- understand various theoretical explanations about why countries adopt particular accounting practices in preference to others;
- be able to explain what is meant by the term harmonisation (or standardisation) of accounting;
- be able to identify and explain some of the perceived benefits of, and obstacles to, harmonising or standardising accounting practices on an international scale;
- understand the key factors which are leading to greater international harmonisation of accounting.



Since the start of 2005, accounting standards issued by the International Accounting Standards Board (IASB) have become the accounting standards which are to be followed within Australia and a number of other countries (including member states of the European Union). Do you believe that different countries should adopt the same accounting standards—that is, that a *one-size-fits-all* approach to financial accounting is appropriate? What are some of the advantages and disadvantages that arise as a result of a country adopting the accounting standards issued by the IASB?

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Introduction

In the previous chapters we considered how regulation can shape the practice of financial reporting. We learned that various factors can influence the actions of regulators (for example, their own perceptions about what is in the 'public interest' or about the economic implications of newly proposed accounting standards), and that various theoretical perspectives can be applied when making a judgement about the factors that will be more likely to impact on a regulator's ultimate decision to support or oppose particular financial accounting requirements. We saw how differences in, or changes to, accounting regulations can result in different accounting 'numbers' being reported for a given underlying transaction or event, and how these differences in reported accounting results can lead to both positive and negative social and economic consequences. Clearly, therefore, any differences in accounting regulations between different countries are likely to result in the accounting outcomes reported from a specific set of transactions and/or events varying from country to country.

In this chapter we consider theoretical explanations regarding why accounting regulations and practices vary between different countries (or perhaps why they varied before national accounting regulators decided to adopt accounting standards issued by the IASB), including the impact various cultural and institutional factors might have on the shape of accounting. We also explore some theoretical insights into reasons for, and the potential success of, attempts to reduce international differences in accounting regulation. To provide context for the latter area, we examine recent developments in accounting harmonisation within Australia and the European Union (EU).

EVIDENCE OF INTERNATIONAL DIFFERENCES IN ACCOUNTING

Before we explore some key theoretical reasons which have been used to explain why accounting practices vary between countries, it would be useful to establish whether such differences actually exist. Evidence of these international differences would be provided if a given set of transactions or events produced different accounting results in different countries. Differences in the underlying economic performance of companies from different countries are not evidence of accounting differences, they are just indicators that the economic climate varies from country to country. Therefore, for example, if a French steel manufacturer which produced and sold all of its steel in France reported a different pattern of profits from an Italian steel company (which produced and sold all of its steel in Italy), this could be the result of different economic and market conditions between France and Italy. The differences in the reported results could also be partially due to differences in accounting rules, but unless we knew all of the underlying transactions and events, it would not be possible for us (as external users of financial reports) to tell how much of the difference in reported profits was due to differences in the underlying economic performance and how much was due to differences between French and Italian accounting rules.

Instead, an effective way to establish whether there are international differences in accounting, which impact directly on reported accounting results, is to compare the results reported in different countries from an identical set of underlying economic transactions and events. Given that each company will have a unique set of transactions and events each year, this comparison cannot effectively be undertaken by comparing the results of different companies located in different countries. The comparison can, however, be undertaken by looking at the results of a single company (or group of companies) which produces separate financial accounts in accordance with the regulations of more than one country.

In recent years there have been a number of large multinational corporations which have raised finance through the stock exchanges of more than one country (for example, by selling shares through the Sydney, London and New York stock exchanges—where their shares continue to be listed). To support its sale of shares and continued listing on any stock exchange, a company has to produce financial reports which have been drawn up in accordance with accounting regulations acceptable to that stock exchange. Historically, this has usually been the national accounting regulations of the country where the stock exchange is located. Therefore, when a multinational corporation has its shares traded on stock exchanges in more than one country, it has usually had to produce more than one version of its accounts—with a separate set of results drawn up in accordance with the national accounting regulations of each nation where its shares are traded. Clearly, as these different accounts are based on the same set of underlying economic transactions and events (all the economic activities of the particular multinational for that particular year), any differences in the reported results between the different versions of the accounts should be due solely to international differences in accounting regulations.

¹ As we will see later in this chapter, many stock exchanges now accept accounts drawn up in accordance with International Financial Reporting Standards/International Accounting Standards. If a company has its shares traded on stock exchanges in more than one country, but all these stock exchanges accept financial reports drawn up using these international standards, then the company may only have to produce one version of its accounts, which will be accepted by all of the stock exchanges where its shares are traded.

Nobes and Parker (2004, p. 4) have undertaken such a comparison of the results of a small number of European-based multinationals which report their results in accordance with both their home nation's accounting rules and US accounting rules. This shows, for example, that the underlying economic transactions and events of the Anglo-Swedish drug company AstraZeneca in the year 2000 produced a profit of £9,521m when reported under UK accounting rules, but the same set of transactions produced a reported profit of £29,707m under US accounting rules—a difference of 212% in reported profits from an identical set of underlying transactions and events! Extending this analysis to a more recent period, the 2003 annual report of AstraZeneca (p. 116) shows that profits under UK accounting rules of \$3,036m became profits of \$2,268m when calculated in accordance with US accounting rules—this time a difference of 25% compared to the UK rules. In its balance sheet, AstraZeneca's shareholders' equity at 31 December 2003 was \$13,178m when reported in accordance with UK accounting rules, but this became \$33,654m when calculated in accordance with US accounting rules, a difference of 155%. Although percentage differences of this size might be unusual, examination of the financial reports of almost any company which reports its results in accordance with more than one set of accounting regulations will show some differences both between the profits reported under each set of regulations and between the net assets reported under each set of regulations. Consider the following statement from an article in The Australian Financial Review (25 November 1998):

From time to time, the fundamental differences in accounting and reporting standards among the various countries of the western world hit the headlines. This was never more dramatically demonstrated than when Daimler-Benz achieved a listing on the New York Stock Exchange (the first German company to do so) in October 1993.

When the group accounts were converted from German accounting rules to US GAAP (generally accepted accounting practice), a DM168 million profit for the first half year became a staggering DM949 million loss.

More recently, German conglomerate Hoechst, which had adopted international accounting standards (IAS) in 1994, also listed in New York. In the process of reconciling its accounts with US GAAP an IAS profit of DM1.7 billion became a loss of DM57 million.

Accounting Headline 4.1 illustrates how a large accounting profit, according to Australian accounting standards, became a significant loss for the Australian company News Corporation Ltd when US standards were applied.

Having considered how different countries' accounting rules can generate significantly different profits or losses, we can consider whether such differences are a justification for the decision by many countries to adopt accounting standards issued by the IASB. What do you think? Certainly, this justification has been used by Australian accounting standard-setters.

A further dramatic example of the existence of differences between the accounting rules of different countries was provided by Enron. As Unerman and O'Dwyer (2004) explain, in the aftermath of the collapse of Enron many accounting regulators, practitioners and politicians in European countries claimed that the accounting practices which enabled Enron to 'hide' vast liabilities by keeping them off their US balance sheet would not have been effective in Europe. In the United Kingdom this explanation highlighted the differences between the UK and US approaches to accounting regulation, and argued that under UK accounting regulations these

accounting rules

Illustration of the impacts on profits of international differences in

News learns wealthy lesson: don't move to US

BY FINOLA BURKE

US accounting principles have turned The News Corporation Ltd's \$1.92 billion net profit in fiscal 2000 into a \$329 million loss, according to documents filed with the US Securities and Exchange Commission.

Accounting Headline 4.1

While the US loss does not change the profit reported by News at the end of last financial year, it does demonstrate how different News's accounts would look if it moved its headquarters to the US.

The net difference before minority interests to the way in which News reported its income last year was a \$2.4 billion loss.

Under US Generally Accepted Accounting Principles (US GAAP), companies are not allowed to capitalise start-ups,

book abnormal losses or gains, or revalue mastheads or television licenses. Depreciation is also treated differently.

US GAAP would have had News making a loss rather than its near \$2 billion profit and shaved its operating income back to \$1.5 billion from the reported \$2.74 billion the company made under Australian accounting rules.

The Australian, 15 November 2000, p. 32

liabilities would not have been treated as off balance sheet, thus potentially producing significant differences between Enron's balance sheet under UK and US accounting practices.

Having demonstrated that differences do exist in practice between the accounting regulations of different countries (although the differences are reducing with global spread of the IASB accounting standards), we will now proceed to explore some of the key theoretical reasons which have been provided to explain the existence of differences in accounting practices. The theoretical reasons given to explain why international differences are expected to exist can in turn be used as possible arguments against international standardisation of accounting—something that is being pursued by the IASB.

EXPLANATIONS OF DIFFERENCES IN ACCOUNTING PRACTICES EMPLOYED IN DIFFERENT COUNTRIES

Authors such as Perera (1989) have argued that accounting practices within particular countries evolve to suit the circumstances of a particular society, at a particular time. While there is a large variation in accounting systems adopted in different countries, it has been commonly accepted that there are two main models of financial accounting which have evolved within economically developed countries: the Anglo-American model and the continental European model (Mueller, 1967; Nobes, 1984). The Anglo-American model is characterised by a system of accounting that

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² For example, France, Italy, Spain and Germany are often presented as examples of the continental European group, while countries such as the United States, the United Kingdom, Ireland, the Netherlands, Canada, Australia and New Zealand are often presented as examples of the Anglo-American group.

is strongly influenced by professional accounting bodies rather than government, emphasises the importance of capital markets (the entities within the countries that use this model of accounting are typically very reliant on public sources of equity and debt finance), and relies upon terms such as 'true and fair' or 'presents fairly', which in turn are based upon considerations of economic substance over and above legal form (legal form being bound by legislation).

The continental European model of accounting, on the other hand, typically is characterised by relatively small input from the accounting profession, little reliance upon qualitative requirements such as true and fair, and stronger reliance upon government. The accounting methods tend to be heavily associated with the tax rules in place, and the information tends to be of a nature to protect the interest of creditors, rather than investors *per se* (the entities within countries that use the continental European model have historically tended to obtain most of their long-term funds from family sources, governments or lenders, often banks).

Over time, numerous reasons have been given for differences in the accounting methods of different countries. Mueller (1968) suggests that such differences might be caused by differences in the underlying laws of the country, the political systems in place (for example, a capitalistic/free-market system versus a centralised/communistic system), or their level of development from an economic perspective. As Mueller (1968, p. 95) explains:

In society, accounting performs a service function. This function is put in jeopardy unless accounting remains, above all, practically useful. Thus, it must respond to the ever-changing needs of society and must reflect the social, political, legal and economic conditions within which it operates. Its meaningfulness depends on its ability to mirror these conditions.

Other reasons such as tax systems, level of education and level of economic development have also been suggested to explain differences in accounting practices (Doupnik and Salter, 1995). At present there is no single clear theory that explains international differences in accounting practices. Many different causes have been suggested. Nobes (1998) reviewed the literature and confirmed that numerous reasons have been proposed to explain the differences. These are summarised in Table 4.1.

According to Nobes, many of the factors in Table 4.1 are interrelated. A number are deemed to be 'institutional', and a number relate to the broader notion of *culture*. We will now consider individually some of the factors identified in Table 4.1. Firstly we will examine the impact that cultural factors (including religious influences) could have on shaping accounting practices. We will then consider how institutional factors, such as different legal and financing systems, might also have caused accounting practices to vary between countries.

Culture

Culture is a broad concept that would be expected to impact on legal systems, tax systems, the way businesses are formed and financed, and so on. For many years culture has been used in the psychology, anthropology and sociology literatures as the basis for explaining differences in social systems (Hofstede, 1980). In recent decades it has also been used to try to explain international differences in accounting systems. One of the earlier papers to consider the impacts of culture on accounting was written by Violet (1983), who argued that accounting is a 'socio-technical activity' that involves interaction between both human and non-human resources. Because the

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1.	Nature of business ownership and financing system	۱					
2.	Colonial inheritance	ĺ					
3.	Invasions	İ					
4.	Taxation						
5.	Inflation						
6.	Level of education						
7.	Age and size of accountancy profession						
8.	Stage of economic development	_					
9.	Legal systems	_					
10.	Culture						
11.	History						
12.	Geography						
13.	Language						
14.	Influence of theory						
15.	Political systems, social climate						
16.	Religion						
17.	Accidents						

Source: Abacus, Vol. 34(2), Nobes, C., Towards a general model of the reasons for international differences in financial reporting', Copyright 1998, Blackwell Publishing.

two interact, Violet claims that accounting cannot be considered culture free. Relating accounting to culture, Violet (1983, p. 8) claims:

Accounting is a social institution established by most cultures to report and explain certain social phenomena occurring in economic transactions. As a social institution, accounting has integrated certain cultural customs and elements within the constraints of cultural postulates. Accounting cannot be isolated and analyzed as an independent component of a culture. It is, like mankind and other social institutions, a product of culture and contributes to the evolution of the culture which employs it. Since accounting is culturally determined, other cultural customs, beliefs, and institutions influence it.

Takatera and Yamamoto (1987) have defined culture as 'an expression of norms, values and customs which reflect typical behavioural characteristics'. Hofstede (1980, p. 25) has defined culture as 'the collective programming of the mind which distinguishes the members of one

human group from another'. It describes a system of societal or collectively held values (Gray, 1988, p. 4) rather than values held at an individual level. 'Values' are deemed to determine behaviour. Gray (1988, p. 4) explains that the term 'culture' is typically reserved for societies as a whole, or nations, whereas 'subculture' is used for the level of an organisation, profession (such as the accounting profession) or family. It is expected that different subcultures within a particular society will share common characteristics. In the discussion that follows we consider the work of Professor Sid Gray in some depth. This work is generally acknowledged as constituting some of the most rigorous research into accounting's relationship to, and to some extent dependence on, national culture.

Gray (1988, p. 5) argues that 'a methodological framework incorporating culture may be used to explain and predict international differences in accounting systems and patterns of accounting development internationally'. Any consideration of culture necessarily requires difficult choices as to aspects of culture that are important to the issue under consideration, and, in turn, how one goes about measuring the relevant cultural attributes. As Perera (1989, p. 43) states, 'the study of culture is characterized by a unique problem arising from the inexhaustible nature of its components'. Gray used the work of Hofstede (1980, 1983). Gray (1988, p. 5) explains:

Hofstede's (1980, 1983) research was aimed at detecting the structural elements of culture and particularly those which most strongly affect known behaviour in work situations in organizations and institutions. In what is probably one of the most extensive cross-cultural studies ever conducted, psychologists collected data about 'values' from the employees of a multinational corporation located in more than fifty countries. Subsequent statistical analysis and reasoning revealed four underlying societal value dimensions along which countries could be positioned. These dimensions, with substantial support from prior work in the field, were labeled Individualism, Power Distance, Uncertainty Avoidance, and Masculinity. Such dimensions were perceived to represent a common structure in cultural systems. It was also shown how countries could be grouped into culture areas, on the basis of their scores on the four dimensions.⁴

Gray argues that the value systems of accountants will be derived and related to societal values (which are reflected by Hofstede's cultural dimensions of Individualism, Power Distance, Uncertainty Avoidance and Masculinity). These social values which are also held by accountants (which Gray terms the accounting subculture) will in turn, it is believed, impact on the development of the respective accounting systems at the national level. Therefore, at this point we can perhaps start to question whether accounting systems can be developed in a 'one-size-fits-all' perspective—an approach which the International Accounting Standards Board (IASB) has adopted (we return to this point later in the chapter). However, while it is argued that there should be some association between various value systems and accounting systems, over time,

³ Perera (1989, p. 43) further states that 'it is essential, therefore, that in analyzing the impact of culture upon the behaviour of the members of any particular subculture, a researcher must select the cultural components or dimensions most pertinent to the particular facet of cultural behaviour being studied'. This is clearly not a straightforward task.

⁴ Hofstede's work is based on international surveys conducted within IBM. The attitude surveys were conducted between 1967 and 1973 and resulted in 117,000 responses from 88,000 employees in 66 countries (Baskerville, 2003). Hofstede was the senior researcher in charge of the survey.

⁵ Hofstede's theory, while being applied to accounting issues, is from the cross-cultural psychology literature and was of itself not directly concerned with accounting.

many events would typically have occurred that confound this possible relationship. For example, in relation to developing countries, Baydoun and Willett (1995, p. 72) state:

It is quite possible that had accounting systems evolved independently in developing countries they would have a rather different form from any we now witness in present day Europe. However, most accounting systems used in developing countries have been directly imported from the West through a variety of channels: by colonialism in the past; and through Western multinational companies, the influence of local professional associations (usually founded originally by Western counterpart organizations) and aid and loan agencies from the industrialised countries.

Returning to the work of Hofstede, the four societal value dimensions identified by Hofstede can be summarised as follows (quoted from Hofstede, 1984):

Individualism versus Collectivism

Individualism stands for a preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only. Its opposite, Collectivism, stands for a preference for a tightly knit social framework in which individuals can expect their relatives, clan, or other in-group to look after them in exchange for unquestioning loyalty (it will be clear that the word 'collectivism' is not used here to describe any particular social system). The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among individuals. It relates to people's self concept: 'I' or 'we'.

With regard to the cultural dimension of *Individualism versus Collectivism* it is interesting to note that a great deal of economic theory is based on the notion of *self-interest* and the *rational economic person* (one who undertakes action to maximise personal wealth at the expense of others). This is very much based in the *Individualism dimension*. In a culture that exhibited *Collectivism* it is expected that members of the society would look after each other and issues of loyalty would exist.⁶

Large versus Small Power Distance

Power Distance is the extent to which the members of a society accept that power in institutions and organisations is distributed unequally. This affects the behaviour of the less powerful as well as of the more powerful members of society. People in Large Power Distance societies accept a hierarchical order in which everybody has a place, which needs no further justification. People in Small Power Distance societies strive for power equalisation and demand justification for power inequities. The fundamental issue addressed by this dimension is how a society handles inequalities among people when they occur. This has obvious consequences for the way people build their institutions and organisations.

⁶ Positive Accounting Theory, a theory developed by Watts and Zimmerman (and which we discuss in depth in Chapter 7), attempts to explain and predict managers' selection of accounting methods. In developing their theory, Watts and Zimmerman assume that individuals will always act in their own self-interest. Such an assumption would be invalid in a community which embraces a Collectivist perspective. In a similar vein, Hamid, Craig and Clarke (1993) suggest that finance theories developed in Western cultures will not apply in Islamic cultures. According to Hamid, Craig and Clarke (1993), the Islamic principles do not allow the payment of interest. They argue (p. 146) therefore that 'much of Western finance theory, in particular the capital asset pricing model, which draws upon interest-dependent explanations of risk, cannot be part of the (Islamic) accounting and finance package'.

Strong versus Weak Uncertainty Avoidance

Uncertainty Avoidance is the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. This feeling leads them to beliefs promising certainty and to sustaining institutions protecting conformity. Strong Uncertainly Avoidance societies maintain rigid codes of belief and behaviour and are intolerant towards deviant persons and ideas. Weak Uncertainty Avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated. The fundamental issue addressed by this dimension is how a society reacts to the fact that time only runs one way and that the future is unknown: whether it tries to control the future or to let it happen. Like Power Distance, Uncertainty Avoidance has consequences for the way people build their institutions and organisations.

Masculinity versus Femininity

Masculinity stands for a preference in society for achievement, heroism, assertiveness, and material success. Its opposite, Femininity, stands for a preference for relationships, modesty, caring for the weak, and the quality of life. The fundamental issue addressed by this dimension is the way in which a society allocates social (as opposed to biological) roles to the sexes.

Again, as stated earlier, when countries are given scores on the four value dimensions, a number of countries can be clustered together, reflecting that they have similar cultural values.^{7, 8} Having considered Hofstede's value dimensions, the next step for Gray was to relate them to the values that he perceived to be in place within the accounting subculture. Gray developed four accounting values that were deemed to relate to the accounting subculture with the intention that the accounting values would then be directly linked to Hofstede's four societal values (which we discussed above). Gray's four accounting values were defined as follows (1988, p. 8):

Professionalism versus Statutory Control

A preference for the existence of individual professional judgement and the maintenance of professional self-regulation, as opposed to compliance with prescriptive legal requirements and statutory control.

Uniformity versus Flexibility

A preference for the enforcement of uniform accounting practices between companies and the consistent use of such practices over time, as opposed to flexibility in accordance with the perceived circumstances of individual companies.

⁷ For example, of the many groups, one group with similar scores on each of the four societal values comprises Australia, Canada, Ireland, New Zealand, the United Kingdom and the United States. Another group is Denmark, Finland, the Netherlands, Norway and Sweden, while another group comprises Indonesia, Pakistan, Taiwan and Thailand. The view is that people within these various groupings of countries share a similar culture and therefore share similar norms and value systems.

⁸ A number of authors have been critical of Hofstede's work. One particular criticism is that Hofstede equated nations with cultures (that is, each nation was deemed to be one culture) when in fact numerous cultures can exist within a particular country (Baskerville, 2003).

Conservatism versus Optimism

A preference for a cautious approach to measurement so as to cope with the uncertainty of future events, as opposed to a more optimistic, laissez-faire, risk-taking approach.

Secrecy versus Transparency

A preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing, as opposed to a more transparent, open and publicly accountable approach.

Gray (1988) then developed a number of hypotheses relating Hofstede's four societal cultural dimensions to each one of his own four accounting values.⁹ His first hypothesis was:

Hypothesis 1: The higher a country ranks in terms of *Individualism* and the lower it ranks in terms of *Uncertainty Avoidance* and *Power Distance*, then the more likely it is to rank highly in terms of *Professionalism*.

The basis for the above hypothesis was that a preference for applying judgement (for example, determining whether something is *true and fair*) rather than strict rules is more likely where people tend to be individualistic; where people are relatively more comfortable with people using their own judgement, rather than conforming to rigid codes of rules; and where different people are allowed to make judgements rather than relying on strict rules 'from above' (lower Power Distance).

Gray's second hypothesis was:

Hypothesis 2: The higher a country ranks in terms of *Uncertainty Avoidance* and *Power Distance* and the lower it ranks in terms of *Individualism*, then the more likely it is to rank highly in terms of *Uniformity*.

The basis for the second hypothesis is that communities that prefer to avoid uncertainty prefer more rigid codes of behaviour and greater conformity. A desire for uniformity is also deemed to be consistent with a preference for Collectivism (as opposed to Individualism) and an acceptance of a relatively more Power Distance society in which laws are more likely to be accepted.

Gray's third hypothesis was:

Hypothesis 3: The higher a country ranks in terms of *Uncertainty Avoidance* and the lower it ranks in terms of *Individualism* and *Masculinity*, then the more likely it is to rank highly in terms of *Conservatism*.

As noted previously, Conservatism implies that accountants favour notions such as prudence (which traditionally means that profits and assets are calculated in a conservative manner with a tendency towards understatement rather than overstatement). The basis for the third hypothesis is that communities that have strong Uncertainty Avoidance characteristics tend to prefer a more cautious approach to cope with existing uncertainties. On the other hand, Conservatism is

⁹ Although Gray (1988) developed four hypotheses, he did not test them empirically. To test them, as others have subsequently done, one must determine whether an accounting system scores high or low in a particular country on the four dimensions developed by Gray.

expected to be associated with communities that care less about individual achievement. Communities that tend to demonstrate masculine tendencies emphasise achievement—hence the expectation that lower levels of Masculinity will lead to higher preferences for conservative accounting principles. A more highly masculine community would be deemed to prefer to use methods of accounting that lead to higher levels of performance being reported.

Gray's fourth hypothesis was:

Hypothesis 4: The higher a country ranks in terms of *Uncertainty Avoidance* and *Power Distance* and the lower it ranks in terms of *Individualism* and *Masculinity*, then the more likely it is to rank highly in terms of *Secrecy*.

The basis for the fourth hypothesis is that communities that have a higher preference for Uncertainty Avoidance prefer not to disclose too much information because this could lead to conflict, competition and security problems. Also, communities that accept higher Power Distance would accept restricted information, as this acts to preserve power inequalities. Also, a community that prefers a collective approach, as opposed to an individualistic approach, would prefer to keep information disclosures to a minimum to protect those close to the firm and to reflect limited concern for those external to the organisation. A more Masculine community would be expected to provide more information about its financial position and performance to enable comparisons of the level of performance of different entities. (Masculine communities would be deemed to be more concerned with issues such as ranking the performance of one entity against another.) However, as a caveat to the general position that more Masculine communities disclose more accounting information, Gray (1988, p. 11) argues that 'a significant but less important link with masculinity also seems likely to the extent that more caring societies, where more emphasis is given to the quality of life, people and the environment, will tend to be more open, especially as regards socially related information'. Table 4.2 summarises the hypothesised relationships between Gray's accounting values and Hofstede's cultural values.

Summary of the hypothesised	relationships	between	Gray's	accounting	values	and I	Hofstede's
cultural values							

Cultural values	Accounting values (from Gray)						
(from Hofstede)	Professionalism	Uniformity	Conservatism	Secrecy			
Power Distance	-	+	?	+			
Uncertainty Avoidance	_	+	+	+			
Individualism	+	_	_	-			
Masculinity	?	?	_	-			

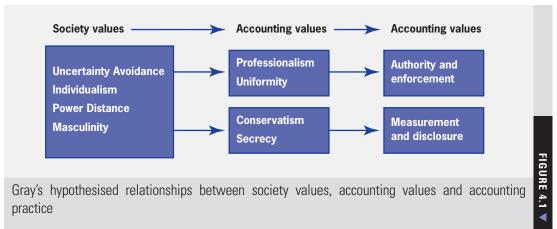
Note: '+' indicates a positive relationship; '-' indicates a negative relationship; and '?' indicates that the direction of the relationship is unclear.

¹⁰ Socially related information would relate to such issues as health and safety issues, employee education and training, charitable donations, support of community projects and environmental performance. A more Feminine (less Masculine) society would tend to consider these issues more important. Hence, while Femininity might be associated with less financial disclosure, it is assumed to be associated with greater social disclosure.

Gray (1988) further hypothesised that relationships can be established between accounting values and the *authority* and *enforcement* of accounting systems (the extent to which they are determined and enforced by statutory control or professional means), and the *measurement* and *disclosure* characteristics of the accounting systems. According to Gray (1988, p. 12):

Accounting value systems most relevant to the professional or statutory authority for accounting systems and their enforcement would seem to be the professionalism and uniformity dimensions, in that they are concerned with regulation and the extent of enforcement and conformity . . . Accounting values most relevant to the measurement practices used and the extent of information disclosed are self-evidently the conservatism and the secrecy dimensions.

Gray's linkage between societal values, accounting values and accounting practice can be summarised, as in Figure 4.1 (as summarised in Fechner and Kilgore, 1994, p. 269).



Source: Fechner and Kilgore (1994), p. 269.

Perera (1989, p. 47) provides additional discussion in respect of the relationships summarised in Figure 4.1. He states:

The higher the degree of professionalism the greater the degree of professional self-regulation and the lower the need for government intervention. The degree of uniformity preferred in an accounting sub-culture would have an effect on the manner in which the accounting system is applied. The higher the degree of uniformity the lower the extent of professional judgement and the stronger the force applying accounting rules and procedures. The amount of conservatism preferred in an accounting sub-culture would influence the measurement practices used. The higher the degree of conservatism the stronger the ties with traditional measurement practices. The degree of secrecy preferred in an accounting sub-culture would influence the extent of the information disclosed in accounting reports. The higher the degree of secrecy, the lower the extent of disclosure.

One objective of Gray's research was to explain how differences between countries in respect of their culture may impede any moves towards international harmonisation of accounting

standards. While some of the above material might appear a little confusing (perhaps not), it does represent quite an intellectual body of research, which is attempting to relate a fairly difficult to measure construct, culture, to differences in values of the accounting subculture, and ultimately to differences in the systems of accounting employed. While we might not be able to remember all the hypothesised relationships described above, what is important is that we appreciate how researchers have attempted to link cultural measures to accounting practice.

A number of other authors have also used Hofstede's cultural dimensions. ¹¹ Zarzeski (1996) provides evidence that supports a view that entities located in countries classified as relatively more Individualistic and Masculine and relatively less in terms of Uncertainty Avoidance provide greater levels of disclosure. Zarzeski also considered issues associated with international profile and found that those entities with a relatively higher international profile tend to be less secretive than other entities. Further, entities from continental European countries, such as France and Germany, which have historically tended to rely more heavily on debt financing than, say, Anglo-American companies, have lower levels of disclosure than Anglo-American companies. In relation to the issue of secrecy, Zarzeski shows that local enterprises are more likely to disclose information commensurate with the secrecy of their culture than are international enterprises. In explaining this she states (p. 20):

The global market is just a different 'culture' than the one the firm faces at home. When a firm does business in the global market, it is operating in a different 'culture' and therefore may need to have different 'practices'. Higher levels of financial disclosures may be necessary for international survival because disclosure of quality operations should result in lower resource costs. When enterprises from more secretive countries perceive economic gain from increasing their financial disclosures, cultural borrowing may occur. The culture being borrowed will be a 'global market culture,' rather than a specific country culture.

Perera (1989) considered both Hofstede's cultural dimensions and Gray's accounting subcultural value dimensions and uses them to explain apparent differences in the accounting practices adopted in continental European countries and Anglo-American countries. According to Perera (p. 51), many countries in continental Europe are characterised by relatively high levels of uncertainty avoidance where rules or 'social codes' tend to shape behaviour, while the opposite applies in Anglo-American countries:

The presence of these rules satisfied people's emotional needs for order and predictability in society, and people feel uncomfortable in situations where there are no rules. Therefore, in general, one can expect more formalization and institutionalization of procedures in strong uncertainty avoidance societies than in weak uncertainty avoidance countries.

There is a preference for the existence of individual professional judgement, the maintenance of professional self-regulation, and flexibility in accordance with the perceived circumstances of individual companies in the accounting sub-culture of Anglo-American countries, whereas there is a preference for compliance with prescriptive legal requirements

¹¹ Baydoun and Willett (1995, p. 72) identify a number of problems in testing the Hofstede–Gray theory. They emphasise that many accounting systems are imported from other countries with possibly different cultures. As they state: 'Due to the interference in what would otherwise have been the natural evolution of financial information requirements there are no uncontaminated examples of modern accounting practices in developing countries. Consequently great care has to be taken in using data from developing countries to draw inferences about relevance on the basis of the Hofstede–Gray framework.'

and statutory control, the maintenance of uniform accounting practices between companies, and the consistent application of such practices over time in the accounting sub-cultures of Continental Europe. Also, there is more support in the latter group for a prudent and cautious approach to income measurement to cope with the uncertainty of future events and the confidentiality of the information by restricting disclosures to only those involved with the management and financing of the organization.

These characteristics, in turn, tend to influence the degree of disclosure expected in the respective accounting systems or practices. For example, in France and West Germany, where the level of professionalism is relatively low and the preference for conservatism and secrecy is relatively high, the combined effect on the degree of disclosure will be negative. On the other hand, the collectivist or anti-individualist values of the society require business enterprises to be accountable to society by way of providing information. Therefore, it becomes necessary for the Government to intervene and prescribe certain disclosure requirements, including those in regard to social accounting. Furthermore, this situation is not likely to be rejected by the accounting profession, because here is a preference for compliance with prescriptive legal regulation and statutory control in the accounting subculture. By comparison, in the United States and U.K., although the relatively high level of professionalism and low level of preference for conservatism and secrecy tend to have a positive combined effect on the degree of disclosure in accounting practices, the individualistic values of the society are more concerned with the provision of information to shareholders or investors than those issues involving accountability to society at large.

Baydoun and Willett (1995) used the Hofstede–Gray theory to investigate the use of the French United Accounting System (which was ranked lowly in terms of Professionalism and highly in terms of Uniformity as well as being considered as quite conservative) in Lebanon. According to Baydoun and Willett, following World War I the Allied Supreme Council granted France a mandatory authority over Lebanon. Lebanon was a French colony until 1943 and French troops remained there until 1946. Strong trading relations between France and Lebanon continued to exist and in 1983 the French government sponsored the transfer of the French Uniform Accounting System (UAS) to Lebanon. What was of interest is whether the French system was actually suited to the Lebanese cultural environment. Baydoun and Willett provided evidence to suggest that Lebanon and France ranked in a relatively similar manner in terms of Power Distance and Individualism. However, Lebanon was considered to rank lower in terms of Uncertainty Avoidance and higher in terms of Masculinity. On this basis (and we can refer back to Table 4.2), Baydoun and Willett (p. 81) conclude that 'it would appear that Lebanon's requirements are for less Uniformity, Conservatism and Secrecy in financial reporting practices'. They further state (p. 87):

Assuming that cultural relevance is or should be a factor in determining the form of financial statements, we would expect Lebanese financial statements to be less uniform across time and between entities, to contain more market value information and provide more items of

¹² In undertaking their work, Baydoun and Willett were, in a number of respects, critical of Gray's work. For example, they state (p. 82) that 'all of Gray's accounting values are defined in terms of preferences for particular courses of action, rather than in terms of apparent attributes of financial statements, such as the qualitative characteristics described in the FASB's conceptual framework project'. Also they state that Gray's theory does not clearly indicate what forms of financial statements might be preferred.

disaggregated information. Normal publication dates should be relatively flexible and there should be less call for conservative valuation rules such as lower of cost and market. It would appear that these and other similar prescriptions cannot be tested directly at present. Since 1983 all Lebanese firms have been required to follow UAS and this system has not yet been modified to accommodate any cultural differences between France and Lebanon . . . However, our analysis suggests that modifications along the lines described above either will or should take place in Lebanese accounting in the future.

Religion

A great deal of the culture-based research, particularly that based on the work of Hofstede and Gray, tends to lead to countries being grouped together in terms of both community and accounting subculture—this is perceived as providing guidance in the harmonisation process and, particularly, in identifying limits therein. That is, a feature of the work of Gray is that it relies on indigenous characteristics which are confined within the boundaries of the countries under review. In subsequent work, Hamid, Craig and Clarke (1993) considered the influence of one cultural input or factor, *religion*, on accounting practices. As they indicate, religion transcends national boundaries. They consider how Islamic cultures, which exist in numerous countries, have typically failed to embrace 'Western' accounting practices and they reflect upon how issues of religion had previously occupied minimal space in the accounting literature. They state (p. 134):

The existing literature dealing with the interaction of business activity and Islam needs extending to capture the particular effects which compliance with Islamic beliefs have on the structure of business and finance within an Islamic framework. In particular, the incompatibility of many Western accounting practices with Islamic principles requires explanation. For jurisprudential Islamic law influences the conduct of businesses in a manner not accommodated automatically by Anglo-American accounting practice. And many Western accounting practices draw upon assumptions which conflict with the tenets of Islam . . . There seems to be little understanding that, unlike the Western tradition, fundamental business ethics flow automatically from the practices of the religion, rather than from the codes (mainly of etiquette) devised and imposed upon members by professional associations.

Hamid, Craig and Clarke (1993) point out that the Islamic tradition does have notions of stewardship—but to God rather than to suppliers of equity or debt capital. That is, Muslims believe that they hold assets not for themselves, but in trust for God. There are also other fundamental differences—for example, Islam precludes debt financing and prohibits the payment of interest, and this prohibition has significant implications for processes aimed at the international harmonisation of accounting standards, particularly:

... in-so-far as harmonisation is perceived necessary to entail implementation of many standard Western accounting procedures in which interest calculations are integral. Many past and present Western standards entail discounting procedures involving a time value of money concept, which is not admitted by Islam (p. 144).¹³

¹³ For example, notions of discounting are found in 'Western' accounting standards dealing with employee benefits, lease capitalisation, impairment of assets, and general insurers.

Hence, Hamid, Craig and Clarke (1993) appear to provide a logical argument that religion can have a major impact on the accounting system chosen. Religion can potentially affect how people do business and how they make decisions. As will be seen in Chapter 6, the conceptual framework projects developed in countries such as the United States, Australia, Canada, the United Kingdom and New Zealand (which, interestingly, have all been grouped together by Hofstede), and by the IASB's predecessor (the International Accounting Standards Committee, or IASC), are based on the underlying objective that financial report users require financial information as the basis for making *rational economic decisions* (and what is 'rational' may be culturally dependent). Such rational economic decisions also take into account the time value of money, which necessarily requires considerations of appropriate interest or discount rates. In some societies, such as Islamic states, this may not be a relevant objective. Further, any claims that particular frameworks of accounting are superior to others should only be made after considering the environments in which the frameworks are to be utilised.

Having examined several theories which seek to explain international accounting differences in terms of broad cultural (including religious) influences, we will now move on to explore five of the more concrete institutional factors which some theorists believe influence the shape of accounting practices in any nation at any point in time. As you may appreciate when reading the following sections, these institutional factors are both interrelated and can be linked to the broader cultural influences we have just examined. A useful exercise to help develop your understanding of both the cultural and institutional factors is for you to attempt, while reading the following sections, to associate (in a broad way) the institutional factors we discuss with cultural influences.

Legal systems

The first institutional factor we will examine is the legal systems operating in different countries. These can be divided into two broad categories: common law and Roman law systems. In common law systems, there have historically been relatively few prescriptive statutory laws dealing with many areas of life. Instead, the body of law has been developed by judges applying both the limited amount of statutory law and the outcomes of previous judicial decisions to the facts of a specific case. Each judgement then becomes a legal precedent for future cases. Conversely, in Roman law systems, parliamentary (statutory) law tends to be very detailed and covers most aspects of daily life. The implications of this for accounting is that in common law countries we would expect to find relatively few detailed accounting laws guiding accounting practices, and therefore historically the development of accounting practices would have been left much more to the professional judgement of accountants (and auditors). With Roman law systems, in contrast, we would expect to find a body of codified accounting laws prescribing in detail how each type of transaction or event should be treated in the accounts. In this type of system there was therefore much less need or scope for the use of professional judgement in preparing accounts or developing accounting practices.

As Nobes and Parker (2004) explain, the common law system was developed in England after the Norman Conquest of 1066, whereas the Roman law system was developed in continental European countries. Countries where the development of legal systems and practices were heavily influenced by England tend to have common law systems. These countries include

England and Wales, Ireland, India, the United States, Canada, Australia and New Zealand. Conversely, most continental European countries, along with countries whose legal systems were developed under the influence of these countries, tend to have Roman law systems. Such countries include most members of the EU (other than England, Wales and Ireland) and many countries in other parts of the world which were former colonies of continental European nations.¹⁴

Therefore, in the EU, we would expect England, Wales, Ireland and (partially) Scotland historically to have had relatively few codified accounting laws, with the development of accounting practices being left to the professional judgement of accountants. In the remainder of the EU we would expect accounting practice to have historically been developed through detailed codified accounting laws (or legally recognised regulations) with relatively little input from professional accountants.

Business ownership and financing system

A second key institutional factor which researchers have demonstrated has an impact on the shape of a nation's accounting practices is the business ownership and financing system. Similarly to legal systems, this factor can be broadly divided into two distinct types—this time referred to as 'outsider' and 'insider' systems.

In 'outsider' systems, external shareholders (that is, those who are not involved in the management of the company) are a significant source of finance for much business activity. As these external shareholders will not be involved in the detailed management of the company, and will therefore not have access to the company's detailed management accounting information, they will need to be provided with separate financial accounting information to help them make their investment decisions. They may invest in the shares of a number of companies, and need a basis to evaluate the performance of any company—for example, by comparing it to the performance of other companies. To help ensure an effective and efficient allocation of finance to different companies in this type of outsider-financed system, it is important for external investors (and potential investors) to be provided with financial accounting information which reflects the underlying economic performance of a business in a fair, balanced and unbiased manner. Thus, given the significance of outsider finance, financial accounting will have historically developed with a primary aim of providing this fair, balanced and unbiased information to external shareholders—a process which requires rather extensive use of professional judgement (Nobes, 1998), for example to handle regular developments or innovations in business practices which cannot easily been foreseen when writing accounting codes or legislation.

Conversely, in 'insider' systems of finance, provision of finance by external shareholders is much less significant. Instead, there has either been a dominance of family-owned businesses, and/or the dominant providers of long-term finance have historically been either banks or governments (Zysman, 1983). With family-owned businesses, the owners will tend to have access to the detailed internal management accounting information of the business, so there is no

¹⁴ Nobes and Parker (2004) point out that a very small number of countries (such as Scotland, South Africa and Israel) have developed legal systems which incorporate aspects of both common and Roman law.

obvious need for financial accounts to provide information to aid investment decision making by shareholders. In some countries (such as Germany) where banks have historically been the dominant source of long-term finance for large companies, banks and companies have tended to develop long-term supportive relationships. These involve banks having a representative on the supervisory board of companies to whom they are major lenders, and these representatives are provided with the detailed management accounting information available to all members of the supervisory board. In the case of family-owned businesses, given that the predominant providers of finance are effectively 'insiders' to the business and have access to detailed management information, there will have been little pressure for financial accounting to have developed to provide information to aid external investment decisions in these countries (Nobes, 1998). 15 Nobes and Parker (2004) explain that in systems where governments provide a significant amount of long-term business finance, government representatives will often become directors of the state-funded companies, and will thus have access to the inside management information. Thus, a characteristic shared by all countries in which insider systems of finance predominate is that the primary role of accounting has historically not been to provide fair, balanced and unbiased information to help outside investors make efficient and effective investment decisions. Thus, financial accounting in these countries has developed to fulfil a different role than in outsiderfinanced countries. One such role, which we will explore in the next section, is the provision of information to calculate taxation liabilities.

Countries which have historically been dominated by insider systems of finance have tended also to be countries with Roman law systems, while outsider-financed countries usually have common law systems (La Porta et al., 1997). Thus, most continental European countries (with the exception of the Netherlands, which has a Roman law system but a large amount of outsider finance) have historically relied on insider forms of finance, with the result that financial accounting in these nations did not develop to serve the needs of investment decisions in capital markets. Conversely, the United Kingdom and Ireland (and, importantly, the USA, Australia and New Zealand among other non-European states) have relied to a much greater extent on outsider forms of finance, with a primary role of accounting historically being to service the information needs of capital markets with fair, balanced and unbiased information. ¹⁶

As an example of empirical research linking financing systems with differences in accounting practices, Pratt and Behr (1987) compared the standard-setting processes adopted in the United States and Switzerland. Differences in the standards and processes adopted were explained by differences in 'size, complexity, and diversity of capital transactions, the wide distribution of ownership, and the opportunistic nature of the capital market participants'.

Before leaving our discussion of the impact of different financing systems on the shape of accounting practices, we should emphasise that with the increasing scale of globalised businesses, multinational corporations based in any country are increasingly relying on financing from more than one nation. The funding needs of many of these companies in countries which have traditionally relied upon insider forms of finance have grown beyond the funding capacity of these insider sources of finance, with several companies now increasingly also relying upon

¹⁵ As such, the entities would not be considered to be reporting entities. We address the topic of 'reporting entities' in Chapter 6. Reporting entities produce reports for parties with a stake in the organisation and who are unable to command information to satisfy their specific information needs.

¹⁶ As we will see in the final chapter, many critical accounting theorists strongly disagree that accounting information is fair, balanced or unbiased.

outsider finance—from shareholders in both their home country and in other nations. Thus, the information requirements associated with outsider-financed systems are now becoming applicable to many large companies in continental European countries (Nobes and Parker, 2004).

Taxation systems

As we saw in the previous subsection, in countries with predominantly outsider systems of finance financial accounting practices historically developed to provide a fair, balanced and unbiased representation of the underlying economic performance of a business to help improve the effectiveness of investment allocation decisions by external shareholders. Such a system requires that accounting reflects some sort of economic reality with, for example, each business selecting depreciation methods that most closely reflect the manner in which it uses its fixed assets.

Conversely, in countries with largely insider systems of finance this pressure for financial reports to have developed to reflect fairly some form of underlying economic reality is not present. Rather, financial reports have developed for different purposes, and one important purpose is the calculation of tax (Nobes and Parker, 2004). In most continental European countries which have traditionally relied heavily on insider forms of finance, for a company to claim an allowance for tax this allowance must be included in its financial reports. For example, if a company wishes to reduce its tax liability by taking advantage of the maximum permitted taxable depreciation allowances, it has to include these tax depreciation allowances in its financial reports. These tax depreciation allowances will be determined by taxation law, and will not necessarily bear any relationship to the amount of the fixed assets which have actually been used in any particular year. The financial accounting results will therefore be substantially affected and determined by the provisions of taxation law in many continental European countries which have historically relied upon insider systems of finance.

In outsider-financed countries, the tax accounts have historically been separate from the financial accounts. Thus, if a company wishes to claim the maximum tax depreciation allowances permitted by taxation law in these countries, this will not affect the calculation of its reported profits in its financial reports. These financial accounts can therefore include a fair depreciation charge reflecting the utilisation of assets without affecting the company's ability to claim the maximum tax depreciation allowances in its tax accounts, and the provisions of taxation law have not therefore exerted much influence on the financial accounts.

Given that (with the notable European exception of the Netherlands) there has tended to be a high correlation between insider-financed systems and Roman law countries (La Porta *et al.*, 1997), this has resulted in the detailed provisions of taxation law effectively becoming a large part of the detailed accounting regulations in many continental European countries which have codified Roman law systems. A further institutional factor which tends to be differentiated between, and also reinforces the distinction between, Roman law insider-financed countries and common law outsider-financed systems is the strength of the accounting profession.

Strength of the accounting profession

Nobes and Parker (2004) explain that the strength of the accounting profession in any country has historically both been determined by, and helped to reinforce, the influence on financial

accounting systems of the institutional factors we have discussed above. In a common law country, which has a predominantly outsider system of long-term finance and where tax law has had little influence on financial accounting, there will have been relatively few statutory laws determining the contents of financial reports. The primary purpose of these financial reports will have been to provide a fair, balanced and unbiased representation of the underlying economic performance of the business, and this will have required the exercise of professional judgement to cope with each different situation. Thus, in these countries there will have historically been demand for a large number of accountants who are able to apply professional judgement to determine the most suitable way of reflecting unique sets of transactions and events in financial accounting reports of many companies. This need for accountants who are able to, and have scope to, exercise professional judgement has led to the development of large and strong accounting professions in countries such as the United Kingdom, Ireland, the United States, Australia and New Zealand. As we saw in Chapter 2, strong accounting professions have then been effective in lobbying governments to ensure that accounting regulatory systems give scope for the exercise of professional judgement, thus possibly reinforcing the strength and influence of the accounting profession.

Conversely, in Roman law countries which have largely insider systems of finance and where compliance with the details of tax laws exerts a substantial influence on the shape of financial accounts, there will have been little need or scope for the use of professional judgement when drawing up financial accounting statements. There has therefore been much less impetus for the development of accounting professions than in outsider-financed common law systems. The accounting professions in many continental European countries have therefore historically been smaller and weaker (in terms of influence) than their counterparts in the United Kingdom, Ireland, Australia or the United States. Nobes and Parker (2004) argue that these weaker accounting professions have had an impact in reinforcing accounting practices which require little exercise of professional judgement in these countries, because the effective implementation of flexible, judgemental accounting practices requires a reasonably large accounting profession which is comfortable with (and has sufficient experience of) applying professional judgements to complex accounting issues.

Accidents of history

As indicated at the beginning of this section, accounting systems tend to be regarded as following either an Anglo-American or a continental European model. The cultural and institutional differences we have discussed so far in this chapter support this view, with countries following the Anglo-American model tending to have common law systems, outsider financing, little influence of taxation law on financial accounting and a strong accounting profession accustomed to exercising a considerable amount of professional judgement—with the opposite applying in countries following the continental European model. If we accept that these influences are significant in shaping a nation's accounting practices, we should expect accounting practices in countries with Anglo-American systems to be broadly similar. However, this is not consistent with the evidence presented in the first section of this chapter when, for example, we saw that both the reported profits and the net assets of the multinational pharmaceutical company AstraZeneca were significantly different when calculated in accordance with UK accounting rules than when

calculated in accordance with US rules. If the cultural and institutional influences we have examined so far in this chapter, and which are broadly similar between the United Kingdom and the United States, are significant in shaping accounting practices, then there must be an important additional influencing factor which varies between the United Kingdom and the United States.

Nobes and Parker (2004) point to the importance of the additional factor of 'accidents of history', whose influence will be restricted to the accounting systems of the individual countries affected by the accidents. For example, following the Wall Street Crash of 1929, the United States established Securities Exchange legislation aimed at investor protection, while there was no such development at the time in the United Kingdom. This legislation included certain accounting requirements, which have been delegated to private sector accounting standardsetting bodies, and which have produced a detailed set of US accounting rules (as we would expect to see in a Roman law country). In contrast, following a series of high-profile accounting failures in the United Kingdom in the late 1980s, the United Kingdom has established a more principles-based system of accounting regulation since the early 1990s. As Unerman and O'Dwyer (2004) highlight, in the aftermath of accounting failures at Enron in 2001, it was claimed by many in the United Kingdom that these different regulatory systems would have prevented Enron using in the United Kingdom the creative accounting techniques it followed in the United States. Going back to the case of AstraZeneca, studying the reconciliation provided in the financial reports between the results calculated using UK and US accounting rules, it is apparent that a substantial difference between the two sets of accounting regulations (in the case of this company) arises from differences between the US and the UK accounting treatment of mergers and acquisitions (including the calculation of goodwill). Different pressures in the United Kingdom (possibly including different lobbying efforts by interested parties in each country) resulted in UK and US accounting rules for mergers and acquisitions being somewhat different, although, for reasons we explore when discussing the IASB towards the end of this chapter, these differences are likely to reduce substantially from 2005.

In summarising this chapter so far, we can see that a number of reasons, including culture, religion (which is a subset of culture) and institutional factors (which we could also imagine would be influenced by culture), have been advanced to explain the accounting systems in place in each country. This discussion has by no means been exhaustive in identifying the many factors proposed to explain international differences in accounting systems, but nevertheless the referenced research indicates that one general approach to accounting, such as that used in the United Kingdom, Ireland, the Netherlands, the United States, Australia, New Zealand or Canada, may suit a particular environment, but not others. Therefore, it is probably somewhat naive to claim that there is any one 'best' system of accounting. With this view in mind we can reflect on the following claim. Former Chairman of the US Financial Accounting Standards Board Dennis Beresford was quoted as claiming that the US accounting and reporting system was regarded by many as 'the most comprehensive and sophisticated system in the world' (as quoted in Wyatt and Yospe, 1993). Perhaps in some countries (perhaps the majority) the US system might be considered as sophisticated—but in others it might be considered as quite irrelevant on cultural, religious or institutional grounds.

Despite various factors which seem to provide logical rationale for international differences in accounting practices, there have been extensive efforts over several decades to reduce the differences between accounting systems in different countries. Before we discuss some of these efforts, termed international harmonisation or standardisation of accounting, we will now consider theoretical reasons which have been proposed to explain why international harmonisation or standardisation is important, and reasons why this harmonisation or standardisation might not be desirable or effective.

REASONS FOR HARMONISATION AND STANDARDISATION

Nobes and Parker (2004, p. 77) distinguish between 'harmonisation' and 'standardisation' of accounting. They define 'harmonisation' as:

a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation.

'Standardisation' of accounting is explained as a term which 'appears to imply the imposition of a more rigid and narrow set of rules [than harmonisation]' (p. 77). Therefore, harmonisation appears to allow more flexibility than standardisation, but as Nobes and Parker (2004) point out, the two terms have more recently been used almost synonymously in international accounting.

Nobes and Parker (2004) explain that the reasons for increased international standardisation of financial accounting are similar to the reasons for standardising financial accounting within any individual country. With increased globalisation, these reasons have gained importance in terms of international standardisation. Thus, for example, if investors are increasingly investing in companies from a variety of countries, and these investors use financial reports as an important source of information upon which to base their investment decisions, it is important for them both to understand the financial reports and have a reasonable basis to compare the financial accounting numbers of companies from different countries. Just as is the case domestically (see the arguments in Chapters 2 and 3), both understandability and interpretation of financial accounting information should be more effective if all accounts are compiled using the same set of underlying assumptions—or accounting rules. If a single international investor has to understand numerous different sets of accounting assumptions and regulations, then the task of making efficient and effective international investments decisions is complicated considerably.

If the long-term finance needs of a multinational company are too great for the providers of finance in a single country, then it may need to raise finance on the stock exchanges of more than one country. For reasons of domestic investor protection, the stock exchange regulators in any country are likely to be reluctant to permit a company's shares to be traded on their exchange if that company does not produce financial reports which are readily comparable with the financial reports of all other companies whose shares are traded on that exchange—that is, reports which have been prepared using comparable assumptions (or rules). Where, as in the case of AstraZeneca, a company has to produce financial accounting results in accordance with the accounting rules of each of the stock exchanges where its shares are traded, its accounting procedures would be considerably simplified if there was a single set of internationally recognised accounting rules which were acceptable to all the stock exchanges where its shares are traded. As

these are likely to have to be very similar to the accounting rules used by all other companies whose shares are traded on each of the stock exchanges, it makes sense to utilise a single set of international accounting rules and regulations for all companies listed on any stock exchange—even where companies' shares are traded only on their domestic stock exchange.

A further reason for international standardisation of accounting provided by Nobes and Parker (2004) is that it will facilitate greater flexibility and efficiency in use of staff by multinational firms of accountants and auditors, as different accounting regulations in different countries act as a barrier to the transfer of staff between countries.

OBSTACLES TO HARMONISATION AND STANDARDISATION

So it seems that there are strong reasons for accounting to be standardised internationally. However, as this has not fully happened there must be forces preventing the complete international standardisation of accounting. Some theoretical explanations have been advanced to clarify these obstacles to harmonisation or standardisation.

One key obstacle to international harmonisation or standardisation are the cultural and institutional differences which we saw caused financial accounting to vary in the first place. As argued earlier, if these causal factors continue to vary between countries, then it is difficult to see how a single set of accounting rules will be appropriate or suitable for all countries. That is, as accounting varies between different countries for good reasons (such as cultural, religious or institutional reasons), a key impediment to international standardisation is the fact that these good reasons continue to exist. As an example of this obstacle to harmonisation, Perera (1989, p. 52) considers the potential success of transferring accounting skills from Anglo-American countries to developing countries. He notes:

The skill[s] so transferred from Anglo-American countries may not work because they are culturally irrelevant or dysfunctional in the receiving countries' context.

Perera (1989) also argues that international accounting standards themselves are strongly influenced by Anglo-American accounting models and, as such, these international standards tend to reflect the circumstances and patterns of thinking in a particular group of countries. He argues that these standards are likely to encounter problems of relevance in countries where different environments from those found in Anglo-American countries exist. Thus, for example, if the majority of German companies continue to rely on 'insider' forms of finance, and Germany continues to use a Roman law system, its existing codified accounting regulations will probably be more appropriate for most German companies than the imposition of a form of the Anglo-American accounting system. ¹⁷ Nobes and Parker (2004) suggest that in such circumstances it might be more appropriate to have a dual system, where all companies in each country are required to prepare financial reports in accordance with their historically developed domestic system, and companies which raise funds internationally can prepare an

¹⁷ In a similar way, the imposition of a detailed codified accounting system would not be appropriate for Australia, the United Kingdom, the United States or New Zealand, for example, where the 'outsider' system of finance requires financial accounts to provide fair and balanced information reflecting some form of underlying economic reality.

additional set of financial reports (probably only the consolidated or group accounts) in accordance with Anglo-American-style international accounting rules. 18

A further obstacle to harmonisation has been explained by Nobes and Parker (2004) as the lack of a developed accounting profession in some countries. Thus, as discussed earlier, in countries where strong accounting professions have not developed there are likely to be initial problems implementing international accounting regulations based on the Anglo-American professional judgement model. Furthermore, some countries might have nationalistic difficulties in being seen to implement a system of international accounting standards which are regarded as being closely aligned to the Anglo-American systems.

A final potential and significant obstacle to international standardisation is that, as we saw in Chapters 2 and 3, accounting regulations can and do have economic consequences (Nobes and Parker, 2004). Governments of individual countries may be unwilling to give control over a process which has real economic consequences to an international body over which they have little influence (indeed, this was a concern within Australia, where the AASB's role in developing accounting standards has effectively been transferred to the IASB—although the AASB provides input to the standards being developed by the IASB). We saw how this can impact on the process of international standardisation in Chapter 3, when we examined the recent difficulties which have been experienced with the refusal of some EU countries to endorse fully the provisions of the revised IAS 39, partly because of the potential negative economic impact these provisions might have on banks in their countries.

PROCESSES AND INSTITUTIONS OF INTERNATIONAL ACCOUNTING STANDARDISATION

Examination of the processes and institutions of international harmonisation and standardisation of accounting is much more closely related to accounting practice than to accounting theory, and might therefore be considered to be outside the scope of a book such as this on accounting theory. However, given the importance of recent developments in harmonisation and standardisation of accounting in Australia, New Zealand, the EU and globally, a basic knowledge of the current processes of international accounting standardisation should help in understanding several of the empirical examples we use in this book. The final section of this chapter will therefore briefly examine these processes and institutions of harmonisation and standardisation.

The main institution involved in international standardisation of financial accounting is the International Accounting Standards Board (IASB) and its predecessor the International Accounting Standards Committee (IASC). The IASC was established in 1973 with the objectives of:

formulating and publishing in the public interest accounting standards to be observed in the presentation of financial statements and promoting their worldwide acceptance and observance; and working generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements (IASC, 1998, p. 6).

¹⁸ In this regard, although companies in member states of the EU are required to follow accounting standards released by the IASB, this requirement is restricted to companies listed on a stock exchange.

Its approach to accounting regulation essentially followed the Anglo-American model, but initially many of the International Accounting Standards (IASs) it published permitted a wide range of accounting options. As such, they were not particularly effective at standardising accounting practices internationally, as different companies (or countries) could use substantially different accounting policies while all being able to state that they complied with the single set of IAS regulations. Therefore compliance with IASs did not ensure or enhance the comparability or understandability of financial accounts—a key purpose of accounting regulation—and was not accepted by stock exchanges as a basis of the preparation of financial reports to support a listing on their exchange.

In the late 1980s the International Organization of Securities Commissions (IOSCO), a body representing government securities regulators worldwide, recognised that to foster a greater number of multinationals raising funding from stock exchanges in more than one country it would be useful to have a single set of rigorous international accounting standards—compliance with which would be acceptable to any stock exchange regulated by an IOSCO member. This would then reduce costs of companies that had to produce a different set of financial accounting results for each of the countries in which their shares were listed. However, for IASs to be acceptable for this purpose, they would have to be much more effective at standardising accounting practice, and would therefore need to permit a much narrower set of accounting practices.

Accordingly, the IASC (which subsequently became the IASB) then embarked on a comparability and improvements project to reduce the range of permitted options in IASs, and make them acceptable to IOSCO (Purvis *et al.*, 1991). This project culminated in the publication of a revised core set of IASs by 1999, which was then accepted by IOSCO members—with the important exception of the US Securities Exchange Commission. After this endorsement by IOSCO, any company which drew up its accounts in accordance with the revised IASs could use this single set of IAS-based accounts to support its listing on any stock exchange regulated by any IOSCO member anywhere in the world—with the exception of the United States.

After completion of the core of this comparability and improvements project, the IASC was replaced in 2001 by the IASB, which adopted all existing IASs and from 2001 has published new regulations in the form of International Financial Reporting Standards (IFRSs). The IASB has a structure which is seen to be considerably more independent and rigorous than the former IASC, and comprises 14 full-time members who have to sever their connections with other organisations (including previous employers). They are appointed by a board of '19 trustees, who have promised to operate in the public interest' (Nobes and Parker, 2004, p. 102). A two-thirds majority of the 14 members of the IASB is all that is needed to approve an IFRS (or a revised IAS), and this is regarded as a mechanism likely to ensure that the IASB can develop rigorous regulations which deal with contentious issues, especially where the resultant accounting standard might be unpopular among many companies. Initial membership of the IASB was dominated by accountants from Anglo-American-type accounting nations, and this could reinforce its tendency to develop Anglo-American-style accounting regulations.

¹⁹ When the IASC issued accounting standards they were referred to as International Accounting Standards (IASs). When the IASB now issues accounting standards they are referred to as International Financial Reporting Standards (IFRSs). Many of the IASC's standards are still in existence, although many have been modified or updated by the IASB. These modified standards are still referred to as IASs and retain the same title and number, rather than becoming an IFRS, such that at the international level there are many IASs as well as numerous newly released IFRSs. A list of the currently applicable accounting standards can be found on the IASB's website, which is located at <www.iasb.org>.

Despite these reforms to the IASB, IFRSs/IASs have still not been accepted by the US Securities Exchange Commission as an adequate basis for the preparation of accounts to support a listing on a US stock exchange. However, the IASB and the US standard-setter (the Financial Accounting Standards Board) have been working to reduce the differences between international standards and US accounting standards in what is referred to as its convergence project (Nobes and Parker, 2004).

A key reason why the EU became involved in accounting regulation at the EU level (rather than leaving this entirely to individual member states) is that a founding principle of the EU was freedom of movement within the EU of people, goods and capital. As we saw earlier in this chapter, differing accounting principles in different countries act as an impediment to investors understanding and comparing the financial accounts of companies in these different countries, and thereby act as an impediment to them freely investing their capital in companies from different EU member states (an inhibition to the free movement of capital). The approach towards harmonisation of accounting in the EU has historically differed from the IASC/IASB approach. This should be of little surprise, given that most countries in the EU, by definition, follow a continental European system of accounting rather than the Anglo-American model of the IASC/IASB, so the EU approach to accounting harmonisation has historically been through legislation. This EU legislation has primarily been in the form of EU directives on company law, which have to be agreed on by the EU and then implemented in the domestic legislation of each EU member state. This is a very lengthy process, and during the 1990s the EU recognised that it was far too inflexible to respond to the requirements of a dynamic business environment where financial accounting practices need to adapt quickly to rapidly changing business practices especially for companies which rely on 'outsider' forms of finance (which include an increasing number of the largest companies in many continental European nations).

Following proposals made in 2000, the EU agreed in 2002 that from 1 January 2005 all companies whose shares were traded on any stock exchange in the EU would have to compile their consolidated accounts in accordance with IASs/IFRSs.²⁰ This was seen as a method of both ensuring accounting rules were flexible enough to suit the needs of a dynamic business environment, and ensuring that the financial accounts of EU-listed companies maintained international credibility. Further details regarding the EU adoption of IASs/IFRSs are shown in Accounting Headline 4.2, which reproduces a press release issued by the European Commission when this route for accounting regulation was formally adopted in 2002.

Having read Accounting Headline 4.2, it appears that the views being embraced in favour of the adoption of IASs/IFRSs are based on various beliefs about the information people need in making various decisions (which can be tied back to decision usefulness theories—some of which we consider in Chapters 5 and 6); beliefs about how individuals and capital markets react to accounting information (which can be tied back into behavioural and capital markets research—the topics of Chapters 10 and 11); and a view that the adoption of IASs/IFRSs is in the public interest, rather than being driven by the private interests of particular constituents (and we consider public interest theories and private interest theories in Chapter 3). There also appears to be a view that new accounting methods will be embraced in a similar manner across various countries (which perhaps disregards some of the literature discussed in this chapter—for example, that religion, culture or taxation systems influence the usefulness of various alternative

accounting approaches). It would be hoped that accounting regulators making important decisions in relation to matters such as accounting, as well as commentators that report on actual

Accounting Headline 4.2 EU adoption of IASs/IFRSs

Agreement on International Accounting Standards will help investors and boost business in EU

The European Commission has welcomed the Council's adoption, in a single reading, of the Regulation requiring listed companies, including banks and insurance companies, to prepare their consolidated accounts in accordance with International Accounting Standards (IAS) from 2005 onwards (see IP/01/200 and MEMO/01/40). The Regulation will help eliminate barriers to cross-border trading in securities by ensuring that company accounts throughout the EU are more reliable and transparent and that they can be more easily compared. This will in turn increase market efficiency and reduce the cost of raising capital for companies, ultimately improving competitiveness and helping boost growth. The IAS Regulation was proposed by the Commission in February 2001. It is a key measure in the Financial Services Action Plan, on which significant progress has been made in the last few weeks (see IP/02/796). Unlike Directives, EU Regulations have the force of law without requiring transposition into national legislation. Member States have the option of extending the requirements of this Regulation to unlisted companies and to the production of individual accounts. Although the Commission put forward the IAS

proposal long before the Enron affair, this is one of a series of measures which will help to protect the EU from such problems. Others include the Commission's recent Recommendation on Auditor Independence (see IP/02/723) and its proposal to amend the Accounting Directives (see IP/02/799)

Internal Market Commissioner Frits Bolkestein said: 'I am delighted that the IAS Regulation has been adopted in a single reading and am grateful for the positive attitude of both the Parliament and the Council. I believe IAS are the best standards that exist. Applying them throughout the EU will put an end to the current Tower of Babel in financial reporting. It will help protect us against malpractice. It will mean investors and other stakeholders will be able to compare like with like. It will help European firms to compete on equal terms when raising capital on world markets. What is more, during my recent visit to the US. I saw hopeful signs that the US will now work with us towards full convergence of our accounting standards.

To ensure appropriate political oversight, the Regulation establishes a new EU mechanism to assess IAS adopted by the International Accounting

Standards Board (IASB), the international accounting standard-setting organisation based in London, to give them legal endorsement for use within the EU. The Accounting Regulatory Committee chaired by the Commission and composed of representatives of the Member States, will decide whether to endorse IAS on the basis of Commission proposals.

In its task, the Commission will be helped by EFRAG, the European Financial Reporting Advisory Group; a group composed of accounting experts from the private sector in several Member States.

EFRAG provides technical expertise concerning the use of IAS within the European legal environment and participates actively in the international accounting standard setting process. The Commission invites all parties interested in financial reporting to contribute actively to the work of EFRAG. The Commission recently proposed amendments to the Accounting Directives which would complement the IAS Regulation by allowing Member States which do not apply IAS to all companies to move towards similar, high quality financial reporting (see IP/02/799).

European Commission Press Release, Reference: IP/02/827 Date: 7 June 2002

and proposed accounting changes, should be familiar with the research being undertaken within the academic community—some of which might question the logic or efficacy of various proposals for reform to accounting. Unfortunately, this will not always be the case. Accounting researchers must make an effort to ensure that accounting regulators are aware of the relevance of the research being undertaken.

Despite the European Commission's enthusiasm for the adoption of IASs/IFRSs, there were concerns that, for both legal and political reasons, the EU could not be seen to endorse in advance regulations which could be developed at any time in the future by an international body not under control of the EU (Nobes and Parker, 2004). That is, the EU was unwilling to give a blanket approval covering all future IFRSs (which would apply to many EU companies) without considering the details of these IFRSs. Therefore, as can be seen in Accounting Headline 4.2, the EU established a mechanism whereby each IAS/IFRS would have to be endorsed separately by the EU before becoming mandatory for listed companies in the EU. This endorsement process involves an eleven-member committee entitled the European Financial Reporting Advisory Group (EFRAG), with members drawn from preparers and users of accounts, commenting on each IAS/IFRS to a new EU Accounting Regulatory Committee (ARC). This ARC has a member from each EU state, and votes on whether to recommend approval of the IAS/IFRS to the EU commission, with a two-thirds majority of the 25 members of the ARC required to recommend approval of any IAS/IFRS. This mechanism was used in 2004 to block recommendation of full EU endorsement of IAS 39 (on financial instruments) by governments who argued that aspects of IAS 39 were unrealistic and would have potentially significant negative economic consequences on banks in their nations. It will be interesting to see whether this action by the EU will damage the movement towards international harmonisation and standardisation of accounting, as was argued by some commentators at the time.

Having considered the actions of the EU we can briefly consider the efforts undertaken within Australia to harmonise or standardise Australian accounting practice with international practice. For a number of years the Australian Government was concerned about the differences between Australian accounting standards and their international counterparts. In response to this concern, since 1995 Australia was involved in a process that would harmonise Australian accounting standards with those being released by the IASC. The 'harmonisation process' required Australian accounting standards to be as compatible as possible with IASs, but still allowed some divergence where the Australian treatment was construed to be more appropriate. A document released in 1997 as part of the government's Corporate Law Economic Reform Program (Accounting Standards: Building International Opportunities for Australian Business) discussed the rationale for the harmonisation efforts. It stated (p. 15):

There is no benefit in Australia having unique domestic accounting standards which, because of their unfamiliarity, would not be understood by the rest of the world. Even if those standards were considered to represent best practice, Australia would not necessarily be able to attract capital because foreign corporations and investors would not be able to make sensible assessments, especially on a comparative basis, of the value of the Australian enterprises.²¹

²¹ The view that harmonisation might lead to Australia abandoning particular standards that might represent 'best practice' is very interesting. It implies that harmonisation might lead to systems of accounting that are less than ideal. Also, moving away from 'best practice' obviously has implications for qualitative characteristics such as representational faithfulness and neutrality.

The need for common accounting language to facilitate investor evaluation of domestic and foreign corporations and to avoid potentially costly accounting conventions by foreign listed companies are powerful arguments against the retention of purely domestic financial reporting regimes.

The above view is also consistent with the view provided in Policy Statement 6: *International Harmonisation Policy* (issued in April 1996 by the Australian Accounting Standards Board) which emphasised the need for international comparability of financial statements. As the Policy Statement noted in paragraph 1.2:

The globalisation of capital markets has resulted in an increased demand for high quality, internationally comparable financial information. The Boards believe that they should facilitate the provision of this information by pursuing a policy of international harmonisation of Australian accounting standards. In this context the international harmonisation of Australian accounting standards refers to a process which leads to those standards being made compatible, in all significant respects, with the standards of other national and international standard-setters.

This process led to revised Australian accounting standards which were not the same as those issued by the IASC, but they were very comparable. Once these revisions were almost complete and many new accounting standards had been issued, a decision was then made in 2002 by the Financial Reporting Council (FRC) that Australia would 'adopt' accounting standards being issued by the IASB and no divergence was to be acceptable. This led to yet another set of accounting standards being released for application in 2005. Hence this was a very frustrating time period for Australian accountants—just as they were getting used to a new set of accounting standards that were released to harmonise Australian accounting standards with IASs, such revised (harmonised) standards were then dumped in favour of a standardisation process which involved the adoption of IASs. The Bulletin released by the FRC outlining its direction on the adoption of international accounting standards is reproduced in Accounting Headline 4.3. As can be seen, there is much similarity between the arguments in favour of standardisation provided in Accounting Headline 4.3 and the supporting arguments expressed in Accounting Headline 4.2.

Accounting Headline 4.3 Australia's adoption of IASs/IFRSs

Adoption of International Accounting Standards by 2005

The Chairman of the Financial Reporting Council (FRC), Mr Jeffrey Lucy, AM, today announced that the FRC has formalised its support for the

adoption by Australia of international accounting standards by 1 January 2005.

announced that the FRC has Subject to the Government's formalised its support for the support at the appropriate time

for any necessary amendments of the Corporations Act, this will mean that, from 1 January 2005, the accounting standards applicable to reporting entities under

²² The FRC has an oversight function over the Australian Accounting Standards Board and appoints the nine part-time members. There are 14 members on the FRC.

the Act will be the standards issued by the International Accounting Standards Board (IASB). After that date, audit reports will refer to companies' compliance with IASB standards.

The FRC considered the issue at its meeting on 28 June and formally endorsed the 2005 objective, in line with statements made recently by the Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell. Mr Lucy paid tribute to the Government's strong leadership over the last five years in pressing for the international convergence of accounting standards. This objective is reflected in the Government's 1997 Corporate Law Economic Reform Program initiative (CLERP 1) and amendments made in 1999 to the Australian Securities and Investments Commission Act 2001.

The FRC fully supports the Government's view that a single set of high quality accounting standards which are accepted in major international capital markets will greatly facilitate cross-border comparisons by investors, reduce the cost of capital, and assist Australian companies wishing to raise capital or list overseas.

Mr Lucy said he understood that the 1 January 2005 timing is somewhat later than the Government would have liked. However, it is determined by the decision of the European Union to require EU listed companies to prepare their consolidated accounts in accordance with IASB standards from that date, in support of the EU single market objective. Australia certainly cannot afford to lag [behind] Europe in this regard, Mr Lucy said. He also expressed his support for efforts to encourage the United States to further converge its standards with IASB standards with a view to eventual adoption.

Mr Lucy was pleased to note that the Chairman of the IASB, Sir David Tweedie, had issued a statement in London welcoming the FRC's decision. Sir David said that the FRC's announcement demonstrates growing support for the development and implementation of a single set of high quality global accounting standards by 2005.

'This vote of confidence is a reflection of the leadership role that Australia continues to play in standard-setting, and will increase momentum for convergence towards high quality international standards. The input and active participation of interested parties in Australia and the Australian Accounting Standards Board (AASB), under the leadership of Keith Alfredson, are and will remain a vital element in ensuring the IASB's success. It is through national standard-setters, such as the AASB, and the members of our various committees that we are able jointly to develop high quality solutions to accounting issues, leverage resources to research topics not yet on the international agenda so as to expedite conclusions, reach interested parties throughout the world and better understand differences in operating environments, thus fulfilling our role as a global standard-setter.'

The full statement is available on the IASB's website www.iasb.org.uk.

While there will be a need for business and the accounting profession to adapt to significant changes in some standards, and to some complex new standards, the AASB has been harmonising its standards with those of the IASB for some years, resulting in substantial synergies between the two.

Nevertheless, Mr Lucy urged the accounting bodies to prepare for the changeover through their programs of professional development and their influence on accounting education. He also urged the business community to participate fully in commenting on exposure drafts of IASB standards issued in Australia in the period ahead.

Mr Lucy noted that implementation issues would also need to be considered by the FRC (to the extent they did not involve the content of particular standards) and the AASB between now and 2005. These could relate, for example, to the timing of introduction of particular IASB standards in Australia before 1 January 2005 (which would be AASB standards until that date), as well as to issues of interpretation.

The FRC and AASB will be doing everything they can to keep constituents informed about these issues and to communicate an overall strategy for adoption, Mr Lucy said.

Mr Lucy also confirmed that Australia would be making a substantial financial contribution, through the FRC, to the International Accounting Standards Committee (IASC) Foundation in 2002-03. This contribution will be sourced from funds available to the FRC for the standardsetting process contributed by the Commonwealth, State and Territory governments, the three accounting bodies, the Australian Stock Exchange, and from the Financial Industry Development Account (as announced Senator Campbell on 12 June).

Among the FRC's functions are to further the development of a single set of accounting standards for world-wide use and to promote the adoption of international best practice accounting standards in Australia if doing so would be in the best interests of both the private and public sectors in the Australian economy.

Continued

The IASB, which is based in London, is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in financial statements. In pursuit of this objective, the IASB cooperates with national standard-setters, including the AASB, to achieve convergence in accounting standards around the world.

The AASB has been harmonising its standards with IASB standards for a number of years and is now working in close partnership with the IASB as a liaison standard-setter, aligning its work program with that of the IASB and standing ready to allocate resources to lead or support projects on the IASB agenda. Recently, the AASB issued to its Australian constituents invitations to comment on a number of exposure drafts of IASB standards.

Australians are actively involved in the work of the IASB. Mr Ken Spencer is a member of the oversight body for the IASB, the IASC Foundation Trustees (and Chairman of the Foundation's Nominating Committee). Mr Warren McGregor is a member of the IASB, also designated the Liaison Member for Australia and New Zealand. Mr Kevin Stevenson, a former director of the Australian Accounting Research Foundation, is the IASB's Director of Technical Activities. Australians are also on the IASB's Standards Advisory Council (Mr Peter Day and Mr Ian Mackintosh) and its Interpretations Committee (Mr Wayne Lonergan).

Bulletin of the Financial Reporting Council, 2002/4, 3 July 2002

Chapter summary

In this chapter we identified and considered international differences in accounting practices and we have seen that numerous reasons (generated from different theoretical perspectives) have been advanced to explain such differences (including differences in culture, religions as a subset of culture, legal systems, financing systems, taxation systems, the strength of the accounting profession and accidents of history). Much of the existing research into comparative international accounting questions whether it is appropriate to expect that we will ever have one system of accounting adopted uniformly throughout the world (which has been stated as a long-term objective of the IASB).

While many researchers question the relevance of 'Western-style' accounting standards across all countries, efforts by a number of international organisations are nevertheless continuing to encourage quite culturally disparate countries to adopt IASs/IFRSs. This implies that the members of some international organisations are either unaware of the literature or, alternatively, choose to reject it as irrelevant. As efforts by a number of countries, for example Australia and particular members of the EU, continue in relation to the domestic implementation of international standards, it is to be expected that this debate will continue.

Questions

- 4.1 In the context of financial accounting, what is harmonisation and/or standardisation?
- 4.2 Identify some factors that might be expected to explain why different countries use different systems of accounting.
- **4.3** After considering the Hofstede–Gray model, briefly explain the hypothesised link between society values, accounting values and accounting practice.
- 4.4 Any efforts towards standardising accounting practices on an international basis implies a belief that a 'one-size-fits-all' approach is appropriate. Is this naive?
- 4.5 While it is often argued that within particular countries there should be some association between various value systems and accounting systems, it is also argued (for example, by Baydoun and Willett, 1995) that over time many events would typically have occurred that confound this expected relationship. What type of events might confound the expected relationship?
- 4.6 Baydoun and Willett (1995, p. 72) identify a number of problems in testing the Hofstede–Gray theory. They emphasise that many accounting systems are imported from other countries with possibly different cultures. As they state: 'Due to the interference in what would otherwise have been the natural evolution of financial information requirements, there are no uncontaminated examples of modern accounting practices in developing countries. Consequently great care has to be taken in using data from developing countries to draw inferences about relevance on the basis of the Hofstede–Gray framework.' Explain the point of view being provided by Baydoun and Willett. Do you believe that they are correct?
- 4.7 As noted in this chapter, Hamid, Craig and Clarke (1993) provide an argument that religion can have a major impact on the accounting system chosen by particular countries and that before 'Western' methods of accounting are exported to particular countries it must be determined whether particular religious beliefs will make the 'Western' accounting policies irrelevant. Provide an explanation of their argument.
- 4.8 Nobes (1998) suggests that for countries that have organisations that rely relatively heavily upon equity markets, as opposed to other sources of finance, there will be a greater propensity for such organisations to make public disclosures of information. Evaluate this argument.
- 4.9 In the early 1990s, US Financial Accounting Standards Board's chairperson Dennis Beresford claimed that the US accounting and reporting system was regarded by many as 'the most comprehensive and sophisticated system in the world'. Evaluate this statement. How do you think its validity might have changed in the aftermath of accounting failures at Enron, WorldCom and Andersen in 2001/02? Do you think that the US system would be regarded as sophisticated in all cultural contexts?
- 4.10 Do you think it is realistic to expect that one day there will be internationally uniform accounting standards? What factors would work for or against achieving this aim?

- 4.11 Would you expect that large international companies domiciled in a particular country would adopt different accounting policies from companies that only operate within the confines of that country? Explain your answer.
- 4.12 Evaluate how reasonable it is to assume that the inflow of foreign investment into Australia would have been restricted if Australia, through the decision of the Financial Reporting Council, had not made the decision to apply IASs/IFRSs from 2005.
- 4.13 Explain possible barriers to harmonisation or standardisation of financial accounting across all EU member states. Given these barriers, do you think that the EU has been naive in embracing the standardisation process for all member states?
- **4.14** What are some perceived benefits that flow from the decision that a country will adopt IASs/IFRSs?
- 4.15 On the basis of recent actions to standardise accounting across countries, does it appear that organisations such as the AASB and IASB are ignoring academic research which signals why we would expect to find international differences in financial accounting practices?
- 4.16 Is it appropriate for accounting standard-setting bodies to consider culture and religion when devising accounting regulations, particularly given that the output of financial reporting is expected to be objective and unbiased? Explain your view.
- **4.17** What are some possible reasons for the differences in accounting rules operating within Australia, the United States and the United Kingdom?
- 4.18 The IASC (1998, p. 50) stated that 'many developing and newly industrialised countries are using International Accounting Standards as their national requirements, or as the basis for their national requirements. These countries have a growing need for relevant and reliable financial information to meet the requirements both of domestic users and of international providers of the capital that they need.' Do you think that IASs/IFRSs will provide 'relevant and reliable information' that meets the needs of all financial statement users in all countries?

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