International Financial Accounting and Policy

Worldwide Accounting Diversity

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Worldwide Accounting Diversity

- What is Worldwide Accounting Diversity?
  - Differences in accounting and financial reporting rules between countries.
  - Examples

    Goodwill treatment
    - U.S. - goodwill is an asset on the purchaser's books.
    - Germany - goodwill is often subtracted from stockholders' equity on the purchaser's books.

    Asset Revaluation treatment
    - U.S. - upward revaluation of fixed assets is not allowed.
    - UK - upward revaluations are allowed and sometimes required.

    Inflation Accounting
    - U.S. & UK - financial statements are not adjusted for inflation.
    - Latin American countries - experience significant inflation, financial statements are adjusted for changes caused by inflation.

Problems Caused by Accounting Diversity

Consolidated financial statements

- U.S. MNEs often have subsidiaries in a large number of countries.
- Accounting records in local GAAP and local currency are consolidated into U.S. GAAP. - Require conversion from local to U.S. GAAP.
- Require translation from the local to U.S. currency.

Difficulties with access to foreign capital markets

- Companies often need to go outside their home country in order to access financing.
- Raising foreign capital often requires reconciliation to comply with different accounting rules or needs of investors and creditors.

Non-comparability of financial statements

- International investors need to make their own reconciliations or adjustments to financial statements.
- International investors also must face differing levels of disclosure, quality of accounting standards, and quality of auditing.

Environmental Factors Leading to Accounting Diversity

Legal systems - Common law

- Fewer statutes and more interpretation by courts to apply laws to specific situations.
- Leads to the creation of precedents or case law.
- Found most often in Great Britain and other English-speaking countries.
- In these countries, the source of accounting rules tends to be non-governmental organizations.

Legal systems - Code law

- Characterized by relatively more statutes or code law.
- Found more often in non English-speaking countries.
- Accounting rules in these countries tend to be legislated (i.e., the source is the government).

Environmental Factors Leading to Accounting Diversity

Providers of financing

- In many countries major sources of capital are families, banks, and the government.
- Accounting and disclosure in those countries tend to be less important.
- In the U.S. and UK the providers of financing are diverse shareholders, so accounting and disclosure are more important.

Inflation

- Some countries have historically high rates of inflation.
- Accounting in these countries often requires adjustments to offset the impact of inflation. - This is common in Latin American countries.
- Given extended periods of low inflation in the U.S., inflation accounting is not required.

Political and economic ties

- These linkages tend to make information sharing easier.
- Nations that share relationships often have similar accounting systems.

Financial Reporting System Classification - Accounting Clusters

Fair presentation / full disclosure

- Gives primacy to the information needs of investors.
- Most descriptive of the UK.

Legal compliance

- Accounting heavily influenced by tax rules and needs of government.
- Commonly found in continental Europe.

Inflation-adjusted

- Similar to the legal compliance approach.
- Is distinguished by the requirement for adjustments to mitigate the effects of inflation.

The Influence of Culture on Financial Reporting - Hofstede's Cultural Dimensions

Individualism (vs. Collectivism)
- Degree of interdependence among individuals in a society.
- More interdependence equates to less individualism (more collectivism).

Power Distance
- Level of acceptance of unequally distributed power within and across the society's institutions and organizations.

Uncertainty Avoidance
- Degree to which members of a society feel threatened by uncertain or unknown situations.

Masculinity
- Emphasis on traditional masculine values of performance and achievement vs. feminine values of relationship, caring and nurturing.

Long-term Orientation
- The extent to which the society values persistence, thrift, observing order and respect for tradition.

The Influence of Culture on Financial Reporting - Gray's Accounting Values

Professionalism vs. Statutory Control
- Professionalism is reflected by individual professional judgment and self-regulation of the profession.
- Statutory control focuses on legal compliance and legislative control of the profession.
- The former is more indicative of the UK and the latter more so with continental Europe.

Uniformity vs. Flexibility
- Uniformity indicates preference for standardized accounting methods.
- Flexibility is reflected in the varying of accounting practices for differences between companies.
- UK approaches are examples of flexibility.

The Influence of Culture on Financial Reporting - Gray's Accounting Values

Conservatism vs. Optimism

- Conservatism indicates preference for caution and prudence.
- Optimism tends more toward fair presentation.
- Germany has traditionally reflected a strong tendency toward conservatism.

Secrecy vs. Transparency

- Secrecy reflects a preference for minimal information disclosure.
- Transparency reflects openness and full disclosure.
- Countries with predominantly family-owned and bank financed firms tend toward secrecy.

International Differences in Financial Reporting

Nobes' model

- Describes international differences as a function of culture and the system of financing.
- Culture influences the development of the system of financing which influences the development of accounting.
- Uses two classifications, A and B.

Class A Accounting

- Descriptive of Anglo-Saxon countries.
- Strong outside shareholder equity-financing.
- Optimism & Transparency.

Class B Accounting

- Descriptive of continental Europe.
- Less widespread outside shareholder equity-financing.
- Conservatism & Secrecy.

International Differences in Financial Reporting

- **What is FDI net inflows / outflows?**
  - FDI net inflows are the value of inward direct investment made by non-resident investors in the reporting economy. This is usually reported for a given year.
- **Inward investment stock**
  - This is the total accumulated level of foreign direct investment in a country.

Additional differences between countries

- Different financial statement formats.
- Level of detail in financial statements varies between countries.
- Terminology, level of disclosure, and rules governing recognition and measurement.
- Different financial statements included in the annual report.


Thank you!