

# Reasons for international differences in financial accounting

International Accounting and  
Financial Analysis  
-Prof. Dr. Cornelia Scott

Gaurav Bhatia : 5027013

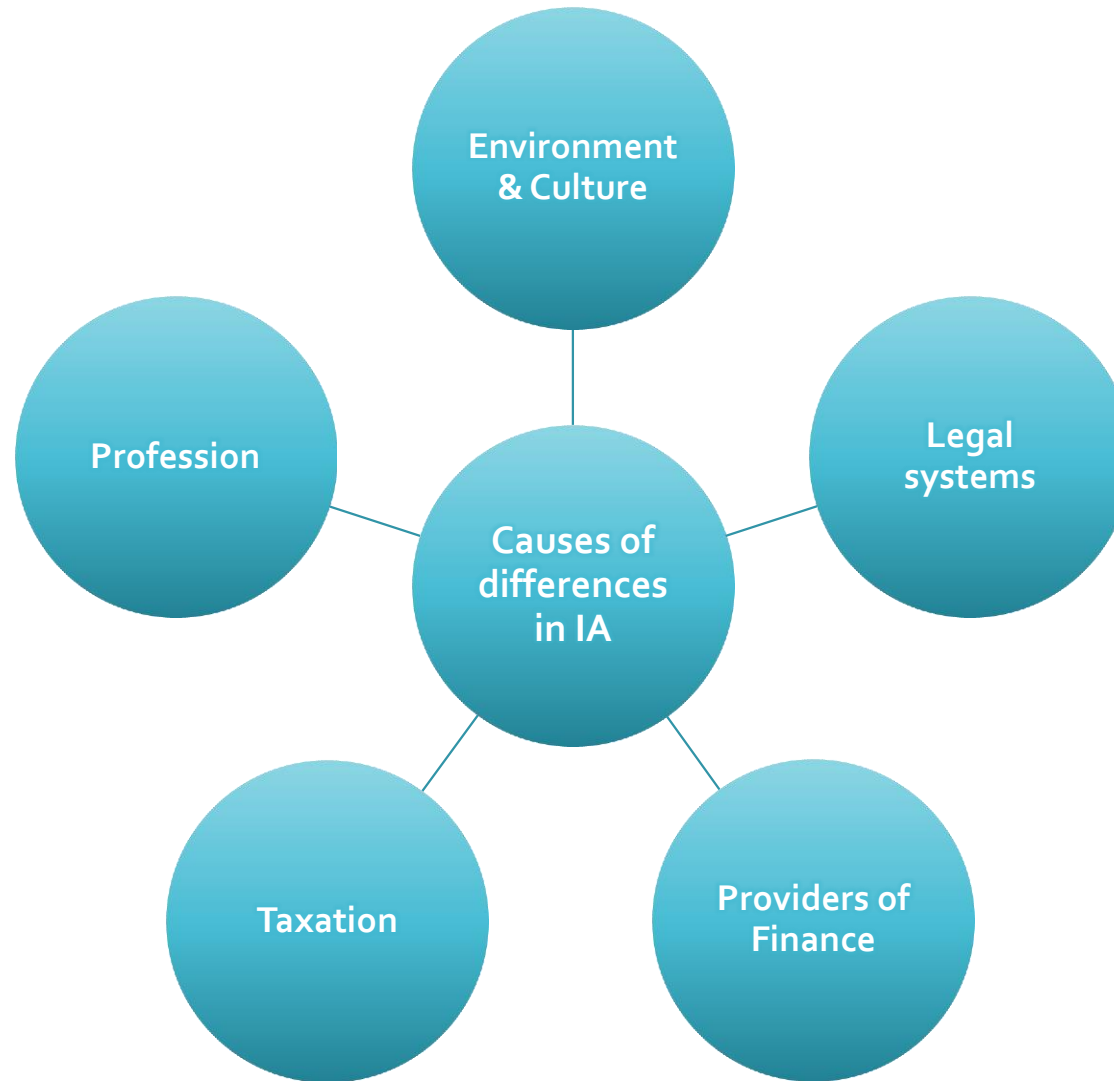
# Contents

- Introduction
- Causes of difference in International Accounting
- Accounting Convergence
- Summary
- Future Scope

# Introduction: Financial Accounting

- A series of standards developed by independent organizations (standard setters).
- To keep record of all the transactions, to see how money flows in and out.
- Preparation & disclosure of F/S of commercial, industrial and business companies in public and private sectors.
- To provide information to outsiders such as investors, creditors, suppliers and customers.

# Causes of difference in International Financial Accounting



Source: Source: Cornelia Scott, "International Accounting and International Financing Script", Hochschule Anhalt, accessed on 10/02/2021 at 21:30.  
C. Nobes, R. Parker, Comparative International Accounting, (2008), p 25-37, accessed on 11/02/2021 at 10:15.  
Hofstede, Geert. "Cultural dimensions in management and planning." Asia Pacific journal of management 1.2 (1984): 81-99, accessed on 11/02/2021 at 10:20.

# Environment and Culture

- Culture is the collective programming of the mind which distinguishes the members of one human group from another.
- Based on a study of over 100,000 IBM employees in 39 countries, Hofstede defined and scored the basic dimensions of Culture:

Individualism versus collectivism

Large versus small power distance

Strong versus weak uncertainty avoidance

Masculinity versus femininity

# Environment and Culture

Fundamental issue addressed: degree of independence.

## Individualism vs Collectivism

- A preference for a loosely knit social framework in society.
- Individuals are supposed to take care of themselves and their immediate families only.

- A preference for a tightly knit social framework in society.
- Individuals can expect their relatives, clan, or others to look after them in exchange for unquestioning loyalty.

# Environment and Culture

Fundamental issue addressed: how society handles inequalities among people.

## Large Power Distance vs Small Power Distance

- People in societies accept a hierarchical order, everybody has a place which needs no further justification.
- Members of the society accept that power is distributed unequally.

- People in societies strive for power equalization, and demand justification for power inequalities.
- Members demand reasons for power inequalities.

# Environment and Culture

Fundamental issue addressed: how society deals with the uncertainty & ambiguity in the future.

## Strong Uncertainty Avoidance vs Weak Uncertainty Avoidance

- Societies maintain rigid codes of belief and behavior.
- Societies are intolerant towards deviant persons and ideas.

- Societies maintain a more relaxed atmosphere.
- Practice counts more than principles, and deviance is more easily tolerated.



# Environment and Culture

Fundamental issue addressed: how society allocates social roles to the sexes.

## Masculinity vs Femininity

➤ A preference in society for:

- Achievement
- Heroism
- Assertiveness
- Material success

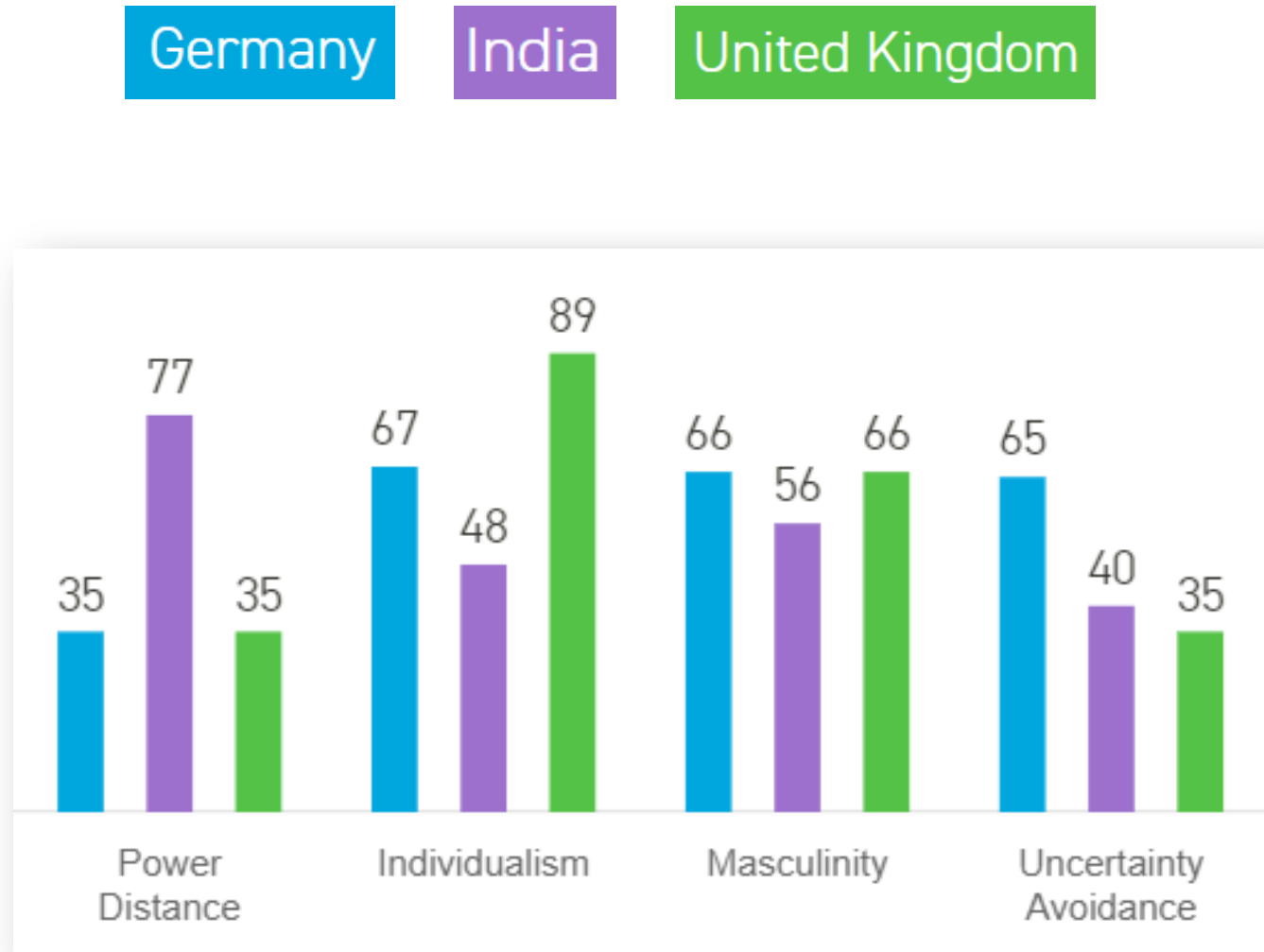
➤ A preference in society for:

- Relationships
- Modesty
- Caring for the weak
- Quality of life

# Hoefstede Model

The country scores on the dimensions are relative.

Overview of the drivers of the cultures relative to other country cultures.



# Legal Systems

Based on the societal values, Gray(1988) has identified these significantly related accounting values.

Gray (1988) applies these cultural differences to explain international differences in the behavior of accountants and therefore in the nature of accounting practices.

## Professionalism vs Statutory Control

- Accountants adopt independent attitudes & exercise individual professional judgment.
- Professional self-regulation.

- Accountants comply with prescriptive legal requirements.
- Maintenance of statutory control.

# Legal Systems

Based on the societal values, Gray has identified these significantly related accounting values.

## Uniformity vs Flexibility

- Code law, every case is treated in the same way (typically prescriptive, detailed and procedural), e.g. Germany, France.
- Uniform accounting practices between companies and the consistent use of such practices over time.

- Common law, develops case by case and does not prescribe general rules, for e.g. USA, UK.
- Accountant themselves establish rules for accounting practices, known as standards or regulations.

# Legal Systems

Based on the societal values, Gray has identified these significantly related accounting values.

## Conservatism vs Optimism

- Cautious approach to accounting measurement to cope with uncertainty of future.
- Prudence principle: Profits are not accounted for until realized but once losses are anticipated they are accounted for, e.g. France, Germany.

- A more optimistic & risk-taking approach to cope uncertainty of future.
- Accrual principle: Once profits are anticipated they are accounted, and losses are recognized when they are incurred, e.g. USA, UK.

# Legal Systems

Based on the societal values, Gray has identified these significantly related accounting values.

## Secrecy vs Transparency

- Confidentiality and the restriction of disclosure of information about the business.
- Companies in code law countries are hesitant to disclose information, e.g. Germany.

- More transparent, open and publicly accountable approach of disclosure of information.
- Companies in common law countries have higher levels of disclosures, e.g. USA, UK.

# Providers of Finance

- According to Zysman, countries can be grouped into types by financial system:

Capital market systems (USA, UK)

Credit-based governmental systems (France, Japan)

Credit-based financial institution systems (Germany)

- These three types could be simplified further into 'equity' and 'credit' based financing.

# Providers of Finance

## Equity/outside vs Credit/insiders

- Equity based financing
- Many outside shareholders
- Separate accounting and tax rules
- Encourages flexibility, judgement & fairness
- Gearing ratio:  
U.S.A (98.03), U.K (107.07)

- Debt based financing
- Core, insider shareholders
- Tax dominates accounting rules
- Encourages precision, uniformity & stability
- Gearing ratio:  
Germany(236.35), Spain (240.26)



# Taxation

- In most of the code law countries, the tax rules are accounting rules. As a result, the problems related to deferred taxation are very low.
- In these countries, it is due to the pervasive influence of codified law and due to the predominance of tax authorities as users of accounting.
- On the other hand, most of the common law countries have different accounting and tax rules.
- This leads to problems related to deferred tax, and a considerable amount of accounting standard documentation.

# Profession

- The level of each professional accountant's education and experience directly cause international differences in the application of accounting standards.
- The auditing profession is large in common law countries as compared to code law countries.
- Professional accountants in developing countries may not have relevant experience in exercising judgement, particularly in issues related to complex accounting standards.

Source: C. Nobes, R. Parker, Comparative International Accounting, (2008), p 32-37, accessed on 12/02/2021 at 20:10.

# Accounting Convergence

- The International Accounting Standards Board (IASB) develops International Financial Reporting Standards (IFRSs) with the objective of achieving comparable financial reporting across countries.
- The challenge, which the IASB has to overcome in the convergence process, is to eliminate both the de jure (consistency in form or rules) and de facto (consistency in actual application) differences in accounting practices between nations.
- International regulators and the bodies vying for accounting convergence have to consider the relationship between the national and organisational cultures of a country adopting IFRSs and those formulating IFRS.

# Summary

- Reasons for difference in International Accounting are discussed.
- The factors causing differences in international accounting seem to be largely dependent rather than independent.
- Even if the countries converge with IFRS, accounting standards may not be applied & interpreted in a consistent manner.

Source: Chand, P., Patel, C., & Day, R. (2008). Factors causing differences in the financial reporting practices in selected south pacific countries in the post-convergence period. Asian Academy of Management Journal, 13 (2), (2008), p 121-125, accessed on 13/02/2021 at 20:00.

C. Nobes, R. Parker, Comparative International Accounting, (2008), p 32-37, accessed on 13/02/2021 at 22:10.

# Future Scope

- The IASB and other regulators, both national and international, need to work towards reducing these differences and help facilitate the process of de facto not just de jure accounting convergence.
- Identify differences between other regions and countries in the post-convergence period, and to empirically test the interaction of the proposed factors.
- Understanding and eliminating the differences across various jurisdictions, until then effective convergence will just be a myth, rather than a reality.

Thank you!