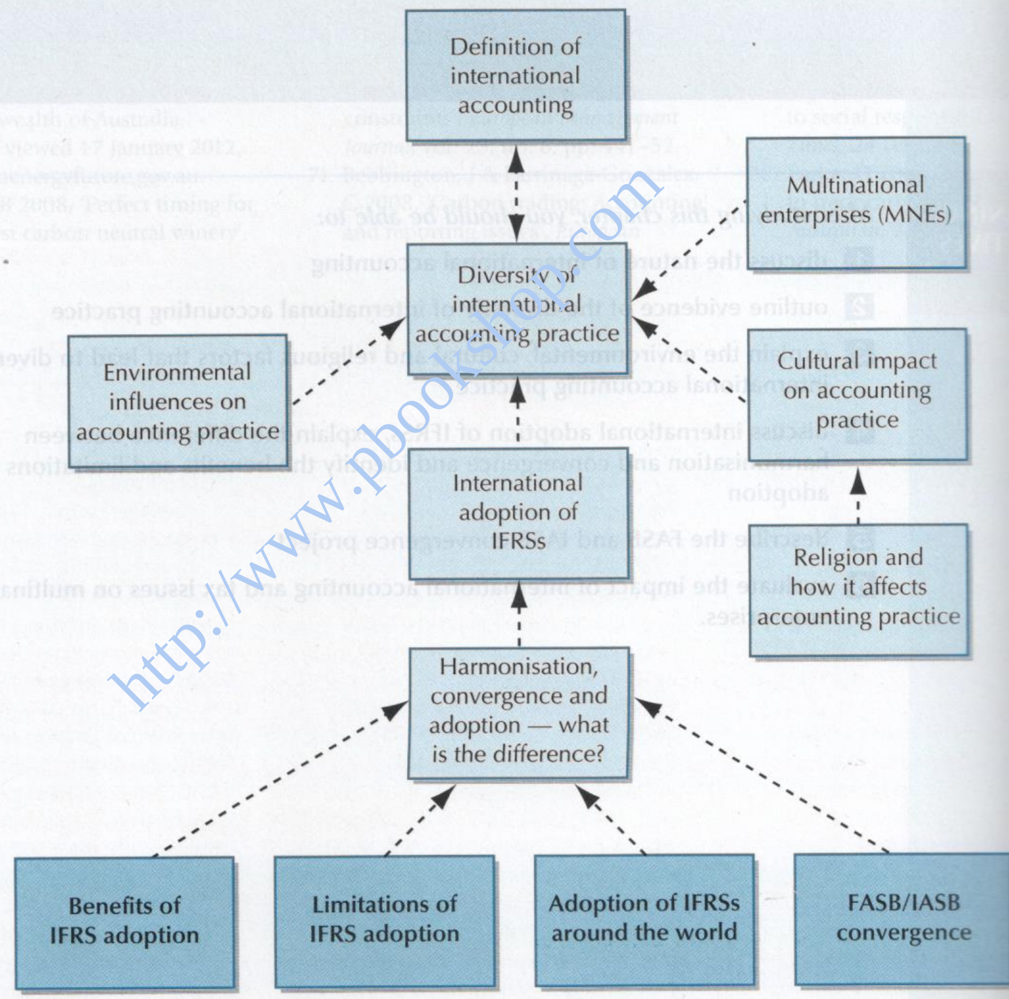
12 International accounting

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. discuss the nature of international accounting
2. outline evidence of the diversity of international accounting practice
3. explain the environmental, cultural and religious factors that lead to diversity of international accounting practice
4. discuss international adoption of IFRSs, explain the difference between harmonisation and convergence and identify the benefits and limitations of IFRSs adoption
5. describe the FASB and IASB convergence project
6. evaluate the impact of international accounting and tax issues on multinational enterprises.


Definition of international accounting
Multinational enterprises (MNEs)
Diversity of international accounting practice
Environmental influences on accounting practice
Cultural impact on accounting practice
International adoption of IFRSs
Religion and how it affects accounting practice
Harmonisation, convergence and adoption — what is the difference?
Benefits of IFRS adoption
Limitations of IFRS adoption
Adoption of IFRSs around the world
FASB/IASB convergence

International business in the twenty-first century is increasing rapidly. There is increasing foreign investment and capital markets are opening up in countries that were previously closed, such as China. Accountants and managers need to keep up to date with the changing accounting and financial complexities of doing business on a global stage and the regulations that impact on financial reporting of their business activities globally.

This chapter introduces international accounting and highlights a range of issues that impact on financial reporting around the world. It starts with an explanation of what is meant by international accounting. This is followed by a discussion of the global environment of financial accounting, including examples of internationally diverse accounting practices, and how culture, legal and environmental factors influence accounting at a national level. Adoption of International Financial Reporting Standards (IFRSs) is then explored. Lastly, we examine how the global regulatory and reporting environment affects the operation of multinational enterprises, and the challenges that foreign currency transactions place on business activities.

LO 1 DEFINITION OF INTERNATIONAL ACCOUNTING

International accounting refers to a description or comparison of accounting in different countries and the accounting dimensions of international transactions. While it encompasses financial accounting, management accounting, auditing, taxation and management accounting systems, this broad range of areas is beyond the scope of this chapter, so we restrict our examination to external financial reporting.

Doupnik and Perera note that international financial reporting can be defined at three levels:

1. supranational, universal or world accounting;
2. the company level standards, guidelines and practices that companies follow relating to their international business activities and accounting for foreign subsidiaries; and
3. comparative or international accounting.[1]

Universal or world accounting is the largest in scope and relates to standards, guidelines and rules issued by supranational organisations such as the Organisation for Economic Co-operation and Development or the International Federation of Accountants. Under this definition accounting is considered a universal system that can be adopted by all countries. Practices and principles would be applicable to all countries.[2] As we will discuss later in this chapter, over the last ten years we have been moving closer to achieving a goal of international standardisation of accounting practices and principles, with over 100 countries adopting IFRSs in addition to the convergence project between the International Accounting Standards Board (IASB) and the United States Financial Accounting Standards Board (FASB).

Company-level accounting is the definition of international accounting with the narrowest focus and relates to the accounting process required to account for a range of international transactions, including parent-foreign subsidiary consolidations, accounting for foreign investments and foreign currency transactions.

Comparative accounting is the study of rules, standards and guidelines that exist in different countries, and a comparison of these items across countries. Comparative accounting considers the diversity of accounting practices across the globe and assesses the impact of these diverse practices on financial reporting.[3]

It is important to understand the differences in accounting practices across a range of countries. Such practices can impact on multinational enterprises when expanding their operations or seeking foreign investment, and can contribute to our [illegible] the accounting standard convergence process. In this chapter, we examine [illegible] factors that can lead to different accounting practices.

LO 2 DIVERSITY OF INTERNATIONAL ACCOUNTING PRACTICE

Accounting practices can differ substantially across countries. For example, [illegible] United States are not permitted to capitalise any research and development [illegible] while entities in Australia are permitted to capitalise development costs if [illegible] tions are met. Property, plant and equipment in Australia must be recorded [illegible] cost, while European entities are permitted to use market values.

A variation in accounting requirements can result in significant [illegible] recorded in company accounts when they are required to report under the [illegible] ferent jurisdictions. Westpac Banking Corporation in its 2007 annual report [illegible] note reconciling its report prepared in accordance with Australian accounting [illegible] ments (A-IFRS) to United States generally accepted accounting principles [illegible] Net profit as reported under A-IFRS was $3 451 000 000, while according [illegible] it was $3 824 000 000 — a difference of nearly $375 000 000 or 10% of [illegible] December 2007, the US Securities and Exchange Commission (SEC) [illegible] foreign companies listed on the New York Stock Exchange (NYSE) that [illegible] IFRSs no longer had to reconcile to US GAAP. As a result, Westpac Banking [illegible] and other multinational corporations which list on the NYSE only have [illegible] set of accounts, thus decreasing costs of preparation.[5]

While there have been some moves to harmonise (or converge) accounting [illegible] globally, there are still a number of environmental and cultural factors [illegible] to lead to diversity in accounting practices around the world.

LO 3 ENVIRONMENTAL INFLUENCES ON ACCOUNTING

Internationally, accounting is influenced by a range of economic, political, [illegible] social factors. These environmental influences are represented in figure [illegible] national level, accounting systems will be influenced by the taxation system, [illegible] finance, the political system, the stage of economic growth and development, [illegible] development of a capital market, the legal system, the existence of an accounting [illegible] sion and the nature of accounting regulation. All of these influences are [illegible] impact on financial reporting in different countries.

The taxation system can affect accounting practice in countries [illegible] reports are used to determine an entity's tax liabilities. This is the situation [illegible] Japan and Germany for example. On the other hand, in Australia, the [illegible] and the United States financial statements are adjusted for tax purposes, [illegible] reports being sent to taxation authorities. In Germany, the expense [illegible] ation purposes is the same expense used to calculate financial income. [illegible] German entities are more likely to use accelerated depreciation methods [illegible] income and minimise tax. In Australia, which adopts IFRSs, different [illegible] rates are permissible. While an entity may use accelerated depreciation [illegible] poses, a straight-line method might be used to calculate financial income. [illegible] ferences will lead to deferred income taxes. Accounting rules are generally [illegible] tax laws.[6]

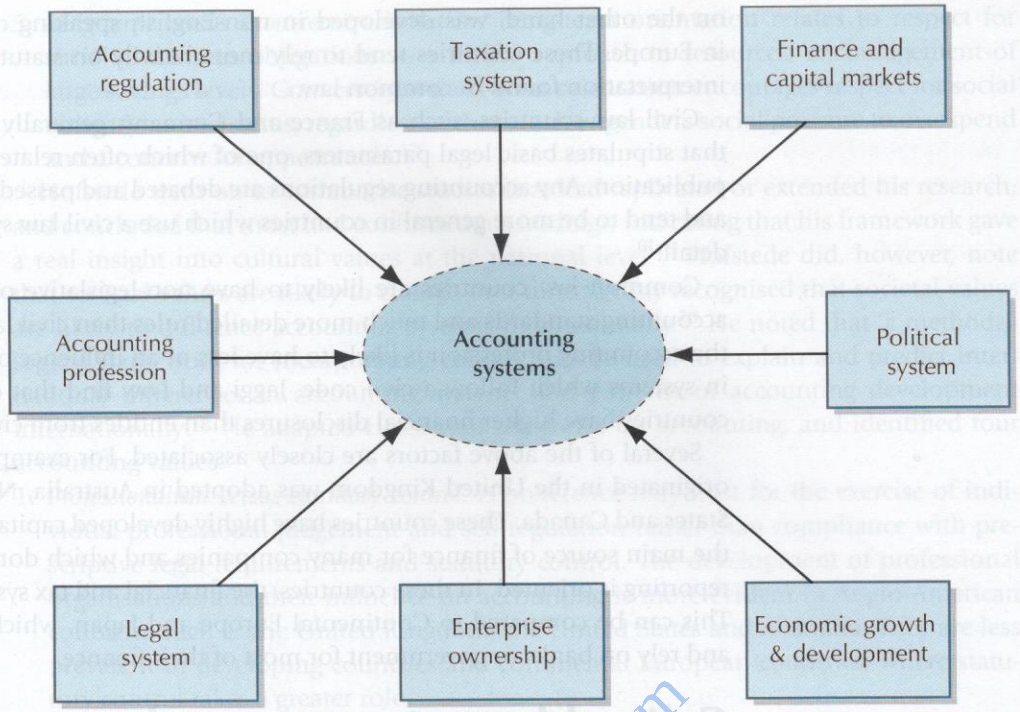


FIGURE 12.1 Environmental influences on accounting

Source: Adapted from Lee Radebaugh, Sidney Gray & Ervin Black, *International accounting and multinational enterprises*.[7]

Sources of finance differ across countries. Major sources of finance include banks, government, families and shareholders.[8] In Germany, for instance, the majority of finance is obtained from banks, while in the United States funds are more likely to be raised through share issues on the stock exchange. In this case, there is going to be greater levels of information disclosure to external shareholders. This also relates to the extent to which the capital market has been developed. A highly developed capital market will mean there are many external users of accounting information, which will affect accounting disclosure practices. A difference in sources of finance will often lead to a difference in financial statement orientation, with shareholders more interested in profits (an income statement focus), and banks placing a greater emphasis on solvency and liquidity (a balance sheet focus).[9]

The political system in place also plays a large role in the nature of the accounting system, which will reflect political philosophies and objectives. Similarly, the extent of economic growth and development and the nature of the economic system will influence the accounting practice. A change from a predominantly agricultural economy to a manufacturing economy — for example, as is the case in China — will pose challenges relating to leasing and depreciation of machinery.

When enterprises are owned by a larger range of external shareholders, in comparison to high levels of family or state ownership, it may be expected that public disclosure will be greater. Where state ownership is prevalent — for example, in China — the state is likely to influence the nature of accounting requirements.

The legal system plays a significant role in corporation law and accounting regulation. There are two major legal systems — common law and codified Roman law (often referred to as civil law). Common law, which originated in England, relies on a limited amount of statute law, which is interpreted by the courts, resulting in case law. Civil law, on the other hand, was developed in non-English speaking countries and originated in Europe. These countries tend to rely more heavily on statute law, without the common law interpretation found in common law.

Civil law countries, such as France and Germany, generally have a corporations law that stipulates basic legal parameters, one of which often relates to financial statement publication. Any accounting regulations are debated and passed by a national legislature and tend to be more general in countries which use a civil law system, with little specific detail.[10]

Common law countries are likely to have non-legislative organisations developing accounting standards and much more detailed rules than civil law countries.[11] Similarly, the accounting profession is likely to have less of an influence on accounting regulation in systems which follow a civil code. Jaggi and Low find that entities in common law countries have higher financial disclosures than entities from civil law countries.[12]

Several of the above factors are closely associated. For example, the legal system that originated in the United Kingdom was adopted in Australia, New Zealand, the United States and Canada. These countries have highly developed capital markets which provide the main source of finance for many companies and which dominate the way financial reporting is oriented. In these countries, the financial and tax systems operate separately. This can be compared to Continental Europe and Japan, which have civil law systems and rely on banks or government for most of their finance.

Cultural impact on accounting practice

In addition to economic and political determinants, national culture has increasingly been recognised as a factor that influences diversity of accounting systems. The term 'culture' has traditionally been used in sociology and anthropology to explain different societal systems.[13] Harrison and McKinnon incorporated culture into a proposed framework for analysing changes in financial reporting regulation at a national level.[14] Gray further proposed a theoretical framework, again incorporating culture, that could be used to explain international differences in accounting systems.[15] The work is based on earlier research by Hofstede who, in his original work, identified four cultural dimensions that could be used to describe general characteristics of cultures around the world.[16] In subsequent work, Hofstede added a fifth cultural dimension. These dimensions are as follows:

1. *Individualism versus collectivism.* **Individualism** relates to a preference for a loosely knit social framework where individuals take care of themselves and their immediate family. In this system families tend to be nuclear rather than extended. **Collectivism** refers to a preference for a tightly knit social framework where relatives or clans look after each other and there is a large amount of loyalty amongst relatives.
2. *Large versus small power distance.* **Power distance** refers to the extent to which members of society view power in organisations as distributed unequally. People in large power distance societies accept there is a hierarchical order in place and this is not questioned. Conversely, in a small power distance society people look towards equality and seek justification for any power inequalities.
3. *Strong versus weak uncertainty avoidance.* **Uncertainty avoidance** refers to how comfortable members of society are with uncertainty and ambiguity. Strong uncertainty avoidance societies tend to have rigid codes of belief and behaviour. Weak uncertainty avoidance societies are happy to tolerate uncertainty and do not attempt to control the future.
4. *Masculinity versus femininity.* Masculinity relates to a preference for assertiveness, achievement and material success, while societies with feminine traits have a preference for nurturing and caring for the weak.

5. *Long-term versus short-term orientation.* Long-term orientation relates to respect for social and status obligations — a thrifty approach to resources, encouragement of large savings levels. Conversely, a short-term orientation encourages respect for social obligations and status, regardless of the cost. It engenders social pressure to overspend and a concern for appearances.[17]

Hofstede went on to summarise studies that had replicated or extended his research, and concluded that most had confirmed his findings, indicating that his framework gave a real insight into cultural values at the national level.[18] Hofstede did, however, note that societal values are likely to change over time.[19] Gray recognised that societal values are likely to influence accounting systems internationally.[20] He noted that 'a methodological framework for incorporating culture may be used to explain and predict international differences in accounting systems and patterns of accounting development internationally'.[21] He adapted Hofstede's categories for accounting, and identified four accounting values:

1. *Professionalism versus statutory control.* A preference may exist for the exercise of individual professional judgement and self-regulation rather than compliance with prescriptive legal requirements and statutory control. The development of professional organisations and their influence on accounting is more evident in Anglo-American countries such as the United Kingdom, the United States and Australia. They are less prevalent in developing countries and continental European countries, where statutory control takes a greater role.
2. *Uniformity versus flexibility.* A preference may exist for the enforcement of uniform accounting practices between companies and for the consistent use of such practices over time, compared to flexibility in accordance with the perceived circumstances of individual companies. Some countries have well established uniform accounting plans and tax rules for measurement purposes. France is an example. In contrast, in the United States there is a greater need for flexibility and inter-company comparability.
3. *Conservatism versus optimism.* A preference may exist for a cautious approach to measurement so as to cope with the uncertainty of future events, as opposed to being optimistic and taking risks. Conservatism or prudence in asset measurement and reporting of profits is a fundamental principle of accounting. However, conservatism varies according to country, ranging from a strongly conservative approach in Europe to a less conservative and to some extent risk-taking approach in the United Kingdom and the United States.
4. *Secrecy versus transparency.* This reflects a preference for confidentiality and disclosure only to those who are most closely involved with management and financing, as opposed to a more transparent, open and publicly accountable approach. While conservatism relates to the measurement function of accounting, secrecy relates to the disclosure function. Disclosure practices vary across countries, with lower levels generally evident in Japan and Europe than in the United Kingdom and Australia.[22]

The accounting values with the greatest association to accounting disclosure and financial reporting are conservatism and secrecy. Countries that require limited disclosures in financial statements (high secrecy) are expected to be more conservative in measuring assets and liabilities. According to Gray, this would include less-developed Latin countries such as Mexico.[23] Conversely, Anglo countries, such as the United States, Australia, the United Kingdom, Canada and New Zealand, sit at the opposite end of the spectrum, with low levels of conservatism (or high optimism) and low levels of secrecy (or high transparency). Doupnik and Tsakumis conduct a comprehensive review of research that has tested Gray's theory of cultural relevance. The authors find much support for Gray's framework in the literature.[24]

In a study of accounting systems in a developing country, Baydoun and Willett … that accounting systems in developing countries have been imported from the … through a number of mechanisms, including colonialism through western multinational companies and the influence of professional associations and loan agencies. The … examine the relevance of the French Unified Accounting System (UAS) in Lebanon … apply the Hofstede-Gray scheme to analyse the system's usefulness. They conclude … distinction needs to be made between accounting measurement and accounting … sure, and it may well be the disclosure aspect of an accounting system that is most … to fail to satisfy the needs of users in developing countries.[25]

Religion and how it affects accounting practice

Religion is often seen as a subset of culture and can have a significant effect on … practice in some jurisdictions. This is particularly true of Islam. Two aspects … relationship between Islam and accounting:

1. Islamic law regulates all aspects of life, and accountants must perform their … accordance with the rules and regulations of Islam.
2. In addition to providing a set of business ethics, certain Islamic economic and … cial principles have a direct impact on accounting practices. In particular, these … the obligation to pay *zakat* (a religious levy) and prohibition on *riba* (usury) … institution of an interest-free economic system.[26]

Under Islam, it is incumbent on the Islamic state to guarantee a minimum … food, clothing, shelter, medical care and education.[27] To guarantee a fair … living, *zakat* is the most important instrument for the redistribution of wealth. … compulsory levy which is collected by the state or Islamic banks, where a *zakat* … established.[28]

The one aspect of Islamic economics that is probably most controversial … Western accounting and finance perspective is the prohibition of interest (*riba*) … taking of interest as it would normally occur in a Western finance system is … so investors are compensated by other means.[30]

Muslims cannot compartmentalise their behaviour into religious and … dimensions — including business and commerce — and their actions are always … by Islamic law.[31] Values reflected in Islamic law include: *iqtisad* (moderation), … tice), *amanah* (honesty) and *infaq* (spending to meet social obligations). … there are a number of negative values that should be avoided: *zulm* (tyranny), … *iktinaz* (hoarding of wealth) and *israf* (extravagance).[32]

The Accounting and Auditing Organization for Islamic Financial Institutions … — a standard-setting body based in Bahrain — has been active in developing … accounting standards which consider the transactions carried out by Islamic … institutions. These have been considered by the Malaysian Accounting Standards … (MASB), which has developed a range of accounting standards dealing with … accounting and reporting. With MASB's move to convergence with IFRSs, a decision … been made by the MASB to issue further guidance for Islamic-based transactions … nical releases instead of accounting standards.[33]

LO 4 INTERNATIONAL ADOPTION OF IFRSs

After examining worldwide accounting diversity and some of the factors that … to that diversity, it becomes apparent that this diversity creates challenges for … tional business operations and investment. It is costly for multinational … restate their accounts to meet the requirements of every jurisdiction in which …

listed. Investors also incur costs in comparing results of companies when their financial reports are prepared using different rules. International investment is also likely to be reduced as the risks of investing across borders increase with inconsistencies associated with accounting diversity.

As a result, accounting standard setters and governments have been under pressure to reduce diversity and align accounting requirements worldwide. In this section the efforts of the IASB towards international harmonisation or convergence are discussed. The difference between these terms can sometimes be confusing, so we will start with a definition of harmonisation, convergence and adoption. The benefits and limitations of adoption of IFRSs are also discussed.

Harmonisation, convergence and adoption — what's the difference?

A number of different terms are used when discussing the implementation of a common accounting system worldwide. Harmonisation can sometimes mean different things to different people. To some it refers to adoption or standardisation, where the one set of accounting standards are adopted around the globe, whereas others see harmonisation as a reduction of alternatives while maintaining a degree of flexibility.[34] Harmonisation implies reconciling different points of view and reducing diversity, while allowing countries to have different sets of accounting standards. Harmonisation leads to increased communications in a form that can be interpreted and understood internationally.[35] It is a process that takes place over time.

Convergence, while also a process that takes place over time, implies the adoption of one set of standards across the globe. This is often referred to as 'adoption' and 'standardisation'. The predecessor to the IASB — the International Accounting Standards Committee (IASC) — was working towards an objective of harmonisation. However, with the formation of the IASB in 2001, the focus changed to one of global adoption of accounting standards.

Benefits of IFRS adoption

There are a range of advantages to IFRS adoption. Many countries, and developing nations in particular, do not have well codified accounting standards. Adoption of IFRSs is a cost-effective way to institute a comprehensive system of accounting standards.[36] Adoption of IFRSs would also enhance the operation and globalisation of capital markets. Financial statements would be more comparable, making it easier for investors to evaluate a range of investment opportunities. This would lead to a reduction in risk to investors through international diversification.[37]

IFRS adoption would reduce the costs of financial report preparation when companies seek to cross-list on multiple exchanges. This would enhance the ability of multinational firms to access less expensive capital in other countries, as well as reducing the costs associated with investors acquiring a company's shares.[38] Further, it would reduce the cost of preparation and audit of consolidated financial statements.

Limitations of IFRS adoption

Zeff questions the desire for international comparability of accounting practices through IFRS adoption or convergence. He indicates that enhancing comparability may be difficult to achieve for a number of reasons, primarily concerning differences in business, financial and accounting culture from one country to another.[39] The diversity of legal and political systems across the world was discussed earlier in the chapter. One of the greatest obstacles to global adoption of IFRSs is the magnitude of these differences, and the costs involved in overcoming them, if indeed they should be overcome through convergence. Zeff cites as an example the different business customs and corporate structures that exist.[40] For example, in Japan and Korea companies tend to encompass networks of entities with interlocking relationships where it is not clear which is the holding company.[41] As such, it could be questioned whether an accounting standard on consolidated financial statements could be applied to provide comparability with financial reports of companies operating in other countries with clear hierarchical relationships between holding companies, or parent entities and subsidiaries.

Fair value accounting is becoming more common in IFRSs. However, in many countries there may not be asset pricing markets with sufficient depth to generate a reliable fair value measure.[42] In this case, artificial methods are likely to be used in order to meet the accounting standard requirements, which may produce figures that lack comparability.

As discussed previously, religion can also be a factor that affects accounting practices. This presents a challenge to harmonisation or convergence. Any move towards uniformity of accounting standards conflicts with 'the economic, social and cultural contexts of different accounting systems, and even with some manifestations of national sovereignty'. The purpose of financial reporting in Islamic organisations is different to that proposed by the IASB. In its framework, the IASB highlights that the purpose of financial reporting is to provide information to assist resource providers to make decisions about the allocation of scarce resources. They also assume a profit motive. This is contrary to the purpose of accounting and reporting in the Islamic system, where businesses operate with an ethical motive.[44]

As noted above, the primary benefits of IFRS convergence are to enhance the operation and globalisation of capital markets by making financial statements more comparable and therefore making it easier for investors to evaluate a range of investment opportunities. This implies that everyone wants to invest on global markets or seek foreign investment. While convergence might be beneficial for large multinational entities and institutional investors, it is unlikely to benefit entities which operate only in one jurisdiction and do not seek international sources of funds through global markets. For these entities, the increased compliance costs would likely outweigh the benefits of convergence. Therefore, whether it is appropriate in some instances to override local accounting rules with global standards that do not consider country-specific legal and political circumstances is questionable.

Finally, even if worldwide adoption of IFRSs eventuates, the range of reporting and measurement options available under some IFRSs can mean there is limited comparability of reporting practices.

Contemporary Issue 12.1 outlines the perceived benefits of IFRS adoption in Asia.

12.1 CONTEMPORARY ISSUE

Adopting IFRS in Asian countries vital

As Sri Lanka is complying with International Financial Reporting Standards (IFRS) by 2011, it is important to create a better understanding of the challenges and solutions prepared for comparative financial statements by 2010.

IFRS by 2011

- Increased benefits having a commonly understood financial reporting framework supported by strong globally accepted standards
- Mixed picture in cost of equity capital in Europe
- IFRS to drive organizations through the journey of implementing standards successfully

Get Through Guides (GTG) CEO, Vandana Saxena said that there were numerous misunderstandings about the different IFRS in local Generally Accepted Accounting Principles (GAAP) and many people believe that the conversion will only affect the finance function.

Asia was the first to recover from the global finance meltdown. Therefore, adopting the IFRS in Asian countries is vital, as it will have a conducive effect over the world's economy in the near future, she said.

She said that as the forces of globalization prompt more countries to open their doors to foreign investments and expand business the public and private sectors have increasingly recognized the benefits of having a commonly understood financial reporting framework supported by strong globally accepted standards.

The IFRS adoption in Europe was fairly smooth and it helped the companies to enhance their management reporting in an effective manner.

The benefits viewed by Indian professionals noted that comparability and credibility was high with the enhanced conducive investment environment.

Enhanced business opportunities and easy access to finance are the other benefits in adopting the IFRS to the Indian financial statements, Saxena said.

Source: Excerpts from 'Adopting IFRS in Asian countries vital', *Daily News (Sri Lanka)*.[45]

Questions

1. Outline the benefits of adoption of IFRSs in Sri Lanka. J K
2. What are the challenges expected to be faced by the country in adopting IFRSs from 2011? J

Adoption of IFRSs around the world

Table 12.1 lists a selection of IFRS users around the globe. The information is adapted from a more complete table updated by Deloitte's annually. A number of countries are in the process of adopting IFRSs, including Canada, which adopted from 2011, and Malaysia, which will adopt from 2012.

Jurisdictions will have differing degrees of convergence with IFRSs. In some jurisdictions (e.g. Australia) IFRSs are required for all corporate reporting for listed and unlisted entities. By contrast, in others, IFRSs are required for consolidated reporting of listed entities, while unconsolidated reporting is still *allowed* to use national rules (e.g. Denmark, the Netherlands and the United Kingdom) or is *required* to use national rules (e.g. Belgium, France and Spain).[46]

Nobes develops a theory for the motives and opportunity for the emergence of different national variants of IFRS practice. He suggested that the environmental factors — financial systems, legal systems and taxation systems — that have previously been associated with international differences in accounting still can be used to explain differences in IFRS adoption practices across jurisdictions.[47]

Use of IFRSs

Europe

From 2005 all EU listed companies have been required to adopt IFRSs for reporting purposes. EU member states can extend this to non-listed companies, which has been carried out by most member states.[48] As noted above, some either require or allow national standards for unconsolidated reporting.

From December 2008, for non-EU companies listed on EU stock exchanges, the EU designated the GAAP from a range of countries including the United States, Australia, Japan, Canada and Korea to be equivalent, so any companies reporting under these jurisdictions do not have to prepare separate EU accounts.[49]

TABLE 12.1 A selection of IFRS users around the globe

Location	IFRSs not permitted	IFRSs permitted	Required for some domestic listed companies	Required for all domestic listed companies
Abu Dhabi (UAE)				X
Argentina	X (d)			From 2012
Australia				X (c)
Austria				X (a)
Bangladesh	X			
Bermuda		X		
Brazil				From 2010
Cambodia	No stock exchange. Companies may use IFRSs.			
Canada				From 2011
Chile				X
China		(k)		
Czech Republic				X (a)
Dubai (UAE)				X
Fiji				X
France				X (a)
Germany				X (a)
Haiti		X		
Hong Kong				X (c)
India	X (i)			
Indonesia	X			
Iran	X			
Iraq				X
Israel		All except banks		
Japan		X		
Kenya				X
Malaysia	X (d)			
Maldives		X		
Mexico		X (d)		From 2012
Morocco		Non-banks	Banks	
New Zealand				X (c)
Pakistan	X			
Papua New Guinea				X
Philippines	X (e)			
Russia	X			
Saudi Arabia			X (j)	
Singapore	X (d)(e)			
South Africa				X
Sri Lanka	X			

Location	IFRSs not permitted	IFRSs permitted	Required for some domestic listed companies	Required for all domestic listed companies
Taiwan	X (h)			
Thailand	X			
Turkey		X (f)		
United Kingdom				X (a)
United States	X (g)			
Vietnam	X			
Zimbabwe		X		

Notes:
(a) Audit report and basis of presentation note to the financial statements refer to IFRSs as adopted by the European Union (EU).
(b) By law, all companies must follow IFRSs approved by the local government, and approval is not up to date with the Standards and Interpretations issued by the IASB.
(c) Local standards identical to IFRSs, but some effective dates and transitional provisions differ.
(d) All domestic listed companies must use IFRSs starting 2012.
(e) Most IFRSs adopted, but various significant modifications were made.
(f) Turkish companies may follow English versions of IFRSs, or Turkish translation. If the latter, because of the translation delay, audit report and basis of presentation refer to 'IFRSs as adopted for the use in Turkey'.
(g) SEC permits foreign private issuers to file financial statements prepared under IFRSs as issued by the IASB without having to include a reconciliation of the IFRS figures to US GAAP.
(h) Plan announced for full adoption of IFRS starting 2013, including financial institutions supervised by the Financial Supervisory commission of Taiwan except for credit cooperatives, credit card companies and insurance intermediaries who will be required to adopt Taiwan-IFRS starting 2015.
(i) Phasing in of IFRSs for listed companies 2011 to 2014.
(j) All listed banks and insurance companies must use IFRSs.
(k) The new Chinese Accounting Standards for Business Enterprises (CAS) were published by the Ministry of Finance (MoF) in 2006 and became effective on 1 January 2007. These standards are substantially converged with IFRSs, except for certain modifications (e.g., disallow the reversal of impairment loss on long term assets) which reflect China's unique circumstances and environment. In April 2010, the MoF released the roadmap for continuing convergence of CAS with IFRSs. The CASs are now mandatory for entities including PRC-listed companies, financial institutions (including entities engaging in securities business permitted by China Securities Regulatory Commission), certain state-owned enterprises, private companies in certain provinces. In the roadmap, the MoF has indicated its intention to have all large and medium-sized enterprises (regardless whether they are listed companies or private companies) adopt the new CAS by 2012. In December 2007, the HKICPA recognized CAS equivalence to HKFRS, which are identical to IFRSs, including all recognition and measurement options, but have in some cases different effective dates and transition requirements. From then the CASC and HKICPA together with the IASB, created an ongoing mechanism to reinforce continuously such equivalence. In December 2010, the Hong Kong Stock Exchange decided to allow mainland-incorporated companies listed in Hong Kong to have an option to present financial statements using CASs and audited by an approved mainland audit firm. A number of such companies have chosen to present financial statements using CASs for annual reporting. The EU Commission permits Chinese issuers to use CAS when they enter the EU market without adjusting financial statement in accordance with IFRS endorse by EU.

Source: Adapted from Deloitte Touche Tohmatsu, *IFRS in your pocket 2011*.[50]

Canada

Publicly accountable Canadian entities are required to apply IFRSs from 1 January 2011; however, earlier use is permitted upon approval of the securities regulator.

South America

Use of IFRSs has developed across the region. Chile phased in IFRSs use by listed companies in 2009. Brazil required use of IFRSs by listed companies and banks in 2010 and Mexico will start phasing in use from 2012. IFRSs are already required in a number of other Latin American or Caribbean countries such as Bermuda.[51]

Asia–Pacific region

Asian jurisdictions take a range of approaches to IFRS adoption. IFRSs have [illegible] national GAAP in Mongolia, while in Hong Kong, Australia, Korea and New [illegible] national standards are virtually word for word the same as IFRSs. The Philippines [illegible] Singapore have adopted nearly all IFRSs but have made significant modifications.[illegible]

In India, Malaysia, Pakistan and Thailand some IFRSs have been adopted [illegible] however, significant differences exist for others. India is moving towards full [illegible] in the future — between 2012 and 2014 — while Malaysia will adopt IFRSs as [illegible] Financial Reporting Standards by 2012.[53]

While there has been extensive adoption of IFRSs around the world, some [illegible] whether convergence of accounting standards actually leads to convergence of [illegible] practices.[54] Research shows that the institutional differences in culture, legal, [illegible] political and socioeconomic systems may in fact lead to non-comparable [illegible] figures despite similar accounting standards.[55] This concern is likely to be [illegible] nounced in emerging economies, such as China, where accountants, auditors [illegible] lators do not have the expertise to support compliance.[56] This issue has been [illegible] in China as a case of an emerging and transitional market economy.[57] Peng et al. [illegible] out that standards developed by the IASB are primarily aimed at countries with [illegible] developed capital markets, and it can be questioned whether the resulting [illegible] are optimal for developing and transitional economies that lack the infrastructure [illegible] monitor financial reporting decisions.[58]

The Chinese capital market has increased rapidly since it was established [illegible] early 1990s, where it comprised 14 companies. This has risen to 1488 companies [illegible] the end of 2006.[59] The market at the end of 2006 was the eighth biggest in the [illegible] with a market capitalisation equivalent to US$500 billion.[60] The rapid expansion [illegible] the desire to attract foreign investment has provided an incentive for the Chinese [illegible] ernment to put in place measures to improve the quality of financial reporting.[illegible] Chinese share market is segmented into A-share and B-share markets. A-shares [illegible] owned and traded only by Chinese citizens, while B-shares can be owned and [illegible] only by foreign investors.[62] Companies which issue both A-shares and B-shares [illegible] required to supply two sets of annual accounts — one in Chinese GAAP and the [illegible] in accordance with IFRSs.

China has made substantial changes to Chinese GAAP since 1992 in an effort [illegible] verge domestic standards with IFRSs. Since 1992, China has issued four sets of [illegible] regulations (in 1992, 1998, 2001 and 2006), with each replacing the previous [illegible] The standards are considered to increasingly conform to IFRSs.[63] However, research [illegible] found little relationship between Chinese GAAP and IFRS-based net income for [illegible] listed companies in both 1992 and 1998.[64] Peng et al. and Chen and Zhang find the [illegible] of convergence has improved with the advent of the 2001 standards.[65]

LO 5 FASB AND IASB CONVERGENCE

Any moves towards global adoption of IFRSs are dependent upon whether the [illegible] States adopts or converges with IFRSs. One issue that has stood in the way of [illegible] to date is a differing underlying 'philosophy' of the two standards. While the IASB [illegible] dards are '**principles-based**', the FASB have previously taken a '**rules-based**' [illegible] to standard setting. However, while the SEC and FASB in United States were [illegible] reluctant to embrace IFRSs, there have recently been moves towards convergence.

The IASB and FASB formed the *Norwalk Agreement* — a memorandum of [illegible] — in 2002, aimed at removing any differences between international standards [illegible]

US GAAP. In the interim, the SEC requirement for non-US companies that use IFRSs to provide a reconciliation to US GAAP when they list on US securities exchanges was removed from 2007. It is generally thought that US GAAP reconciliations were looked upon as a 'mostly futile and expensive exercise',[66] which acts as a barrier to entry for foreign companies seeking to list on the US securities exchanges. Most investors were not relying on the reconciliation to US GAAP in their investment decisions and instead were using IFRSs.[67]

The convergence commitment was further strengthened in 2006 when the FASB and IASB set milestones to be reached by 2008.[68] While the two boards are still progressing towards convergence, there have been delays and the milestones outlined in 2006 were not reached. In 2008, the two boards issued an update to the memorandum of understanding, which identified a series of priorities and milestones to complete the remaining major joint projects by 2011.[69]

In June 2010, the standard setters jointly announced a modification to their convergence strategy as a result of concerns about the number of draft standards due for publication over a short period of time. While the June 2011 target date was still set to complete those projects for which the need for improvement of IFRSs and US GAAP is the most urgent, a later completion date was given to those projects with a relatively low priority or for which further research and analysis is necessary.

The convergence project is continuing, with priority projects as at 2011 including:

- financial instruments
- leases
- revenue recognition
- consolidations
- fair value measurement
- derecognition
- insurance contracts.

Other projects include:

- post-employment benefits
- joint ventures
- financial statement presentation
- financial instruments with characteristics of equity
- emissions trading schemes.[70]

LO 6 MULTINATIONAL ORGANISATIONS

As indicated previously, multinational enterprises are particularly affected by the range of environmental factors and accounting systems in the different countries in which they operate. As such they face a range of issues not faced by domestic entities.

Multinational enterprises (MNEs) can be differentiated from domestic enterprises because they operate simultaneously in a number of countries. They tend to be larger and have more complex business operations than their domestic counterparts.

MNEs operate across different countries with often different legal, tax and reporting requirements, and different currencies. They are likely to have a large number of intra-corporate transactions between their operating units located in different countries. Internally, decision-making authority is likely to be delegated to subsidiary managers who can respond to local conditions. However, this practice is difficult to manage where subsidiary managers are required to meet operational and reporting requirements in their respective countries which might not align with the organisational culture. Any strategic decisions need to consider the national culture in which the MNE subsidiaries operate.

When looking to globalise business operations an entity needs to decide to what extent decision making should be held in a few key centres, or spread across a large number of units.

As we previously saw, taxation systems can vary significantly across the globe. MNEs face the challenge of understanding how their operations are taxed in the countries in which they operate. Countries can offer tax incentives to either attract foreign investors or to encourage export of goods and services.

MNEs need to consider inter-corporate transfer pricing — the pricing of goods and services that are transferred between members of a corporate family. These transfers can relate to raw materials, finished goods, loans, fees and allocation of fixed costs. There may be differing internal and external factors that influence transfer prices. Transfer pricing can be a management control tool designed to maximise performance, obtain financial efficiencies and minimise costs or maximise profits. This may not align with external motivations stemming from tax laws in the various countries in which the MNE operates, however. Contemporary Issue 12.2 outlines some tax challenges facing MNEs relating to taxation of internal transactions.

12.2 CONTEMPORARY ISSUE

Survey finds multinationals facing new tax challenges

Multinationals are facing new tax challenges due to growing transfer pricing (TP) scrutiny by world's tax authorities, according to a survey.

The survey by international accounting firm Ernst & Young found a dramatic increase in the scope of TP documentation required by governments with penalties imposed more frequently and at higher levels when multinationals get it wrong.

Given the need for governments to raise revenues in this challenging economic climate and the changing regulatory environment, the study anticipates heightened litigation in the near future.

The expectation is driven by the almost universal trend towards increased TP investigation resources within tax authorities, it said, adding that this trend is also shared by Malaysia.

'As governments search for tax revenues to offset growing budget deficits, many are sharpening their focus on compliance, enforcement and legislative approaches,' said Ernst & Young Malaysia's partner and head of transfer pricing, Janice Wong.

Source: Excerpts from 'Survey finds multinationals facing new tax challenges', *Organization of Asia-Pacific News Agencies*.[71]

Questions

1. How can multinationals use transfer pricing to minimise their taxation burden? K
2. Why do you think taxation authorities would get involved in transfer pricing? J K

Summary

LO 1

Discuss the nature of international accounting

- There are a number of views of the meaning of international accounting. International accounting can be defined at three levels:
  1. supranational, universal or world accounting
  2. the company-level standards, guidelines and practices that companies follow relating to their international business activites and accounting for foreign subsidiaries
  3. comparative or international accounting.

LO 2

Outline evidence of the diversity of international accounting practice

- Accounting practices can differ substantially across countries. A variation in accounting requirements can result in significant differences being recorded in company accounts when they need to report under the rules of different jurisdictions.

LO 3

Explain the environmental, cultural and religious factors that lead to diversity of international accounting practice

- Accounting systems at a national level will be influenced by:
  - the taxation system
  - sources of finance
  - the political system
  - the stage of economic growth and development
  - the stage of development of a capital market
  - the legal system
  - the existence of an accounting profession
  - the nature of accounting regulation.
- In addition to economic and political determinants, national culture has increasingly been recognised as a factor that influences diversity of accounting systems.
- Religion is often seen as a subset of culture, and can have a significant effect on business practice in some jurisdictions.

LO 4

Discuss international adoption of IFRSs, explain the difference between harmonisation and convergence and identify the benefits and limitations of IFRSs adoption

- Harmonisation implies reconciling different points of view and reducing diversity, while allowing countries to have different sets of accounting standards. It leads to increased communications in a form that can be interpreted and understood internationally.
- Convergence, a process that takes place over time, implies the adoption of one set of standards across the globe.

- Adoption of IFRSs is a cost-effective way to institute a comprehensive system of accounting standards. Adoption of IFRSs would enhance the operation and global-isation of capital markets. Financial statements would be more comparable, making it easier for investors to evaluate a range of investment opportunities.
- One of the greatest obstacles to global adoption of IFRSs is the magnitude of these dif-ferences and the costs involved in overcoming them. Critics question the real benefits that can be achieved from IFRS adoption on a global scale, citing the current existence of a well-developed global capital market.

LO 5

Describe the FASB and IASB convergence project

- The IASB and FASB formed the *Norwalk Agreement* — a memorandum of understanding — in 2002, aimed at removing any differences between international standards and US GAAP.
- In December 2007, the SEC announced that foreign companies listed on the New York Stock Exchange which accounted under IFRS no longer had to reconcile to US GAAP.

LO 6

Evaluate the impact of international accounting and tax issues on multinational enterprises

- MNEs operate across different countries with often different legal, tax and reporting requirements, and different currencies.
- MNEs are likely to have a large number of intra-corporate transactions between them operating units located in different countries.
- MNEs need to consider transfer pricing when pricing goods and services that are trans-ferred between members of a corporate family.
- Transfer pricing can be a management control tool designed to maximise performance, obtain financial efficiencies and minimise costs or maximise profits.

Review questions

1. Outline and differentiate the various definitions of international accounting.
2. Explain the environmental factors that lead to national differences in accounting.
3. What are the two main legal systems operating worldwide? How might these affect accounting?
4. Countries that rely on capital markets for finance, as opposed to banks and governments, are likely to expect greater levels of public disclosure in their accounting systems. Evaluate this argument and provide examples.
5. Outline and discuss three cultural aspects that can differ across countries. How do these cultural differences relate to differences in accounting systems?
6. What does accounting harmonisation mean? Differentiate harmonisation from convergence or adoption.
7. Explain the benefits of global adoption of IFRSs.
8. What are advantages of having one set of accounting standards worldwide?
9. What are the limitations of global adoption of IFRSs?
10. Outline the key challenges of US GAAP and IFRS convergence.
11. What is transfer pricing and how does it affect the operation of MNEs?

Application questions

12.1

Visit the website of the IASB and FASB and read the documents relating to US GAAP and IFRS convergence. Prepare a summary of the progress to date and the timelines for future convergence. K

12.2 The New York Stock Exchange (NYSE) is the largest exchange in the United States. Visit the website of the NYSE, www.nyse.com, and determine the number of foreign companies listed on it. Choose three of these companies and analyse their latest financial reports, available from the companies' websites. Document how the companies have addressed the difference, if any, between their reporting requirements for United States purposes and those for their home jurisdiction. Why would foreign companies have gone to the effort of listing their shares on the NYSE and the expense of preparing separate financial statements in some cases? J SM

12.3 Find the financial reports available on the websites of one domestic company and one foreign company that operate in the same industry and complete the following:

(a) Document what accounting principles the foreign and domestic companies used to prepare their financial reports.
(b) Document any differences between the formats of the reports or the accounting principles used between your two companies.
(c) Document any differences in the directors' report for each company.
(d) Prepare a table which outlines the similarities and differences you have observed. J K AS SM

12.4 Form small teams and have each team select two countries from different cultural areas. Identify and compare each country's environmental, cultural and accounting values. J K CT

12.5 Visit the website of the Australian Securities Exchange, www.asx.com.au. Select a large company that is listed on the securities exchange that also has operations in different countries — an MNE. You may need to refer to the company website or annual report for this information. Access the latest annual report and evaluate the impact of operating across countries on the company's financial reporting requirements. J K SM

12.1 CASE STUDY

US accounting switch to aid multinationals

By Patrick Durkin

An expected switch by the United States from the US Generally Accepted Accounting Principles to the International Financial Reporting Standards will benefit investors and multinationals, observers said yesterday. The move by the US Securities and Exchange Commission comes after the chairman of the International Accounting Standards Board, David Tweedie, provided the SEC with evidence that the international accounting standards were better at uncovering problems during the credit crisis. 'The value of Australia moving to IFRS has always been diminished by the US not participating,' said National Australia Bank chief financial officer Mark Joiner. The switch is expected to benefit US companies with Australian operations including General Electric, Citigroup and ExxonMobil.

Source: Excerpts from Patrick Durkin, 'US accounting switch to aid multinationals', *Australian Financial Review*.[72]

Questions

1. Outline some reasons the US regulators are likely to accept financial reports prepared under IFRSs rather than US GAAP for listing purposes. J K
2. What would you perceive to be negative aspects of convergence between the FASB and IASB? Explain your answer. J K
3. How do you think the agreement to accept IFRSs will impact on US companies? J K