

International Accounting^{and} Multinational Enterprises

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Preface

A truly phenomenal growth in international business activity has occurred in the past two decades. Because international business events now affect almost everyone's life either directly or indirectly, there has been a commensurate increase in interest in the subject by practitioners, academics, and governments.

Although the formal recognition of the importance of international business was somewhat slower in the United States than in several other countries, it markedly accelerated during the 1970s. In 1974, the American Assembly of Collegiate Schools of Business changed its accreditation standards to include a requirement that the international dimension of business be added to the curricula. In 1978, the American Accounting Association specifically recommended the internationalization of the accounting curricula. The federal government, through many of its departments and agencies, has promoted programs to enhance the international competence of American industry.

Despite the attention being paid today to international business, there are still many questions to be answered and many problems to be solved. In reality, in many areas of international business people are still trying to identify which questions need to be answered and what are the major issues to be addressed. And of all the subareas of the general field of international business, accounting has remained the least developed. In fact, only in 1980 was the first systematic effort made to identify and rank the major international problems and to assess the appropriate research methodologies for resolving them.* Comparatively

****Eighty Eight International Accounting Problems in Rank Order of Importance***—A Delphi Evaluation was conducted for the American Accounting Association by George Scott with Pontus Troberg of the University of Oklahoma. All the major categories of problems identified in Scott's monograph are addressed in this book.

speaking, there remain fewer courses, books, articles, and instruction materials concerning the international aspects of accounting than in the other major areas of business such as management, finance, and marketing. While *International Accounting and Multinational Enterprises* will not fill the void by any means, it should certainly help close the gap. We also hope it will encourage others to do additional work in the area, for it is truly one of great importance and need.

This book is intended to benefit graduate and upper-division students of accounting, as well as accountants working for public accounting firms, corporations, and other enterprises engaged in international business, and governmental institutions and international organizations. One needs to have a fundamental grasp of accounting principles in order to appreciate and be challenged by the principles contained in the book. We have attempted to cover a broad range of issues in order to convey a fundamental understanding of the problems faced by multinational enterprises, as well as an appreciation for the ways different countries perceive certain accounting problems and the rationale for how they deal with those problems. In most chapters, one or more cases are provided to illustrate the kinds of problems that are encountered in a day-to-day business operation. In addition, all the chapters provide study questions.

The authors of any book are always indebted to numerous other scholars whose work helped form the foundation of knowledge on which their book is based. We are no exception. The pioneering efforts of Paul Garner, Emeritus Dean of the University of Alabama, Gerhard G. Mueller of the University of Washington, and Vernon K. Zimmerman of the University of Illinois are especially notable in that they provided the impetus and inspiration for the field of international accounting in its infancy period in the United States, and we have striven to emulate the standards of excellence set by the cadre of international accounting researchers whose contributions are woven throughout this book.

We would also like to acknowledge the constructive comments of the reviewers of the manuscript for this book: Vinod Bavishi of the University of Connecticut, Thomas G. Evans of the University of South Carolina, and Helen Morsicato of the University of Oregon. Special thanks are also due to the typists who struggled tirelessly and with only minor complaints to type, retype, and type again the countless drafts of the manuscript: Renetta Aldrich, Janice Clower, Elly Rogers, and Susan Akbulut at Georgia State University; Dee Williams at the University of South Carolina; and LuAnn Jaworski, Elaine Martins, and Crystal Stover of The Pennsylvania State University.

We also owe a great deal of thanks to our publisher, Warren, Gorham & Lamont, for their perseverance and the high degree of professionalism given to every aspect of the book. Particularly, we would like to thank Eugene Simonoff who convinced us we could and should write the book, and Cynthia Hausdorff, the text editor, who steadfastly badgered us into improving the format of the book and thus its readability and substance!

And finally, unmeasurable gratitude is due to our wives and children who

suffered through late nights and weekend absences as we put all the pieces together.

Despite all this help, there will undoubtedly remain some errors and omissions in our book. Such is the imperfect nature of man. As authors, we assume full responsibility for errors in judgment and communication and all unintended omissions. At some point, however, the book has to go to press. . . . We welcome the opportunity to receive comments from anyone who has occasion to use this book, and to learn from them how it can be improved further.

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November 1980

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1

An Overview of International Accounting

Despite rumors to the contrary, the field of accounting has had a notable international history and promises to have an even better future. Like the other functional areas of business, accounting has changed as the environments it serves have changed, moving sequentially from the more rudimentary to the more complex and sophisticated. This chapter (1) traces the international development of accounting, (2) highlights some of the critical factors which determine national differences in accounting systems, and provides an initial perspective on these differences and their importance for accountants in the modern world, and (3) discusses the evolution of world trade and investment patterns, together with some of the accounting implications of these developments.

THE INTERNATIONAL DEVELOPMENT OF THE ACCOUNTING DISCIPLINE

Record keeping, the foundation of accounting, has been traced back as far as 3600 B.C. Concepts such as depreciation were evident during the early Greek and Roman civilizations, where, for example, walls were depreciated at 1/80th per year. Yet most accounting historians agree that modern accounting dates from the fourteenth century, when the double entry system began.

The first record of a complete system was found in Genoa, in what is now Italy, in 1340. The Genoan system assumed the concept of a business entity, and because it recorded items in money terms, it was the first to imply that unlike items could be compared in terms of a

common monetary unit; in other words, that economic events were quantifiable. The Genoan system also implied some understanding of the distinction between capital and income, as it included both expenses and equity accounts.

The Italian domination of accounting was further cemented in 1494 with the publication of the first formal treatise on accounting, *Summa de Arithmetica, Geometria Proportioni et Proportionalita*, by Luca Pacioli, a Franciscan friar residing in Venice. His treatise was unique also because it was one of the earliest printed books (printed in fact on Gutenberg's printing press).

Although one might argue that accounting made little progress from 3600 B.C. to A.D. 1494, one must recognize that several important antecedents had to take place—including the art of writing, the development of arithmetic, the widespread use of money, the development of business organizations such as partnerships, the concept of private property, the development of credit, and a significant accumulation of private capital.

Pacioli's accounting system represented a landmark in accounting development. Its major objective was to provide information for the owner, reporting on stewardship and serving as a basis for granting credit. However, little distinction was made between the entity and the owner, as Pacioli's system reported together all the personal and business affairs of the owner. In addition, there was no concept of an accounting period or the continuing nature of a business; profit was calculated only at the termination of a venture, with no accruals or deferrals.

The concept of an accounting period did not emerge until the seventeenth and eighteenth centuries, when end-of-the-year reconciliations became prominent. During this period the center of commerce shifted sequentially from Italy to Spain, to Portugal, to Northern Europe. With this commercial shift was an accompanying shift in accounting development. In 1673, France adopted the first official accounting code, which required, among other things, that balance sheets be drawn up every two years. This period also saw the first *personification* of accounts (the practice of treating accounts as independent, living entities) and the standardization of debits on the left, credits on the right.

While accounting took a long time to get rolling, it really surged in the nineteenth and early twentieth centuries. The major force in this development was the Industrial Revolution. As the scale of enterprises increased following technological breakthroughs such as mass production, and as fixed assets grew in importance, accounting had to accommodate for depreciation, allocating overhead, and inventory. In addition, the basic form of business organization shifted from proprietorships and partnerships to limited liability and stock companies and ultimately to full-blown corporations. Accounting had to accommodate to these

new needs. Massive railroad and canal construction during this period once and for all forced the distinction between income and capital. Increased government regulation of business made new demands and generated new accounting systems which were harbingers of bigger moves to come. Most notable was the increased taxation of businesses and individuals, which brought with it new tax accounting systems and procedures.

Since the early years of this century the rapidity of change and the increasing complexity of the world's industrial economies has necessitated still more changes in accounting. Mergers, acquisitions, and the growth of giant multinational corporations fostered new internal reporting and control systems. With widespread ownership of modern corporations came new audit and reporting procedures, and new agencies became involved in promulgating accounting standards: stock exchanges, securities regulating commissions, internal revenue agencies, and so on.

And finally, with the dramatic increase in foreign investments and world trade and the formation of regional economic groups such as the European Economic Community, problems arose concerning the international activities of business. This phenomenon remains particularly complex, for it involves reconciling the accounting practices of different nations in which each multinational operates, as well as dealing with accounting problems unique to international business.

NATIONAL DIFFERENCES IN ACCOUNTING SYSTEMS

One might infer that these developments had a uniform effect on accounting systems throughout the world, yet nothing could be further from the truth. There are at least as many accounting systems as there are countries, and no two systems are exactly alike. The underlying reasons for these differences are essentially environmental; accounting systems evolve from and reflect the environments they serve. The reality of the world is that environments have not evolved uniformly or simultaneously. Countries today are at stages of economic development ranging from subsistence, barter economies to highly complex industrial societies.

In some countries there is no private ownership; in others there is virtually no manufacturing. In some countries there have been inflation rates of 200 to 300 percent per year; in others there has been no significant economic growth in years. Given these differences in economic conditions, differences in accounting practices should not be surprising. Just as the accounting needs of a small proprietorship are different from those of a multinational giant, so are the accounting needs

of an underdeveloped agrarian country different from those of a highly developed industrial country.

Economic factors are not the only influences. Educational systems, legal systems, political systems, and sociocultural characteristics also influence the need for accounting and the direction and speed of its development. For example, in countries where religious doctrine does not permit the charging of interest, there is unlikely to be elaborate accounting procedures related to interest.

The ways in which environmental factors affect the evolution and development of accounting practices are covered in greater detail in Chapter 2. For the moment, it is sufficient to acknowledge their role and the fact that in each country their unique combination results in a unique system of accounting.

Pragmatic Implications of National Differences in Accounting

There is some benefit in understanding how different nations do things. After all, there is always something to be learned from the experiences of others. As a case in point, consider inflation. Suppose a country has never experienced any significant inflation and has therefore never developed accounting procedures related to inflation. What would happen the first time the country experienced substantial and persistent inflation?

It could independently try to devise appropriate accounting procedures. It could also benefit from the experiences of other countries, which, having experienced significant inflation for some time, have developed inflation accounting procedures that work and make sense. However, one has to acknowledge that another country's solution may not be appropriate or feasible for our hypothetical country. The nature of the inflation may be different, its effects may be different, and the other country's practices for dealing with inflation may be incompatible or inconsistent with our country's accounting system.

On the other hand, if the practices are suitable and feasible, they could significantly shorten the time it would take our country to adapt its system so as to account properly for the effects of inflation. In this sense, accounting is a form of technology which can be borrowed or shared, depending on its suitability.

At the present time the most important reason for understanding different national accounting systems lies in the increasingly internationalized world of business, in which people buy and sell, invest and disinvest from one country to another. If an enterprise is considering granting credit to or acquiring a company in another country, it must be able to assess the financial position of that company. This is easier said than done.