

INTERNATIONAL
ACCOUNTING
AND
COMPARATIVE
FINANCIAL
REPORTING

SELECTED ESSAYS OF
CHRISTOPHER NOBES

CHRISTOPHER W. NOBES

International Accounting and Comparative Financial Reporting

Selected Essays of Christopher Nobes

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Preface

I am grateful to Edward Elgar, the eponymous publisher, for suggesting that I should collect together some of my writings on international accounting. My selection criteria are explained in the Introduction.

While working on the papers included here, I have benefited, for over twenty years, from a continual stream of encouragement, advice and, occasionally, admonishment from Bob Parker. More recently, I have come also to rely on rapid, detailed and refreshingly honest advice from Alan Roberts. These two colleagues have provided many useful ideas and have stopped me from making many errors.

Of the twenty pieces reproduced in this volume, seven have been co-authored. Graham Diggles, Lisa Evans, Margaret Lamb, Samantha Miles and Julie Norton have written, or are writing, doctoral theses under my supervision. I hope that they have gained as much from our discussions and joint work as I have. Alan Roberts is a co-author of one of the papers, but provided guidance on all the others published in the 1990s. Another recent co-author, Gerhard Mueller, was an inspiration for some of my early work, as he was for that of many others. Missing as a co-author here is Bob Parker, with whom I have written on international accounting and for academic journals but not both at once.

Many other colleagues have provided help. Those acknowledged in the original versions of the papers reproduced in this volume are listed overleaf. Many known journal editors and unknown referees have also provided invaluable advice.

Other indispensable aid, particularly for someone who still relies on the word-processing developments pioneered by László Biro, has been supplied over the years by many secretaries, reaching their acme in Carol Wright.

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Introduction

The selection

This volume was prepared at the request of the publisher, Edward Elgar. It brings together a number of published papers on international accounting. The papers have been selected using the following criteria:

1. The content of the paper is not purely descriptive, but contains analysis, a proposed model or the testing of a model.
2. The paper has not been significantly overtaken by subsequent events.

Because of the first criterion, the papers are all to be found in *refereed* journals: British, Australian, American and pan-European. This is not to imply that descriptive articles are worthless. Indeed, the production of clear and accurate descriptive material in international accounting is of great value to researchers, students and practitioners. Although the academic field of international accounting has been criticized for its concentration on description, the problem is much worse than that: the descriptions are often inaccurate, misleading or dated.

One reason for establishing the first criterion is that papers are thereby less likely to fail the second. The papers selected were written over a period of twenty years. Perhaps surprisingly, the earliest (on currency translation) seems not to break the second criterion, because its reference points are SFAS 52 and SSAP 20, which are still in force.

The papers are organized into five sections by subject matter, although naturally there are overlaps. One feature of the selection is that eight 'comment' papers have been included. I believe that comments and replies can be a useful way of advancing academic debate, and they often have the merit of brevity and incisiveness. Of course, 'comments' can only be fully understood and assessed in the context of the original papers and any replies. However, it is hoped that the comments selected for reproduction here are intelligible by themselves. In each case, a note is provided to direct readers to the related originals or replies.

My work is nearly all concerned with comparative international financial reporting, which is clearly not the whole of international accounting, although it accounts for the bulk of publications in that wider field.

The rest of this Introduction is devoted to a brief analysis of the contents of this volume, under the headings of the five sections. I acknowledge in the Preface the assistance of several co-authors and of many others in the writing of these papers.

I International origins of double-entry bookkeeping

The import and export of accounting technology (see Parker, 1989) is a constant theme (explicit or otherwise) of the papers in this volume. This international transfer did not start with double-entry bookkeeping, nor did it stop with it. However, the spread of double entry through the movement of persons and texts has been

particularly well described and analysed by several researchers (for example, Yamey, 1940; de Roover, 1978).

My amateur contributions in this area include a paper (Chapter 1) on the Gallerani account book of 1305 to 1308, which seems to comprise the oldest surviving double-entry records written in England, albeit by an Italian firm in the Tuscan language and now preserved in Flanders. The records had been examined before, but by historians and linguists. They contain references and transactions relating to interesting personages of the time, including Edward II, Piers Gaveston and the Grand Master of the Order of the Templars.

Schoolboy Latin plus my long-running attempts to establish a rudimentary grasp of modern Italian came in surprisingly useful when interpreting 700-year-old entries, although expert help was needed. It was also necessary to marshall the previous thoughts of others on how to define double entry. This paper can be seen to fit into a series on account books of the period (for example, Lee, 1977; Peragallo, 1977).

Chapter 2 is a comment on a paper (Lall Nigam, 1986) which suggested that double entry was not an invention of thirteenth-century Italian merchants but of Indians in the fourth century BC or earlier. Claims for non-Italian origin are fairly common, but most share the completely speculative nature of the paper commented on here.

Interestingly, my own comment contained some misleading remarks, as clearly pointed out by Scorgie (1990), but without damaging the main point that there was no convincing evidence to support the Indian claim.

II Causes of international differences and classification of systems

This is a fundamental area of study within the field of comparative international financial reporting. The two issues in the above heading seem to be in the logical order. However, the papers in Part II of this volume are in the reverse order, largely for chronological reasons. The papers are mostly on classification, and they gradually led me towards the 'general model of the reasons for international differences' in the final paper (Chapter 9), which includes proposed improvements to earlier classifications.

The first paper in this Part (Chapter 3: a 'judgemental international classification') is drawn from my doctoral dissertation (examined by Bob Parker and Sid Gray, who provided much useful advice). This paper was an attempt to improve on the pioneering work of Mueller without sacrificing the essential elements of judgement in favour of the appearance of scientific methodology provided by statistics. A comment (Chapter 4) expands on this latter point, as does Nobes (1982).

The conclusions of Chapter 3 (most obviously its two-sided world of Anglo-Saxon and continental systems) have passed into many textbooks (for example, Choi and Mueller, 1992, p. 34; Radebaugh and Gray, 1997, p. 70; Walton, Haller and Raffournier, 1998, pp. 8 and 23; and, of course, Nobes and Parker, 1998, p. 58). They have also been the subject of extension (for example, Al Najjar, 1986) and of, generally supportive, empirical investigation (for example, Dougnik and Salter, 1993). However, some have criticized the classification (for example, Roberts, 1995; Cairns, 1997; Feige, 1997). On the whole, I agree with Roberts. Some of these ideas had developed from our earlier discussions and had been included in a rudimentary

form in Nobes (1992, p. 95); others have been adopted in Chapter 9 here. Replies to Feige and Cairns are reproduced as Chapters 5 and 6; they add a few points to the earlier arguments in Chapters 3 and 4.

Another small contribution to the classification literature was a disagreement (Chapter 7) with a suggestion by Shoenthal (1989) that classification might be made on the basis of different competencies of recently qualified accountants.

One of the major factors associated with international accounting differences is corporate taxation. Several authors (including myself) had suggested that tax differences helped to cause accounting differences. Lamb, Nobes and Roberts (1995) suggest that this is misleading, at least for the first major split of countries into two types. In some countries, the calculation of taxable income is a prime purpose of accounting, and tax rules dominate financial reporting. In this sense, tax rules can certainly cause international accounting differences. However, in other countries there are differences between tax and financial reporting rules on many topics, so that tax rules have no effect on financial reporting *practice* in these areas. All this should be separated from the development of financial reporting *rules* over time, which interacts with the development of tax rules over time.

Chapter 8 draws on the above work to establish a method for assessing the current operational connection between tax and financial reporting practice in the UK, the US, France and Germany. One conclusion is that there is a clear distinction, especially for unconsolidated statements, between the degree of influence of tax on UK or US financial reporting practice and the degree of influence in Germany.

It is suggested above (Chapters 7 and 8) that international financial reporting differences (particularly a two-class classification) are not caused by different education or different tax systems. This leads to the examination of which factors *are* plausible. This is the subject of Chapter 9.

First, one should examine previous models. Many papers contain speculations about dozens of possible causal factors. The two best articulated models are by Gray (1988) and Doupnik and Salter (1995). It is concluded that Gray's cultural model is difficult to operationalize for this purpose and that Doupnik and Salter's contains too many overlapping factors and some unconvincing reasoning. Chapter 9 proposes a parsimonious model based on two factors: the degree of colonial influence and the strength of equity markets. It is suggested that these explain the initial two-class split of systems. Also, the idea that one should examine systems rather than countries is explored.

III International differences and their effects

This part contains three papers on international accounting differences. They each have two international dimensions. Chapter 10 concerns a specific accounting problem of multinational companies (currency translation) and analyses the international debate leading to the current rules in the US and the UK. Chapter 11 deals with international differences in accounting for goodwill and how this affects cross-border acquisitions. Chapter 12 looks at major international accounting differences and how London-based financial institutions deal with foreign accounting data containing these differences.

Chapter 10 concludes that the US and UK argumentation in support of the closing

rate method is similar and similarly unconvincing. The net investment method, which supports the closing rate, seems inconsistent with consolidation theory. This problem could largely be solved by using current values with current exchange rates.

Chapter 11 is a comment on Lee and Choi (1992), who seemed to show that accounting and tax rules gave an advantage to German and Japanese multinationals in international acquisitions. Chapter 11 suggests that the conclusions on tax cannot be correct because the analysis was based on the rules for purchased non-consolidated goodwill rather than those for goodwill on consolidation. A similar criticism of Dunne and Ndubizu (1995) is made in Nobes (1996). Elsewhere, Nobes and Norton (1996) look at international variations in accounting and tax rules, and criticize Dunne and Rollins (1992) in the process.

Choi and Lee (1997) reply to the criticism in Chapter 11 but do not dispute the main point. Dunne and Ndubizu (1996) reply to the similar criticism by suggesting that errors in the analysis of tax rules are not important because tax cash flows are the major issue. They still seem not to recognize the main point that different treatments of goodwill on consolidation do not affect tax cash flows.

Chapter 12 builds on the work of other researchers on (i) the use of UK accounting data in UK acquisitions, and (ii) the effects of international differences on analysis and investment. This paper is different from (i) as it looks at foreign accounting data. It is different from (ii) as it separates analysts from fund managers, and sector specialists from country specialists. Significant findings thereby emerge, such as that fund managers rely on analysts to adjust for accounting differences but that analysts generally make no such adjustments.

IV European harmonization

Another major topic in the accounting journals is harmonization, particularly of financial reporting. In Europe, most attention has been given to the harmonization through Directives of the European Communities. The six papers in this Part are set in that context. They concern the second, fourth, seventh and eighth company law Directives. Many of the papers concentrate on Germany and the UK, which seem to be examples of opposite accounting traditions in Europe.

Chapter 13 traces the arrival of various European (particularly German) ideas into UK law through the second and fourth Directives. Chapter 14 examines a particular issue (the prudence principle) and looks at German and British influence on the fourth Directive and then the latter's implementation in German and British law. Small differences in wording and large differences in practice are found.

Chapter 15 concerns perhaps the most famous and controversial provision of the European accounting Directives: the requirement to give a true and fair view. The paper starts with the UK formulation in the 1940s and traces this into some other countries and then into the fourth Directive, where different language versions have non-literal translations. On implementation as national laws, further linguistic complications occur. The operational effect of the requirement seems to vary from substantial to negligible in EU countries. Other papers have taken further the question of whether there is a 'European' true and fair view (for example, Alexander, 1993; Van Hulle, 1993; and several papers in *European Accounting Review*, Vol. 6, No. 4, 1997).

The mechanisms whereby a final Directive emerges are examined in Chapter 16, using the seventh Directive as a case study. Several players are involved, including accountancy professional bodies, legal bureaucrats in Brussels, national government politicians and large companies. At various stages in the life of the Directive, these players exert different degrees of influence. Also noticeable in this case is the gradual move from a German starting point towards a British conclusion.

Nervousness at the Anglo-Saxon influences on continental Europe are expressed by Hoarau (1995) for France. However, Chapter 17 comments that most of the French changes were deliberately made by France and are a sensible response in that the effects particularly relate to the consolidated statements of listed companies. Subsequent developments (for example, the law no. 98-261 of 6 April 1998, enabling complete departure from normal French rules for such statements) confirm the direction of change.

Finally, in this Part, Chapter 18 looks at harmonization of audit regulations between Germany and the UK, as driven by the eighth Directive. The conclusion is that, although changes to laws were made, only slightly greater *de jure* harmony was achieved.

V IASC harmonization

Much literature, particularly from the mid-1980s onwards, has described the International Accounting Standards Committee and its work. Some has tried to investigate its success empirically. The two papers here are concerned with this.

Chapter 19 identifies some extra requirements of IASC standards beyond US rules and then finds, not surprisingly, that the IASC requirements seem to have had no effect on reporting by US companies. Chapter 20 casts doubt on Doupnik and Taylor (1985), who purported to show some effects of the IASC on financial reporting across time and across regions.

These papers and most others were set in a world before the IASC improved its standards in 1993 and dramatically increased its profile. Current empirical work would probably show major effects in several Commonwealth countries and on some large continental European companies.

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PART I

INTERNATIONAL ORIGINS OF DOUBLE-ENTRY BOOKKEEPING

