

Christopher W. Nobes

Current Debates in International Accounting



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Edward Elgar

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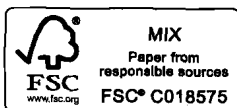
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Preface

This book brings together my writings on international accounting that were published in the first decade of the new millennium. It starts where I left off in *International Accounting and Comparative Financial Reporting*, which was also published by Edward Elgar, in 1999.

I hope that this compendium will be useful to researchers, teachers and students of international accounting. The 'Introduction' to this volume examines themes that run through this literature, and puts the papers into the context of the writings of others.

Five of the papers in this volume were co-authored. Chapter 14's co-author was my much-missed colleague and former doctoral student, Sally Aisbitt (see an obituary in *Accounting and Business Research*, **36** (4), 2006). Chapter 1's co-author, Alan Roberts, had contributed much to the writings contained in the previous volume while he was a colleague at the University of Reading. More recently, I have worked with colleagues at the Norwegian School of Management (BI) where I have a part-time post: Hans Robert Schwenke (Chapter 2) and Erlend Kvaal (Chapter 12). For many years, Steve Zeff has provided help and inspiration, and I am pleased to include a paper co-authored with him (Chapter 13).

In the background, continuing to provide valuable advice on most of my output, remains Bob Parker. The most recent papers have also benefited from the advice of my new colleagues at Royal Holloway: Jane Davison, Brendan McSweeney, Christopher Napier and Christian Stadler.

Christopher Nobes
Royal Holloway
31 May 2010

Introduction

The selection

The papers here are all authored or co-authored by the editor of this volume. They all concern international aspects of financial accounting. They were all published in academic journals from 2000 to 2010. Earlier papers on the same topics were collected in *International Accounting and Comparative Financial Reporting* (Edward Elgar, 1999; hereafter referred to as IACFR).

The papers come from eleven different journals: American (four papers), Australian (four papers), British (six papers), Canadian (one paper) and pan-European (two papers). Five of the papers were co-authored with colleagues (two British, two Norwegian and one American). So, there is internationality in more than the topics of the papers.

Comment papers

The word ‘debates’ in the title of the volume reminds us that any interesting issues are likely to involve different views, which will be refined over time. One way in which this refining occurs is through published ‘comments’ and ‘replies’ to them.

In this volume, seven of the papers are ‘comments’. In the previous volume (IACFR, referred to above), eight of the twenty papers were ‘comments’. In my view, ‘comments’ can be very valuable. The published exchange between authors can, in a very few pages, advance a debate and add useful clarifications. Occasionally, a brief comment can point out a fatal flaw in a long and previously well-regarded paper.

In my view, a journal editor should impose tough criteria before accepting draft ‘comments’. They should of course be subject to blind review, preferably not by the reviewers of the original paper (who might be embarrassed if flaws are pointed out), and obviously not by the author of the original paper. In my experience, both of the above review techniques have happened. However, subject to tough review, editors should in principle be happy to publish comments, for the reasons raised in the previous paragraph.

Of course, editors should also allow the original authors to ‘reply’, subject to review. In this volume, I do not include the original papers or the replies that relate to my ‘comments’ (because they are not authored by me) but I refer to them below in the discussion of the content of the volume.

I pay tribute here to all the authors of the papers upon which I commented. Without exception, they engaged in the comment/reply process in a helpful, pleasant and fruitful way.

International development

Part I of this volume contains four papers on international aspects of the development of financial reporting practices over time. In Chapter 1, Nobes and Roberts extend the theorising of Nobes (1998; reproduced as Chapter 9 in IACFR) on the forces that have driven international differences in financial reporting. Chapter 1 adds corporate

governance systems to the mix of law, tax and corporate financing. It concludes that the influence of a legal system can be overridden by the needs of users of financial reporting. Corporate governance systems are also seen to flow mainly from types of financing not from types of legal system.

Chapter 2 extends the work of Lamb, Nobes and Roberts (1998, reproduced as Chapter 8 in IACFR). Lamb et al. examined the tax/accounting relationships existing in 1996 in France, Germany, the UK and the US. In Chapter 2, Nobes and Schwencke start by setting up a general model for the mutual influences of tax and financial reporting. They then apply the techniques of Lamb et al. (somewhat refined) to the case of Norway over 30 years. Thus, a theory and a time dimension are added to the literature. One conclusion is that there are competing pressures for connection and disconnection of tax and accounting, but that (at least for consolidated statements) disconnection is likely to be maintained and extended.

Chapter 3 is a 'comment' on the dangers of using data for a purpose not intended by its preparers. This is also one aspect of Chapter 7 of this volume and of Nobes (1981) which was reproduced as Chapter 4 of IACFR. In the case of Chapter 3 of this volume, the data was prepared by me and used by Ding et al. (2007). Those authors use the *GAAP 2001* survey (Nobes, 2001) as data for the measurement of national differences from international standards (then IAS). This was part of their research on the effects of variables such as the legal system and the financing system. Chapter 3 notes that many differences in rules are of little importance for practice. It also questions Ding et al.'s distinction between the absence of an IAS rule and divergence from IAS. In the reply by Ding et al. (2009) several of the suggestions in Chapter 3 are taken up.

Another international issue is the origins of double-entry book-keeping. In a paper of an earlier period (Nobes, 1987), I had commented on a paper by Lall Nigam (1986) which had proposed an Indian origin for double entry. Chapter 4 of this volume is a comment on Zaid (2000) which appears to suggest that Islamic recording practices influenced the development of double entry. My main argument in both comments is that, once we are clear about the definition of double entry (including a full set of entries in the same currency, with periodic balancing), the case for a northern Italian origin in the late thirteenth century remains strong. Elsewhere, there is no set of historical records that shows double entry gradually evolving, no surviving books of account in double entry, and no contemporaneous descriptions of double entry. Zaid (2001) replies to some of the detailed points but agrees that there is no evidence for an Islamic influence on the origins of double entry.

Chapter 5 analyses the evolution of the equity method through the twentieth century and across several countries. I conclude that the method began as a form of proto-consolidation. It gradually spread internationally, having different uses in different countries. The 20 per cent threshold for the identification of associated companies was invented without a theory, and it also gradually spread round the world. It is suggested that the method is not appropriate for most of the uses it has had.

Classification

Part II of this volume contains additions to one of the main themes of my work: classification of financial reporting systems. Earlier papers were included as Chapters

3, 7 and 10 of IACFR. The two-system model (Anglo-Saxon versus continental European) whose development I had contributed to came under criticism from several quarters. In IACFR, Chapter 6 contained a comment on the doubts of Cairns (1997). In this volume, Chapters 6 and 7 are comments on the doubts of Alexander and Archer (2000) and of d'Arcy (2001). In Chapter 6, I suggest that Alexander and Archer concentrate too much on the regulatory system as they seek to show that UK and US accounting are different. If, instead, they had concentrated on financial reporting *practices* (and contrasted UK and US practices to Chinese, French, German or Japanese practices), an Anglo-Saxon system would have been easier to discern. Alexander and Archer (2003) reply, *inter alia*, that Nobes understates the importance of the transatlantic difference in the fairness 'override' (see the discussion about Part IV below).

D'Arcy (2001) used a database of accounting differences to classify the accounting rules of 14 countries and international standards. She found no Anglo-Saxon grouping, and noted that Australia was an outlier. In Chapter 7, I show that these findings are explained by unreliable data. D'Arcy (2004) replies by explaining various aspects of her work but not by addressing most of the doubts about the accuracy of the data.

Chapter 8 asks whether the arrival of IFRS has made accounting classification a matter for historical interest only. The conclusion is that classification can still be helpful in explaining how countries react to the availability of IFRS. It is also relevant in that much of financial reporting (for example unconsolidated statements) continues to use national rules.

International Financial Reporting Standards

Part III moves to studies specifically about IFRS. Chapter 9 was one of a series of papers of the mid-2000s on principles and rules in accounting (for example Nelson, 2003; Schipper, 2003). Chapter 9 suggests that the need for rules in standards is often caused by having no principle or a bad principle. Examples are given (from IFRS and US accounting) of pension accounting, financial assets, lease accounting, government grants, scope of the group, and use of the equity method. At the time of writing, all of these issues still remain to be resolved by the standard-setters. However, some progress has been made since 2005 in standards or discussion papers, on reducing complexity and removing options and exceptions.

Chapter 10 is a 'comment' on Haswell and Langfield-Smith (2008a). This is partly a detailed debate about the quality of individual standards within IFRS. Haswell and Langfield-Smith had identified 57 'serious defects' but I suggest that some of the items are not defects and some are not serious. Haswell and Langfield-Smith (2008b) reply, *inter alia*, that opinions can reasonably differ on some of the issues.

Chapter 11 examines a topic that was new to the literature: are there national versions of IFRS practice? Chapter 11 sets out the theory by asking whether the reasons for national difference (see Chapters 1–3) might still be relevant under IFRS, and whether there is scope within the rules of IFRS for practices to differ in this way. The conclusion is affirmative in both cases.

The obvious next step is to discover whether such national flavours of IFRS practice actually exist. Chapter 12 examines that issue by looking at the 2005/6 annual reports

of companies in the stock market indices of five countries. This provides very strong evidence of country-based choices of options within IFRS.

The last chapter in this part (Chapter 13) examines international differences in audit reports on IFRS. In particular, many audit reports do not refer to compliance with IFRS (as issued by the IASB) even where compliance exists.

On truth and fairness

The four last chapters in this volume (Part IV) concern the 'true and fair view' (TFV) requirement. Many papers have been published on this. Most are set in a single national context. Some of these have been collected together by Nobes and Parker (1994) and by Parker, Wolnizer and Nobes (1996). However, starting in the 1990s, some papers have taken a deliberately international approach. Zeff (1990) examines the Dutch version of the concept, in the context of UK and US wordings. Alexander (for example 1993), Nobes (for example 1993), Odelheide (for example 1993) and Van Hulle (for example 1992) debate the issue in a comparative European way.

Nobes (1993; reproduced as Chapter 15 in IACFR) looked at the origins of the TFV requirement and at its implementation in the twelve EU member states of the time. The signifiers, the signified and the significance were examined country by country. This work is taken further by Aisbitt and Nobes (Chapter 14 in this volume), who examine the same issues for the three countries that joined the EU in 1995 (Austria, Finland and Sweden) and for Norway as a member of the European Economic Area. Chapter 14 reports that three of the four new laws depart from the TFV signifiers of the related language versions of the Fourth Directive. Startlingly, none of the four laws contains a straightforward TFV 'override', as foreseen in the Directive.

On the subject of the override, Chapter 15 contains a 'comment' on a paper by Alexander (1999) which had set up a useful model of accounting requirements by splitting them into Type A (general, overriding), Type B (framework) and Type C (detailed). Alexander writes approvingly of the TFV override and of its insertion into IAS 1. Chapter 15 raises arguments against this. It is suggested that an override is best used by standard setters and regulators rather than by preparers or auditors. In an international context (compared, for example, to a UK context), there is greater variability in the interpretation of the expression and in the enforcement of its proper use. Alexander (2001) replies by accepting some of these points into his model, and adding examples of the use of the override by preparers.

Chapter 16 is a further 'comment'. It relates the conclusions by Wüstemann and Kierzek (2005, hereafter WK) that the European Commission had endorsed a number of international standards that did not comply with 'the' European TFV. Chapter 16 suggests that there is no single European TFV, and it questions each of WK's allegedly defective endorsements. Wüstemann and Kierzek (2006) reply. They no longer conclude that any of the endorsements were clearly erroneous, but they suggest a different one (IFRS 3).

Chapter 17 contains a wide-ranging commentary on TFV and fair presentation (FP) in the context of financial statements as prepared by UK companies under International Financial Reporting Standards (IFRS). Most of the commentary is also relevant for other EU countries. Chapter 17 analyses the rather complex relationship between national law, the EU Regulation and IFRS. For example, directors are required by IAS

1 to ensure an FP but auditors are required by law to give an opinion on TFV. There is also discussion of the difference between an override in law and one in standards. There is then an examination of the use of the override in practice, with the conclusion that it does not perform a useful function. This reinforces the expectation of Chapter 15.

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PART I

INTERNATIONAL DEVELOPMENT

TOWARDS A UNIFYING MODEL OF SYSTEMS OF LAW, CORPORATE FINANCING, ACCOUNTING AND CORPORATE GOVERNANCE

This paper examines the relationships between four systems: legal, corporate financing, financial reporting and corporate governance. Nobes (1998) investigated the linkages between the first three of these. The objectives of this paper are to give further explanation and examples of why legal systems need not be seen as causal factors for accounting systems, and then to suggest linkages with the fourth system, corporate governance. It is proposed that, for any of these systems, developments over time and comparisons across countries are best understood by looking at the four systems together. Preliminary suggestions are made towards a unifying theory for the four systems in the shape of a model containing testable propositions.

Discussions in the areas of concern to this paper are sometimes confusing because of a lack of clarity in the terminology used. For the purposes of this paper, certain terms need to be defined.

The expression "legal system" is used to mean the broad nature of law within a particular jurisdiction. The frequently used distinction between Roman codified law and English common law (eg, David and Brierley, 1985; van Caenegem, 1988) is an example of the level of abstraction intended here.

"Systems of corporate financing" are ways in which classes of company are financed within a jurisdiction. For example, in some countries, there is a class of public companies which are largely funded by equity issues to millions of investors. Several systems of financing may exist simultaneously in a country, but one may dominate economic activity.

The term "system of financial reporting" refers to a set of financial reporting practices held in common by the financial reports of a set of companies. The term (sometimes abbreviated here and elsewhere to "accounting system") covers both measurement and disclosure practices, but is not intended to cover the regulatory system for financial reporting or such issues as audit. Nobes (1998) draws on previous descriptions and classifications to propose two main

Several authors have observed a relationship between a country's type of legal system and its style of financial reporting. Generally, the causality is presumed to be from legal system to accounting system.

However, one model of accounting differences suggests that the type of accounting is an influence on the regulatory system rather than vice versa. This helps to explain why the Netherlands has Roman law but approximately Anglo-Saxon accounting. It also allows for the extensive use by European companies of US or international rules. This paper expands on these themes, and extends the model to include corporate governance.