International accounting differences
- Will national differences still play a role in the future?
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1 Introduction

At the beginning of the 1990s, general conditions for (European) business activities changed. Both investment and trade expanded rapidly relative to economic growth. Complementary to this development, the globalization of capital markets took place (Haller 2002).

The access to foreign stock and debt markets, investor behaviour and the activities of MNEs (multinational enterprises) have been an impetus in increasing the debate of if there is a need for a global set of accounting standards. As enterprises compete globally for scarce resources, creditors, investors as well as MNEs are required to bear the cost of reconciling financial statements which are prepared under domestic standards (Murphy 2000). However, the interpretation and analysis of financial statements at international level is hampered by several factors. One of them, for example, is the international diversity in accounting principles (Laínez & Callao 2000). Metaphorically, “[c]omparing two financial reports that are based on different accounting principles is like comparing two lengths without knowing that one is in centimetres and the other in inches” (Alexander et al. 2007, p. 24).

Therefore, in recent years, different organisations like IASC (International Accounting Standards Committee) and EU (European Union) have made considerable effort to harmonize the accounting rules that are enforced in different countries – with the aim of improving the comparability of financial statements of enterprises domiciled in different parts of the world (Laínez & Callao 2000).

The progress of harmonization has been slow and there have been obstacle to the creation of a uniform set of accounting standards on an international basis, not least because of cultural, economic, and legal differences among countries. However, as of January 1, 2005, international accounting harmonization entered a new phase. From that date, all enterprises that are located in the EU with shares listed on securities exchanges have to prepare their consolidated financial statements in accordance with IFRS (International Financial Reporting Standards) issued by the IASB (International Accounting Standards Board) (Baker & Barbu 2007).

It is generally agreed that differences in accounting exist because accounting practices and standards reflect the domestic particular environment in that they are developed (Alexander et al. 2007). In recent years the IFRS become tighter and mandatory application spreads (Nobes 2009d). However, even in a period in which international harmonization seems to be almost realised, is there uniform practice within IFRS use or is there scope for different IFRS prac-

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1 ‘Accounting’ means published annual financial reporting by enterprises in the following.
tice because of national accounting environments? This paper will deal with the origin of international accounting differences and the reasons why IFRS might be applied systematically differently from one country to another.

Section 2 gives a theoretical background on origin of differences in accounting systems. In Section 3 motives and scopes for the survival of differences in practice under IFRS are presented. Section 4 summarizes and concludes the paper.

2 Origin of differences in accounting systems

This section investigates why and how national systems differ. Several causes are discussed in the literature. In the following I will focus on the most important causes referred to in the literature: legal system, finance system, link between taxation and accounting, and cultural differences.

2.1 Existing legal system

No two nations’ laws are exactly alike but comparative scholars agree that some legal systems of different countries are similar in certain critical aspects. Based on these similarities, national legal systems have been broadly classified into two major families of law: civil law and common law (La Porta et al. 1998). In the 20th century, both these legal systems, which have developed in the western world over the years, have been exported to different parts of the world (Alexander et al. 2007).

The civil law system originated in Roman ius civile, as compiled by Justinian in the sixth century, and has been developed by European universities from the twelfth century (Alexander & Nobes 2001). It is characterized by using statues and comprehensive codes as well by a heavy reliance on the opinions of legal scholars to ascertain and formulate the rules (La Porta et al. 1998). In such a system the word ‘codified’ might be associated with. That is, commercial codes or company law need to establish rules in detail for financial reporting and accounting (Alexander & Nobes 2001, Nobes 2009a). The wide set of rules should give guidance in all kinds of situations. Furthermore, in civil law countries accounting standards are often embodied in the company law and accounting regulation is in the hands of the government (Alexander et al. 2007).

2 ‘Accounting system’ means the set of financial reporting practices used by a enterprise in the following.

3 The origin of international differences was handled by Rimmel.

4 The division between common law vs. civil law countries was handled by Olsson [2009-09-11]
Countries with a civil law tradition can be categorised into three common families\(^5\): German, French, and Scandinavian (La Porta et al. 1998).

On the other hand the common law system, which was formed in England, is developed from case law (Alexander et al. 2007). Common law is based on a restricted amount of statute law which is then interpreted by judges (Alexander & Nobes 2001). Precedents from these judicial decisions on specific disputes shape common law (La Porta et al. 1998). As opposed to codified law, common law is less abstract and a common law rule seeks to provide an answer to a particular case rather than to establish a general rule which could be employed in several cases. This naturally affects commercial law, which traditionally does not prescribe accounting rules how companies should prepare their financial statements (Nobes 2009a). Accounting within such a context is kept in minimum and to a large extent not specified in detail in law. Instead, accountants themselves prescribe rule for accounting practice (Alexander et al. 2007, Nobes 2009a). Furthermore, accounting regulation is in the hands of professional organizations of the private sector (Alexander et al. 2007).

The English common law system has spread out the (former) British colonies, for example, the US, Canada, Australia, India etc. (La Porta et al. 1998).

In summary, Table 1 shows some examples of common and civil law countries.

<table>
<thead>
<tr>
<th>Anglo-Saxon law tradition</th>
<th>Continental – Roman-German law tradition</th>
</tr>
</thead>
<tbody>
<tr>
<td>common/case law countries</td>
<td>civil/code law countries</td>
</tr>
<tr>
<td>United States</td>
<td>Germany</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>France</td>
</tr>
<tr>
<td>Australia</td>
<td>Belgium</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Italy</td>
</tr>
<tr>
<td>Canada</td>
<td>Spain</td>
</tr>
<tr>
<td>Ireland</td>
<td></td>
</tr>
</tbody>
</table>

Table 1: Common law versus civil law countries (source: Rimmel)

2.2 Provision of finance

With regard to providers of finance, a two–group distinction can also be drawn as for legal systems because the prevalent types of ownership and business organisation are different as well. In the US and the UK, for example, a major source of corporate finance is the share capital provided by a large number of private shareholders (Alexander & Nobes 2001, Nobes

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\(^5\) Concerning differences between these three families of civil law, refer to La Porta et al. 1998.
2009a). Therefore, these countries have an active stock exchange (Alexander et al. 2007). Although in the US and the UK shares increasingly are held by individual shareholders rather than by institutional investors, this is still in contrast to countries with bank, family, or state holdings. In France and Italy, for example, capital provided by banks or by the state is very significant, as are family–owned companies. In Germany, especially the banks are providers of debt finance as well as important owners of shares (Alexander & Nobes 2001, Nobes 2009a).

Zysman (1983, quoted in Nobes 1983, p. 166) proposed another grouping of countries into types by their financial system. He distinguishes between three types, as follows: (1) capital market systems, in which prices are established in competitive markets (e.g. UK, US); (2) credits–based governmental systems, in which resources are administered by the government (e.g. France, Japan); and (3) credit–based financial institutions systems, in which banks and other financial institutions are dominant (e.g. Germany). All systems vary in the external sources of funds. In countries where external long–term finance prevails, securities are the main source in the capital market system. By contrast, in credit–based systems, the capital market is smaller, so enterprises are more reliant on investors that grant credits. These usually are banks, whether under the influence of governments or not (Nobes 1998, 2009a).

In countries with a widespread ownership, published financial information has to be of higher quality. If enterprises rely to a large extent on the capital market, disclosure becomes extremely important because potential and existing shareholders do not have access to internal information in order to assess the entities’ financial situation. Profit measurement and reported data on earnings, cash flow and financial position are used to make predictions about the future financial position of an entity and to make a decision about an investment. Therefore, the pressure and the need for disclosure are much greater than in countries where providers of finance have the power to obtain certain internal information (Alexander et al. 2007). This also applies for audit, since this is designed to check up managers if the owners are ‘outsiders’ (Nobes 2009a).

By contrast, in debt–oriented countries with a paucity of ‘outsider’ shareholders, financial statements serve the information needs of a lot of different stakeholders, in particular, creditors and the government. Financial reporting has been largely designed to protect creditors and the government, whose needs of information are concerned with the underlying assets of the enterprises and the determination of taxable income. It seems that the greater importance of creditors in countries like Germany lead to more careful conservative accounting because
creditors are interested in if, in the worse case of bankruptcy, they get their money back (Alexander et al. 2007, Nobes 2009a).

Nobes (2009a, p. 32) suggests “that this differentiation between credit/insiders and equity/outsiders is the key cause of international differences in financial reporting.” Table 2 presents some examples of countries in which enterprises are more shareholder oriented and credit/family/state oriented, respectively.

<table>
<thead>
<tr>
<th>Shareholder oriented</th>
<th>Credit/family/state oriented</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>Germany</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>France</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Belgium</td>
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<tr>
<td>Sweden</td>
<td>Italy</td>
</tr>
<tr>
<td>Australia</td>
<td>Spain</td>
</tr>
<tr>
<td>Canada</td>
<td>Portugal</td>
</tr>
</tbody>
</table>

Table 2: Provision of finance (source: Rimmel)

In this context, La Porta et al. (1997, 1998) find empirical evidence that there is a connection between strong equity markets and common law countries, and that common law countries have stronger legal protection of investors than civil law countries do.

In summary, from this two–way splitting mentioned–above several important results can be found (see table 3). First, in equity/outsider countries, there is no great need for audited and published financial reporting by market participants. Instead of that the demand for annual accounting is strongly linked with the government’s need for a calculation of taxable income. As a result, accounting rules are dominated by tax considerations. As opposed to equity/outsider countries where accounting performs a market function. Therefore, the rules need to be separated from taxation (see section 2.3) (Nobes 2009a).

<table>
<thead>
<tr>
<th>Features (A)</th>
<th>Features (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- strong capital market</td>
<td>- weak capital market</td>
</tr>
<tr>
<td>- many ‘outsider’ shareholders</td>
<td>- many ‘insider’ shareholders</td>
</tr>
<tr>
<td>- strong/large auditing profession</td>
<td>- weak/small auditing profession</td>
</tr>
<tr>
<td>- separate accounting and taxation rules</td>
<td>- taxation rules dominate accounting rules</td>
</tr>
</tbody>
</table>

Table 3: Initial classification based on corporate financing (source: Rimmel)
2.3 Link between accounting and taxation

Although tax systems of countries can be classified in a number of ways, merely a few of them bear a meaning for financial reporting. What is more relevant, is the degree to which accounting measurements are determined by taxation regulations (Alexander & Nobes 2001). On the one hand, there are some countries in which the fiscal authorities use financial information that is provided in the financial statements in order to calculate taxable income. In several countries of continental Europe expenses are solely tax deductible when they are also recognized in the profit and loss account. Therefore, financial reporting becomes influenced (or biased) by tax (Alexander et al. 2007). In Germany, for example, the tax accounts (Steuerbilanz) should be identical to the commercial accounts (Handelsbilanz), whereas only the latter are generally published for external stakeholders. This interdependence between tax and commercial accounts is called the Maßgeblichkeitsprinzip (principle of congruence) in Germany (Alexander et al. 2007, Nobes 2009c). With some variations, the Maßgeblichkeitsprinzip operates in many other countries like France, Belgium and Japan. Also in Italy, where a similar position prevails which is described as il binario unico (the single–track approach). Perhaps this principle is due partly to the dominance of taxation as a use of accounting and partly to the pervasive influence of the codification in law (Alexander & Nobes 2001, Nobes 2009a).

Such a link between accounting and taxation is often existent in those countries which do not explicitly have an investor approach (Alexander et al. 2007). However, over the time the relationship between accounting income and tax income can vary. For example, the influence of taxation has been reducing in the Nordic countries (in the early 1980s in Denmark, in the 1990s in Finland, Norway and Sweden) (Alexander & Nobes 2001). On the other hand, in countries like the UK, the US, Australia or the Netherlands another approach exists. More precisely, there is a much weaker link between accounting income and taxable income (Alexander et al. 2007). In these countries, published financial statements are designed primarily as performance indicators for investment decisions. Furthermore, commercial rules are independent from tax rules in many accounting areas (Nobes 2009a). Accordingly, the recognition and measurement rules used in the tax accounts can vary from the valuation rules used in the accounts published for all external stakeholders. For tax purposes separate accounts are filed (Alexander et al. 2007).
In this context, the adoption of IFRS will have an impact on the relationship between accounting and taxation in countries that are characterized by a dependence relationship (Alexander et al. 2007).

Finally, table 4 shows countries with (in)dependent relationships between accounting and taxation.

<table>
<thead>
<tr>
<th>Independence</th>
<th>Dependence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>Germany</td>
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<tr>
<td>Ireland</td>
<td>France</td>
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<tr>
<td>United Kingdom</td>
<td>Belgium</td>
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<tr>
<td>Netherlands</td>
<td>Italy</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Spain</td>
</tr>
<tr>
<td>Poland</td>
<td>Norway</td>
</tr>
</tbody>
</table>

Table 4: General relationship between accounting and taxation (source: Rimmel)

2.4 Cultural differences

Empirical findings indicate that culture also exerts influence on a country’s accounting practice and financial reporting system (Alexander et al. 2007).

Hofstede, one of the prominent famous researchers on cultural differences, defined culture as “the collective programming of the mind which distinguishes the members of one human group from another” (Hofstede 1982, p. 21). Based on his attitude surveys, collected in the multinational corporation IBM with approximately 116,000 respondents from 72 countries in 1967 and 1973, he identified four cultural dimensions which attempt to explain general culture differences between nations and which describe a society’s characteristics. Hofstede (2001) labelled these dimensions, as follows, including a brief description:

*Large versus small power distance.* Power distance is the extent to which members of a society accept unequal and hierarchy power distribution.

*Strong versus weak uncertainty avoidance.* Uncertainty avoidance measures the degree to which individuals in a society feel comfortable with ambiguity and uncertainty.

*Individualism versus collectivism.* Individualism represents the preference for a loosely knit social framework or a tightly knit social, more independent fabric.

*Masculinity versus femininity.* Masculinity is characterized by achievement, heroism, assertiveness, and material success. This dimension addresses the way in which social roles to sexes are divided by society.
Although Hofstede’s cultural dimensions model has been criticized by several authors (see e.g. Ding et al. (2005), Hope (2003) for further references), these dimensions have been widely used in accounting research (Hope 2003). Based on Hofstede’s classification scheme, both Gray (1988) and Perera (1989) provided a theoretical framework linking the four main societal values.

In order to explain international differences in accounting practices, Gray (1988) developed four value dimensions of the accounting sub-culture, as follows:

*Professionalism* (versus statutory control) is the degree to which a nation’s accounting accepts a broad range of individual judgment and the maintenance of professional self-regulation in contrast to adherence with prescriptive legal requirements and statutory control.

*Uniformity* (versus flexibility) stands for the preference for the enforcement of uniform accounting practices among enterprises and for the continuous use of such practices as opposed to flexibility according to individual enterprises’ circumstances.

*Conservatism* (versus optimism) describes the extent to which a nation’s accounting system prefers a cautious approach to measurement in order to cope with the uncertainty of future events versus a more optimistic and risk-taking approach.

*Secrecy* (versus transparency) is the extent to which financial information are restricted to those which are closely involved with the enterprise’s financing and management in contrast to a more transparent and publicly accountable approach.

Furthermore, Gray’s (1988) analysis allows certain direct associations between his accounting values and the societal dimensions of uncertainty avoidance and individualism. He suggests that *individualism* and *uncertainty avoidance* are the most influential dimensions related to the accounting sub-culture values (Gray 1988).

For example, higher levels of *conservatism* are most closely associated with countries that have lower *masculinity* and *individualism* and higher *uncertainty avoidance*. Higher levels of *secrecy* within a society are linked with lower *masculinity* and *individualism* and higher *power distance* and *uncertainty avoidance*. In summary, studies reveal that cultural values that exist in a country affect a country’s accounting values, which in turn influence accounting practice (Perera 1989, Tsakumis et al. 2009).

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6 From accounting perspective, this means the accounting practice of recognizing all possible losses, but not anticipating possible gains. This was handled by Johed.
In the following years after Gray’s contribution, a number of hypotheses which related accounting sub–culture values to societal values have been proposed. One useful explanation was developed by Perera (1989) (Ding et al. 2005).

In particular, Perera’s (1989) contribution is based on Gray’s theoretical framework by suggesting that either one or a combination of accounting sub–culture values influence certain aspects of accounting practice, namely (1) the authority for accounting systems, (2) their force of application, (3) the measurement practices used, and (4) the extent of information disclosed.

In particular, for example, the amount of conservatism that is preferred in an accounting sub–culture would have an effect on the measurement practices used. The higher the extent of conservatism, the stronger the ties with traditional measurement practices. The extent of secrecy that is preferred in an accounting sub–culture would affect the degree of disclosed financial information. The lower the extent of secrecy, the higher is the degree of disclosure (Perera 1989).

In this context, some empirical studies on accounting disclosure of enterprises could reveal that cultural factors have a considerable influence on the accounting practices of enterprises (see, e. g. Eierle 2008, Nobes 2009a, respectively, for references). Accepting cultural determinism in accounting, many attempts have been made to categorize countries into groups using a deductive and/or inductive approach (see, e. g. Eierle 2008, Nobes 2009b, respectively).

In summary, figure 1 shows the associations between societal values, accounting values, and accounting systems, including external influence, ecological influence, and institutional consequences, partly dealt with in the sections above.

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7 This topic was also handled by Rimmel.
2.5 Other external influences

Besides the factors mentioned above, further causes for differences in financial reporting systems are discussed in the literature (Nobes 2009a). These are, for example, level of education, age and size of accountancy profession, history, geography, language, political systems and level of education (Nobes 1998, 2009b).

*Colonial influence* is probably the major explanatory factor in a lot of countries outside Europe. In countries, which were strongly culturally influenced (for example, former colonies), the best predictor of the accounting system may be that it will be the same like that of the former colonial power. Colonial influence will usually overwhelm other factors, even the
financing system. Some former British colonies in Africa, for example Gambia, have an accounting system which is based on that of the UK, even if they have no equity market at all. On the other hand, another former colony, for example New Zealand, may inherit an accounting system, a legal system as well as an equity market. But for many Commonwealth countries, the British influence has been replaced by that of the IASB in the recent years (Nobes 1998, 2009a).

Recent research shows that also some other factors could be of relevance (e. g. risk of litigation, investor protection) (Alexander et al. 2007).

3 International differences: will they still play a role in the future?
This chapter will examine if there is opportunity for the survival of international differences among enterprises despite the adoption of IFRS. Though, a prior question is whether there are motives. This is, are managers driven by various objectives in different countries if they prepare (consolidated) financial statements under IFRS? The starting point is to ask if the factors dealt with in chapter 2 are relevant. Particularly, three factors are considered here: financing systems, legal systems, and tax systems. Most of the following illustrations are narrowed down to the EU’s two largest capital and economic markets: Germany and the UK (Nobes 2006, 2009d).

3.1 Motives for different IFRS practice
Particularly, three factors are considered here: financing systems, legal systems, and tax systems. As discussed in section 2.1, the literature divides the existing legal systems into civil law and common law. This has an effect on the regulation of financial reporting. For example, in the UK the detail in national rules for the preparation of financial statements is found in accounting standards developed by the private sector, whereas in Germany national rules are largely specified by the commercial code [Handelsgesetzbuch (HGB)] and tax law. Concerning IFRS the standards’ content is the same but monitoring and enforcement remain national matter. This concerns, for example, the nature and regulation of audit and the stock exchange rules. Since international differences in these areas persist, the dichotomy in legal systems could still influence accounting practice (Nobes 2006, 2009d).

The second issue, as discussed in section 2.2, countries can also be categorized into ‘insider financing’ (e. g. Germany) and ‘outsider financing’ (e. g. the UK), even though the starkness
becomes weaker. Germany enterprises might still be dominated by ‘insider’ financiers. They might also have no commercial need for the creative accounting and extensive disclosures practiced in the UK (Nobes 2006, 2009d).

The third issue is the influence of tax on financial reporting\(^8\), whereas German financial reporting is more dominated by tax law than that of the UK (section 2.3). Although the tax system does not affect consolidated financial statements under IFRS because consolidated accounting is separated from tax calculations, nevertheless, there are two reasons why tax practice may have an effect on IFRS consolidated statements: tax conformity in the UK and convenience in Germany. In the UK, in general tax authorities expect that accounting policies are equally used within a group. Given an area, which has tax implications and in which IFRS requires considerable judgement, this will flow through to consolidated statements (if individual enterprises use IFRS). In Germany, unconsolidated statements have to prepare under domestic rules, irrespective of any use of IFRS for (un)consolidated financial statements. In some cases, the tax–driven accounting choices might flow through to consolidated IFRS statements, if IFRS gives the room for judgement (Nobes 2006, 2009d).

3.2 Scope for different IFRS practice

This section identifies potential sustained international differences in practice, namely different versions of IFRS, different translations, gaps in IFRS, covert and over options, measurement estimations, and imperfect enforcement.

3.2.1 Different versions of IFRS

Adoption of IFRS notwithstanding, international differences in the IFRS rules legally binding at a particular date can exist. Two cases are considered in this section. First, IFRS can differ from EU-endorsed IFRS. Although in 2004 the majority of the content of IFRS was adopted, the EU Commission refused, for example, the endorsement of the entire IAS 39 (financial instruments). As a result, the endorsed IAS 39 admits more flexibility on the employment of hedge accounting. For example, an Australian bank which has to follow AASB (Australian Accounting Standard Board) 139\(^9\) will have a more volatile profit figure than a German bank.

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\(^8\) The taxation of group and single statements was handled by Olsson [2009-10-13].
\(^9\) This is a standard that is based on the restrictive non–EU version of IAS 139.
which exercises the full EU–endorsed permission. This difference between the IASB’s and the EU–endorsed version of IAS 39 still exists (Nobes 2006, 2009d).

Second, differences within IFRS rules can also result from implementation dates and years ends. In general, new standards have an in–force date of ‘ annual period beginning on or after 1 January 200X’. But an earlier application is usually allowed. As a result, two quite different versions of IFRS can be legally binding at the same time. Furthermore, the EU endorsement process can take a long period of time. So, IFRS might be partly in force, but not endorsed at a particular year end of an enterprise (Nobes 2006, 2009d). An enterprise within the EU may additionally obey the requirements of unendorsed IFRS parts to the extent that those requirements are consistent with IFRS (KPMG 2005).

3.2.2 Different translations

The language in which IFRS is promulgated is English. In 1997, the International Accounting Standards Committee Foundation (IASCF), which oversees the IASB, created an official translation process, which includes committees to review the translations’ quality, so that non–English speaking accountants have access to IFRS. Official translations are available in many European languages as well as Arabic, Chinese et cetera (Nobes 2009d, Tsakumis et al. 2009). In the case of Europe, the various European translations of IFRS have been legal status in their countries since the EU Regulation of 2002 (Nobes 2006, 2009d). In spite of a well–organized and quite rigorous translation process and the existence of the review committees, translation problems can exist. There is a risk that words or phrases cannot be translated without some distortion of meaning from the original version (Nobes 2006, Tsakumis et al. 2009).

The omission of a word in a translated standard or the existence of different definitions for a word used in an English standard can pose a threat to comparability (Nobes 2006, 2009d, Tsakumis et al. 2009). As an example, IAS 41 (para. 34) requires an unconditional government grant, which is related to a biological asset, to be recognised as income (only) when the government grant is ‘receivable’. In the Norwegian version (DnR 2006, p. 543, quoted in Nobes, 2006, 2009d) ‘receivable’ is translated as ‘mottas’, which means ‘received’. This is a significant dissimilarity and can lead to different practice (Nobes 2006).

10 The problem of accounting diversity between languages was handled by Fagerström. In particular, different meanings of expressions/words in different languages hinder international comparability of financial statements.
3.2.3 Gaps in IFRS
In certain respects, there are no gaps in IFRS because IAS 8 (para. 10) defines how a management should choose accounting policies if a standard or an interpretation that specifically applies to a transaction, other event or condition, does not exist. In such a case, the management should refer to, and consider the applicability of, the following sources in descending order: (1) the requirements and guidance in standards and interpretations that deal with similar and related issues; and (2) the general criteria of the IASB’s Framework (IAS 8 para. 11). The management may also consider standards of other bodies which use a similar Framework (most obviously US GAAP), other accounting literature and accepted industry practices, unless these conflict with the two sources mentioned above (IAS 8 para. 12). This allows companies considerable scope for manoeuvre. Assuming that national traditions will persist as different ways of interpreting the Framework, differences will continue (Nobes 2006).

3.2.4 Overt options
IFRS contain a lot of examples of overt options (see Nobes 2009d, p. 151 for further examples). For example, according to IAS 2 (para. 25) the cost of inventories shall be determined by using the ‘first in, first out’ (FIFO) or weighted average cost formula. Taking the example of the Germany and the UK, UK groups will primarily continue to apply FIFO. However, German groups will apply weighted average because this method is common under German commercial code (HGB) practice and FIFO is not allowed by German tax law (Nobes 2006, 2009d).

3.2.5 Covert options
On the other hand, there are further opportunities for international dissimilarities in IFRS accounting practice because of different covert options. Some of these options depend on the interpretation of the word ‘probable’ (Nobes 2006, 2009d). ‘Probable’ is the most common verbal probability expression used by the IASB in order to establish the threshold for (de)recognition of a variety of accounting elements. The term ‘probably’ occurs in a lot of contexts that deal, for example, with the recognition of assets (e.g., IAS 12, Income Taxes), of revenues and expenses, and losses (e.g., both IAS 11, Construction Contracts). Empirical findings of Doupnik and Richter (2004) suggest that accountants in the US interpret ‘probably’ less conservatively than accountants in Germany (Doupnik & Richter 2004).
Specifically, the capitalization of certain development cost, which is required by IAS 38 (Intangible assets, para. 58), is an example for a covert option. Within the EU, capitalisation is in some countries banned by law (for example, German Commercial Code: § 248 HGB) and in other countries allowed, however, not statutory (for example, the UK’s SSAP 13, para. 25). In general, EU domestic rules do not contain such a requirement, as in IAS 38, to capitalise if certain criteria are met. Capitalisation depends on an enterprise’s demonstration that all vague criteria of a list are fulfilled, for example, such as ‘technical feasibility of completion’, and ‘intention to complete’ (IAS 38, para. 57). Hence, there is scope for conscious and unintentional systematic international dissimilarity. As noted in section 3.1, capitalisation in Germany for IFRS consolidation purposes does not have an impact on taxes, whereas the UK’s position is different. There tax considerations can influence accounting practice, whereas this in turn could flow through to consolidated financial statements. Furthermore, capitalisation encounters more resistance in Germany because of its tradition of conservatism rather than in the UK (Nobes 2006, 2009d).

Another aspect of covert options is the IASB’s preference for principle–based standards rather than rules–based standards. That means there are less detailed prescriptions (Nobes 2009d).\footnote{The division between principle-based vs. rule-based was handled by Kirsch [2009-08-31].}

### 3.2.6 Measurement estimations

Different IFRS practice can also result from measurement estimations, as opposed to estimations related to classification or recognition like in the section above. An example of measurement estimation is depreciation, which is required for assets that have limited useful lives and are measured on a cost basis, for example, under IAS 16 (property, plant and equipment), IAS 17 (finance leases), and IAS 38 (intangible assets). Where depreciation is necessary, an asset’s expected useful life, residual value and pattern of consumption have to be assessed (IAS 16, paras. 50, 51 and 60). The method of depreciation is also an estimate choice, and not a policy one, since the appropriateness of a method, for instance, straight line or declining balance, depends on the asset’s wear and tear (Nobes 2006, 2009d).

Nobes (2006) suggests that convenience, tax and tradition are relevant factors here. For example, regarding UK tradition, a convenient method is employed. UK enterprises normally use for plant the depreciation on a straight line basis, zero residual value and depreciable life of ten years. This method is preferred because a completely separate scheme of capital allow-
ances operates for tax purposes. In contrast the German tradition is to accelerate expenses by using the shortest depreciable lives allowed by tax law and the declining balance method at the beginning and changing to the straight line method near the end of an asset’s depreciable life (Nobes 2006, 2009d).

In Germany the declining balance method has mostly been abandoned for IFRS consolidated financial statements, to some extent probably because an amendment to German law had contained the requirement to remove tax–based policies from consolidated financial statements which are prepared under German national rules. However, some other countries in the EU might carry on applying the declining balance method under IFRS (Nobes 2006, 2009d).

3.2.7 Imperfect enforcement

Although there is a requirement to use IFRS, imperfect enforcement is the last of the suggested sources in this chapter which can further international differences. The degree of enforcement of IFRS rules and, therefore, the adherence to them differ among countries because enforcement and monitoring of adherence remains a national matter (Nobes 2006, 2009d). Taking the example of Germany and the UK again, some research results show that the enforcement of accounting rules has been weaker in Germany than in the UK (refer to, for example, La Porta et al. 1997, Hope 2003). If adherence is lower in Germany than in the UK, then the accounting practice under IFRS may differ among these countries (Nobes 2006, 2009d). As a result, Germany financial statements are more difficult to interpret by analysts than UK ones (Nobes 2006).

4 Discussion and conclusion

Concerning the developments of international financial markets, activities of MNEs and investor behaviour at the beginning of the 1990s, financial reporting has itself extended beyond national borders. All over the world different stakeholders use the information that is provided by financial statements for their decision–making process. Although information is less or more equally used, the communication of that can vary according to influencing factors. But financial information, as a communication vehicle, needs to be understood both outside and inside its country of origin (Alexander et al. 2007, Laínez & Callao 2000).

Many influencing factors are discussed in the literature, for example, legal system, development of the capital market, link between accounting and taxation, culture and so on. There
cannot be made any generalization which one is the major explanatory factor for a country. It depends on several circumstances (e.g. was there a colonial influence or not). Moreover, certain factors influence themselves among each other or dependent on each other. In this context, the most important issue is, that accounting diversity exists (see chapter 2) because national environments have different characteristics and standard setter have chosen those accounting policies (e.g. measurement for assets) which best fitted their national environmental (Alexander et al. 2007).

In order to improve the comparability of financial statements, harmonization has become very important and is widely accepted in the recent years. Although within the EU all listed enterprises have to apply IFRS, it is amazing that international differences can still survive in consolidated financial statements. In particular, in the UK and Germany the traditions, based on the legal system, the tax system, and the finance system, can flow through to consolidated financial statements and influence them (see section 3.1).

Some of the scope for IFRS differences, mentioned above, will be removed over time (Nobes 2009d). However, some of them will continue. In my opinion, translation is the most important factor that hindered comparability because certain words/expression have different meanings in different countries and in the translation process there will always be some distortion of meaning. This in turn will affect the accounting practice. Furthermore, covert and overt options as well as measurement estimations provide opportunities for different interpretation. I think these are also a important and relevant factors.

Assuming that accounting differences will still exist because there are various needs of stakeholders worldwide\(^\text{12}\), several implications follow. On the one hand, users of financial statements need to be warned that IFRS statements from different countries might be less comparable than they have expected. On the other hand, ‘comparative international accounting’ still exists and will be remain a field of study in the next years (Nobes 2009d). Recent research confirms this (Alexander et al. 2007).

\(^{12}\) This aspect was handled by Fagerström.
References


**Lectures**

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