

# **The International Harmonisation Process of Accounting Standards**

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**Abstract**

Background: Growth in international trade and capital flows has triggered a rising economic integration. Because of these developments there has been an international homogenising effect upon many customs, practices and institutions. In business life it led among other things to a desire to harmonise Accounting Standards among countries.

Purpose: Our purpose is to answer the question: What is the international harmonisation process of Accounting Standards, what is its status quo and how important is the International Accounting Standard Board (IASB) in it?

Realisation: In order to fulfil this purpose, we have chosen a descriptive approach, which is based on secondary data from textbooks, articles and homepages.

Result: The international harmonisation of Accounting Standards is a process, which brings international Accounting Standards into some sort of agreement, in order to achieve a common set of Accounting principles. 7000 European companies have to use the International Accounting Standards (IAS) in the European Union (EU), beginning 2005. The IAS are developed from the IASB. Furthermore, the long existing rejection of IAS of the U.S. seems to change. Co-ordination of agendas of the American standard-setting board (Financial Accounting Standard Board (FASB) and the IASB have been announced. We conclude, that the IASB plays a major role in the field of international harmonisation.

Keywords: Harmonisation, International Accounting Standard Board (IASB), International Accounting Standards (IAS), Accounting Standards, International Accounting.



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## List of Abbreviations

AICPA	American Institute of Certified Public Accountants
AISG	Accountants International Study Group
ARC	Accounting Regulatory Committee
EC	European Commission
EU	European Union
EFRAC	European Financial Reporting Advisory Group
FASAC	The Financial Accounting Standards Advisory Council
FASB	The Financial Accounting Standards Board
FEE	Fédération des Experts Comptables Européens
IAS	International Accounting Standards
IASB	International Accounting Standard Board
IASC	International Accounting Standard Committee
IASC	Foundation International Accounting Standards Committee Foundation
IFAS	International Financial Accounting Standards
IFRIC	International Reporting Interpretations Committee
IOSCO	International Organisation of Securities Commissions
ISAR	International Standards of Accounting and Reporting
MNE	Multinational Enterprise
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
SCA	Standard Advisory Council
SEC	Securities and Exchange Commission
UN	United Nations
US-GAAP	Generally Accepted Accounting Principles of USA

## Glossary

<b>Accounting</b>	Systematic recording, reporting and analysis of financial transactions of business.
<b>Accounting Practices</b>	Accounting Practices are the actual used practices by accountants. They are influenced by Accounting Standards, which govern the preparation of financial reports. Therefore we see a close relationship between these two terms and would use them interchangeably in our thesis.
<b>Accounting Standards</b>	Are the rules which govern the preparation of financial statements. They are the generally accepted accounting principles (GAAP) (Nobes et al., 1997)
<b>Accounting System</b>	A set of practices used in a published annual report.
<b>Accrual Accounting</b>	Method, when income is recorded, when the sale occurs and not necessarily, when the payment is received. Expenses are recorded, when the good is received. The aim is to give an accurate picture of the financial situation of the business.
<b>Convergence</b>	Convergence in this thesis can be understand as the effort of the IASB that “will examine the Standards promulgated by the national standard-setter of the various countries, utilise the expertise of these national standards-setter of the various and promulgate the best standards.” (Ruder, 2001:5)
<b>Deduction</b>	Deduction means that the research process starts with a general theory from which a hypothesis is developed. This hypothesis is

	<p>tried to explain with observable examples of reality. Therefore it can be said that this way looks at the consequences of theory.</p> <p>Deduction is characterised through its logic. (Ghauri and Gronhaug, 2002)</p>
<b>Disclosure</b>	<p>Disclosure means how and what information shall be provided in financial statements to outsiders. (Radebaugh and Daniels, 2001).</p>
<b>Exposure Draft 32.</b>	<p>Aimed at eliminating most of the choices between various alternative accounting methods allowed under former IASs. (Nobes et al., 1997)</p>
<b>Financial Accounting Standards Board (FASB)</b>	<p>Is the principal body that writes the generally accepted accounting principles by which the financial statements of the U.S. companies must be prepared. (Nobes et al., 1997)</p>
<b>Financial Statement</b>	<p>It is a written report, which describes quantitatively, financial situation of a company. It includes an income statement, balance sheet and if necessary a cash flow statement.</p>
<b>Harmonisation</b>	<p>Harmonisation is the attempt, to bring together different systems. Harmonisation as a <i>“process of increasing the compatibility of Accounting Practices by setting limits on how much they can vary.”</i> (Choi et al., 2002:291)</p>
<b>Induction</b>	<p>Induction starts in real life and conducts first observation and tries then to develop general theories. (Ghauri and Gronhaug 2002) This method begins from a broad perspective and leads to a narrow topic (Remenyi et al., 1998)</p>
<b>International Accounting</b>	<p>In our thesis we understand International Accounting in the sense of World Accounting. The aim of International</p>

	Accounting in that sense is to achieve “ <i>a complete standardisation of Accounting principles internationally.</i> ” (Riahi-Belkaoui, 2000:480). World Accounting is the broadest concept of International Accounting and directs International Accounting “ <i>to the formulation and study of a universally accepted set of Accounting principles.</i> ” (Riahi-Belkaoui, 2000:480)
<b>International Accounting Standards (IAS)</b>	The IAS are Accounting Standards, developed of the IASC (predecessor of the IASB).
<b>International Accounting Standards Committee (IASC)</b>	Organisation, founded 1973, which develops world-wide Accounting Standards.
<b>International Federation of Accountants (IFAC)</b>	IFAC was formed in 1977 to develop a world-wide accountancy profession (Nobes et al., 1997)
<b>International Organisation of Securities Commissions (IOSCO)</b>	The IOSCO is an organisation of security regulators representing more than 80 countries. They want to establish adequate standards for cross border capital raising and trading in order to protect investors. (Choi et al., 2002)
<b>Measurement</b>	Measurement means, how assets and liabilities are valued (Radebaugh and Daniels, 2001).
<b>Prudence Principle</b>	Valuations shall be done with prudence. All predicable risks and losses have to be taken into account. Profits can only be taken into account, if they are realised. It is a principle by which values on asset side are valued with a lower value and liabilities are valued with a higher value.
<b>Reconciliation</b>	Reconciliation allows foreign companies to prepare financial statements based on

	Accounting Standards of their home country. However, additionally they “ <i>must provide a reconciliation between critical Accounting measures (such as net income and shareholders’ equity) of the one country and the country where the financial statements are being filed.</i> ” (Choi et al., 2002:294)
<b>Uniformity</b>	Is a state in which everything is regular, homogeneous and unvarying
<b>U.S.-GAAP</b>	They are the generally accepted accounting principles of the United States.
<b>U. S. Securities and Exchange Commission (SEC)</b>	Is an U.S. government agency charged with ensuring adequate Accounting and reporting standards for companies, whose securities are publicly traded in the United States. (Nobes et al., 1997)



# 1 Introduction

This chapter gives an introduction into the topic ‘The International Harmonisation Process of Accounting Standards’. The problem and purpose of this thesis will be explained. Furthermore, this part will illustrate the scope, the limitations and the target group of this work. Additionally, a structure will be given in order guide the reader through the paper.

## 1.1 Background

Does Accounting have an international dimension? Epstein and Mirza consider Accounting “*as a tool to aid in measuring economic activity*” (Epstein and Mirza, 2001:1). The function of Accounting is to provide information about economic entities that are important for economic decisions (Kam, 1990). Accounting is referred to as the language of business (Mueller et al., 1991). But which language does Accounting speak? When talking about the language of Accounting one can conclude that it must speak an international language. We must therefore ask, how much has Accounting succeeded in establishing itself as an international language?

The technical advancements and the transmission of information, people, goods and services have brought the world closer together. Growth in international trade and capital flows have triggered a rising economic integration. Because of these developments there has been an international homogenising effect upon many customs, practices and institutions. In business life it has led, among other things, to a desire to harmonise Accounting Standards (see glossary) among countries. (Wolk et al., 2001)

International businesses are no longer confronted only with Accounting problems, which end at domestic borders. When companies cross borders they are confronted with new cultures, challenging new laws and different political systems. Besides that international companies must deal with different Accounting Standards abroad. For example in Germany companies use the German standards (Handelsgesetzbuch). In America, companies have to use the U.S.-Generally Accepted Accounting Standards (U.S.-GAAP).

When Daimler-Benz and Chrysler announced their merger in 1998 that did not only mean that two companies from two different countries merged, also two different Accounting

Philosophies were confronted with each other (Radebaugh and Daniels, 2001). However, there are not even two countries, which have the same Accounting Standards. A lack of similar Accounting Standards led among other things to problems in comparing financial data (Hill, 1999). This lack of comparability means an obstacle for the free movement of capital as shareholders might hesitate to invest in foreign companies, which prepare their financial statement in accordance with different Accounting Standards.

International enterprises are confronted with the problem that Accounting rules differ around the world. As a consequence of this they have often to do their financial statements twice: once in the home country in accordance with the home-country rules and once abroad in accordance with foreign rules. This practice includes the risk that the same problems are treated differently around the world.

Another problem concerning the variety of Accounting rules is that not all financial statements or Accounting Standards are accepted at all stock exchanges. Companies, which would like to be listed for example at the New York Stock Exchange (NYSE), have to prepare in addition to their national financial statement a financial statement in accordance with the U.S.-GAAP. In addition to their national financial statement they can as well prepare a reconciliation. This means that main positions like, for example, net income has to be computed in accordance with the rules of U.S.-GAAP. Such practices mean for companies extra costs, which influence the competition for capital. For investors this implies confusion about which Accounting Standards are the rights and which result is more credible. (Kleekämper et al., 2002)

In the last year's international companies, financial analysts, several international organisations as for example the International Accounting Standard Board (IASB) and other actors have put efforts in order to achieve a harmonisation (see glossary) of Accounting Standards. The aim of those was to avoid diversity of financial statements, to reduce extra costs, arising from drawing up different financial statements, and to win foreign investors. (Epstein and Mirza, 2001)

## **1.2 Problem**

The international harmonisation process of Accounting Standards started somewhere in the 1960s' and recent developments show that it is still going on. For us it seems interesting to reflect on this process and to ask about the characteristics (driving forces, actors, stages) of it.

### **Main problem**

What is the international harmonisation process of Accounting Standards?

Throughout our literature research we realised that the harmonisation process was extensively described in textbooks during the 1980's. Recent developments, movements and announcements of actors involved in of the harmonisation process are described in articles and on homepages. However, the situation about the status quo of the international harmonisation of Accounting Standards is not described in detail at the moment. With other words, because of the lack of information about the status quo, we see a need to analyse this field further.

### **Subproblem I**

What is the status quo of the harmonisation process?

During our research we read a lot about the importance of the IASB in the process of harmonising Accounting Standards internationally. Therefore, we aim to analyse the role of the IASB in the harmonisation process.

### **Subproblem II**

What is the role of the International Accounting Standard Board in the harmonisation process?

## **1.3 Purpose**

We consider the international harmonisation process of Accounting Standards as the main development in the International Accounting (see glossary) field. Because of the importance of this process we have decided to dedicate our thesis to describe and analyse it. Our main purpose of the thesis is to describe the harmonisation process. We would like to give the

reader a full picture of it. Therefore, our aim is to answer the question: *What is the international harmonisation process of Accounting Standards, what is his status quo, which role plays the IASB in it?*

Hence, we contribute to the field of International Accounting with describing the harmonisation process from the starting point until the status quo. With other words, the meaning of our thesis is to give the reader an insight in the past, the present and as well an insight in some future developments. He will get an idea of actors, involved in the harmonisation process.

## 1.4 Scope

In the following we would like to give the reader a better understanding, on what we are going to concentrate in our thesis. The graphic below illustrates the frame for our thesis.

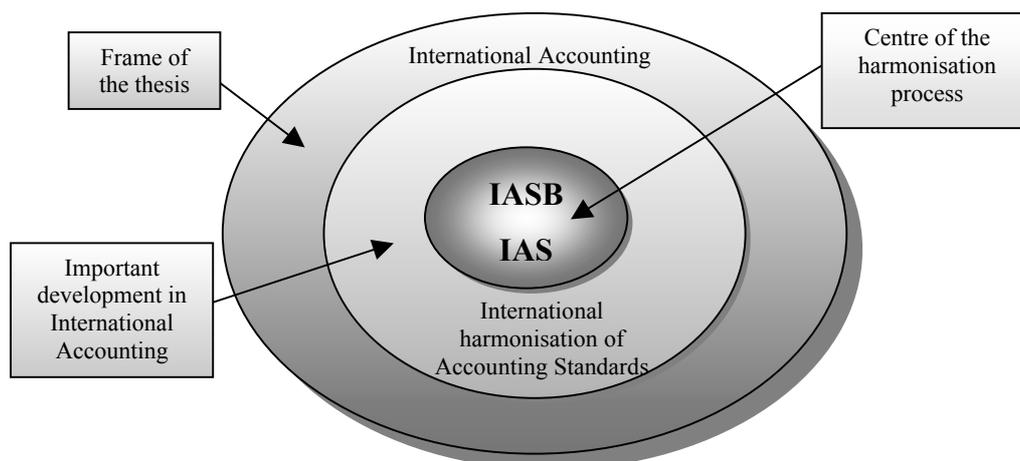


Figure 1: Scope of our thesis

The broader scope for our study is the field of International Accounting. This is the broadest frame, which our thesis will not cross. In this field we chose the process of harmonisation of Accounting Standards to narrow our topic of interest. Furthermore, we want to analyse the role of the IASB in the international harmonisation process, therefore we put it in the centre of our consideration.

There are three approaches to systemise the harmonisation process. These are illustrated in the following figure.

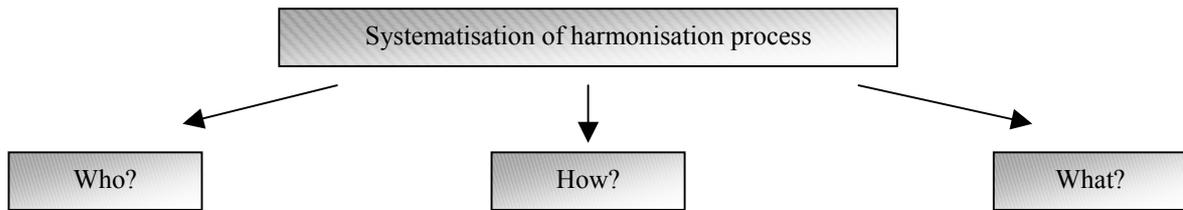


Figure 2: Systematisation of the harmonisation process (source: changed from Pellens, 2001:397)

The *who* of harmonisation deals with the question: Which institutions are involved in the harmonisation process? These are for example the European Union (EU), the Organisation for Economic Co-operation and Development (OECD) or IASB. The *how* looks at differences of enforcement and sanction mechanisms in the harmonisation process. Those can be for example national rules, recommendations, market solutions or international laws. The *what* of the harmonisation process aims at explaining what is actually harmonised. This can be the general purpose of financial statements, specific rules or definitions. It also deals with questions like: Who should apply the harmonised rules? Shall they be applied at the consolidated financial statements level or the single financial statements level? Which kind of businesses shall apply the rules? (Pellens, 2001)

Our thesis deals mainly with the *who* of harmonisation. We would like to emphasise that we describe the harmonisation process from the perspective of standard-setting actors. That means we will mostly be concerned about actors involved in the development and enforcement of international Accounting Standards (IAS), (see glossary).

## 1.5 Limitations

In the following we illustrate, which areas are not considered in our paper. The field of International Accounting is very broad and therefore not all aspects can be covered in this thesis. When writing about International Accounting one could specialise on several topics like, for example, transfer pricing, foreign currency translation or auditing.

However, we do not intend to give technical descriptions of Accounting rules, standards or practices. As we cover the world-wide process, it would lead too far to explain the regulations in depth.

Harmonisation of Accounting Standards takes place at the international and at the regional scope. We made the decision not to write about regional harmonisation processes. In the beginning we wanted to concentrate on the harmonisation process only in Europe. However, after the first literature review we realised that the European process is in a more concluded stage than the international one. Therefore we decided to find out more about the international harmonisation process. Furthermore we would like to emphasise that we describe the harmonisation process not from the perspective of companies. Hence, we do not consider, how they enforce international Accounting Standards.

### 1.6 Structure

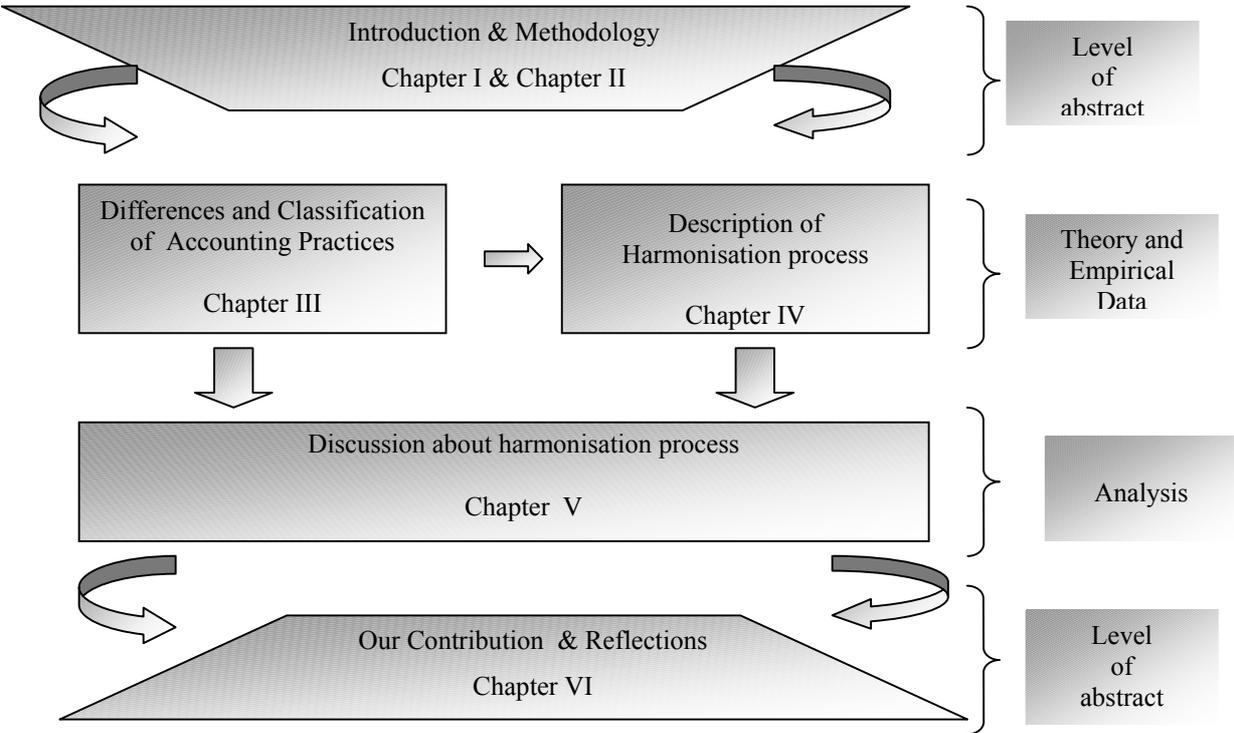


Figure 3: Structure of our work

While the first chapter introduces the topic of International Accounting to the reader and gives a first understanding of the purpose and problem of this thesis, the second chapter will present our methodical framework. Our approach (how our study was conducted) and our special structure will be discussed in more detail.

Then in chapter three we will present environmental influence factors shaping International Accounting Practices (see glossary). In addition, models of possible classifications of

Accounting Practices will be presented. This chapter aims at to show the diversity of Accounting Practices world-wide.

Further, in chapter four, reasons for the international harmonisation of Accounting Standards are given. Actors influencing the process are taken in consideration. Their work in the field of harmonising Accounting Standards will be presented. The relationships between these actors will be illustrated. The main purpose of this chapter is the description of harmonisation process.

The aim of chapter five is to find out what the status quo of the harmonisation process is. Therefore, the role of IASB will be analysed. This should show what hinders and supports the harmonisation process. The work will be finished with a description of our contribution to knowledge and reflections in chapter six.

## ***1.7 Target group***

We recommend our thesis to readers, who are interested in the field of International Accounting. We consider it as a good summary of the ongoing international harmonisation process of Accounting Standards. Thus we dedicate this thesis to readers, who already have a modest knowledge of Accounting but would like to gain a good general introduction to International Accounting and here specifically to the ongoing international harmonisation process of Accounting Standards.

## 2 Methodology

*"The topic to be researched is one of the primary drivers in the choice of methodology"*

(Remenyi et al., 1998:66).

In the methodology part we would like to present our operational framework within our study was conducted. First we will explain, why we consider our thesis as a hermeneutic study. Secondly the methodological approach to our problem will be described and our special structure will be explained in more detail.

### 2.1 Perspective

The aim of this part is to give the reader an understanding from which perspective this thesis is written. In general, two perspectives can be found in the field of research, namely positivism and hermeneutics. In the following we illustrate, why we connect our study to the perspective of hermeneutics.

This thesis has the aim to illustrate the harmonisation process of Accounting Standards. For us, it is important that the reader gets the main concept and understands the phenomenon of harmonisation of Accounting Standards. In order to shape this process for the reader, we collected and interpreted already existing data. Hermeneutics focuses mainly on the interpretation and explanation of written texts (Remenyi et al., 1998). We are aware, that our approach of using existing data, and giving interpretations of interpretations, can be considered as a hermeneutic approach.

However, at the beginning of our work we considered all Accounting texts as facts. For us Accounting is something shaped from the law. Accounting made of rules written down in the company law. Therefore, it seemed for us that Accounting texts do not allow interpretations. However, throughout our research we had to learn that this is not true. We had to understand that Accounting is influenced from its heritage and opinions and that it is not facts or data, which are interpreted, but texts.

Furthermore, we had to learn that we - the researchers - are as well influenced from our background. A background, which has its roots in Europe and therefore in the Continental

system. Our research has taught us that we (as all researchers) are not free of pre-assumptions and that therefore our work is influenced by us. Therefore, we do not believe that researchers can be neutral scientists. We agree with the idea of the hermeneutic perspective that, among others, the language and background of the researcher might influence his understanding and interpretations of texts and documents. However, although we know that we are caught in our thinking structures to a certain degree, we believe that each researcher has to make efforts to be neutral as much as possible. Therefore, we thought over our research policies very often, in order to discover pre-assumptions. However, despite our efforts we cannot guarantee that our work is free of pre-understandings. These pre-understandings are more or less unknown assumptions (Johansson, 2000) and therefore, difficult to remove.

Considering our research we describe the international harmonisation process of Accounting Standards. We limit our study at describing and interpreting the process and explaining the role of the IASB in it. Our aim is not to develop laws or generalisations of the harmonisation process. Since the positivistic view of science sees the researcher as *“working with an observable social reality and that the end product of such research can be the derivation of laws or law-like generalisations”* (Remnyi et al., 1998:32) we would not call our approach as a positivistic one.

Hence, the perspective of hermeneutic is reflected in our thesis in the following way:

<b>Aim</b>	Interpretations are made in order to understand the main concept of the process.
<b>Approach</b>	Qualitative Analysis.
<b>Method</b>	Description, interpretation and explanation of written texts.
<b>Tool</b>	Secondary Data.
<b>Role of the researcher</b>	The researcher has to accept that the world cannot be perceived objectively, however we believe that the researcher has to stay as neutral as possible.

Table 1: Overview on hermeneutic

The meaning of our thesis is to make the reader understand the process of international harmonisation. We want to examine the parts of the harmonisation process (starting point – process – discussion) in order to create a better understanding of the whole. Instead of using a logic validation, used in positivism, we use the method of description, explanation and

interpretation of texts and therefore not facts. Further, we believe that humans cannot be objective. We are biased of previous experiences and knowledge. Therefore, we do not consider us as neutral observers. All in all we believe that we follow the ideas of hermeneutics in our thesis.

## **2.2 Our methodological approach**

Since we describe the international harmonisation process of Accounting Standards we believe that our thesis belongs to the descriptive research field, which is characterised by the purpose “*to document the phenomenon of interest*” (Remnyi et al., 1998). However, the ‘phenomenon of interest’ will not be measured in terms of quantity, amount, intensity or frequency. We have decided to use a qualitative approach, to document our field of interest. Miles and Huberman describe a qualitative analysis as three flows of activity, namely:

- data reduction,
- data display and
- conclusion drawing/verification (Miles and Huberman, 2000).

In the following we give an overview on our qualitative analysis with the help of these three separations.

### **2.2.1 Data reduction**

Miles and Huberman describe data reduction as a process “*of selecting, focusing, simplifying, abstracting, and transforming the data that appear in written-up field notes or transcription*” (Miles and Huberman, 2000:10). We consider data collection already as data reduction because it is a decision, which data should be used. In the following we explain the methods, how we collected data.

In our study we rely on secondary and not on primary data. This is in accordance to Arbnor and Bjerke who argue that in descriptive studies it is useful only to use existing – secondary data (Arbnor and Bjerke, 1997). When writing about secondary data we refer to Howard and Sharp, who define secondary data as information, which got already collected by others and

published in some form (Howard and Sharp, 1983). In our case we used books, previous research reports, articles and homepages as main secondary resources.

Secondary data helped us to save both time and money. As we had only restricted time for writing this thesis, it was very important, that we could collect data in a way, which was possible in this limited frame of time. We see the advantage of secondary data that it gives the researcher help, when deciding on the method to use in his study and where to put emphasis. Several authors before us gave a description of the harmonisation process. Therefore, we decided to use that method as well. None of them gave a clear argumentation of the importance of the IASB in the harmonisation process. Furthermore, none of the textbooks included the recent developments of the status quo of the harmonisation process. Therefore, existing data helped us to find our focus for the analysis part.

Already existing data includes the drawbacks that material has been interpreted by someone else before and might thereby not be objective. In order to minimise the risk of subjectivity, we compared texts and thoughts of authors with each other and tried to be critical, when we evaluated texts. Furthermore, it is of high importance for the quality of data, to check the primary source and to emphasis on recent material, which was not always possible in our case. We are aware that the use of secondary data is an interpretation of already existing material. Hence, one has to admit that already existing data might have been collected for another objective and might not completely fit to our problem. Furthermore, we are aware that the use of web-sites might diminish the academically value of this thesis. Homepages and other web-sites might not contain always academically applied knowledge, because resources from the Internet do not undergo the same scrutiny as for example books (e.g. check by the publisher). Another fact is that resources from the World Wide Web are often changed or removed after a certain time. Therefore we tried to limit our Internet research to homepages of involved actors of the harmonisation process or newspapers. We consider the homepages of IASB, Financial Accounting Standard Board (FASB) (see glossary) or EU as credible. However, the content from these homepages had to be critical reviewed in order to avoid subjective arguments.

We did not use primary data because of the following two reasons: First, we believe that the purpose of our thesis does not require the use of it. As our focus is to describe the phenomenon of a process, we consider our task to put the pieces of this process together in

order to receive the whole picture. However, these parts of the process are already written down in articles and books. Therefore, there is no urgent need to use primary data in order to collect data. Hence, the task can be done and the aim fulfilled by collecting, describing and interpreting the information, which is already written. Secondly, we do not use primary data because of a rather difficult access to main actors on which our thesis is relying. Main actors in this thesis are world-wide organisations as, for example the European Union or the International Accounting Standard Board. These organisations are too global to be able to answer inquiries of students. (IASB, 2002 i)

### 2.2.2 Data display

The second flow of activity in qualitative research is data display. Decisions have to be made, which data, are where best placed. According to Miles and Huberman extended texts have been the most frequent form for the display of information in the past (Miles and Huberman, 2000). However, extended texts might be difficult, confusing and tiring to read. Efforts in this thesis were made to display data to the reader in an organised way. Throughout our thesis we try to illustrate our content with graphics and tables, which give the reader a better understanding of the topic. Furthermore, we have chosen a structure, which is different from the general structure, used in other thesis. As we are going to explain the process of harmonisation, we needed a structure, which suits this process and guides the reader through our work. Therefore, we would like to explain our structure in more detail.

In our beliefs each process can be separated in the following three stages of development:

- a starting point,
- the process and
- the status quo of the process.

Thus, we applied these three stages of development to the structure of our thesis. The following graphic illustrates this procedure:

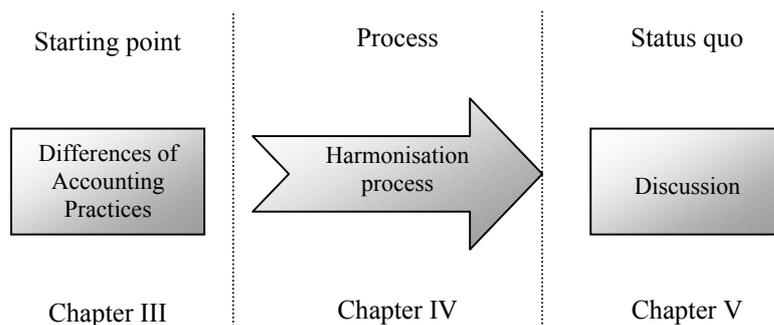


Figure 4: Process-oriented structure of our thesis

Chapter three (frame of references) aims to be the starting point of the harmonisation process. Several environmental influence factors of Accounting Practices and clusters of those will be explained. The purpose of this chapter is to make sure that the reader understands, that these environmental influence factors are the reasons, why Accounting Practices differ around the world. Chapter four (empirical part) describes the harmonisation process with the help of involved actors. The focus will be on the description of the work of IASB. Chapter five can be compared with an analysis part. We consider this chapter as the final point of our process description. We intend to discuss in this chapter the role of the IASB and the status quo of the harmonisation process.

### 2.2.3 Conclusion Drawing and Verification

Conclusion drawing concerns the questions of what factors have influenced the researcher in making the conclusion. Conclusion drawing is in our opinion a question of verification. Huberman and Miles explain that the researcher has from the beginning of data collection, some conclusions about the result of the research (Miles and Huberman, 2000). We agree with this statement. In our case, we had from the beginning the feeling that the IASB plays an important role in the international harmonisation process. However, we were interested in the reasons behind it. Therefore, we chose the IASB as a main actor in our thesis, despite our pre-conclusions. In order to prevent subjective results we made efforts to remain open and sceptically, to find other point of views during our study.

How did we try to achieve a verification of data in our study? We used books and articles both from American as well as European authors. Efforts were made to avoid one-single arguments and therefore, we try to consider both sides of the medal. This is done for example

by not only trying to present the European view but also to explain the American view. Further we consider the achievements and weaknesses of the IASB. In order to make our study as transparent as possible, we try to present our arguments in an easy retrievable form and explain our decisions and methods.

### 2.3 Thoughts and Reflections

Here we would like to reflect our thoughts, when writing the thesis. Thus, the reader will get throughout this part an idea about questions and problems, which raised.

#### 2.3.1 Theory versus Practice

The question we have asked ourselves several times during our work was, if we peck at practice and contribute to theory:

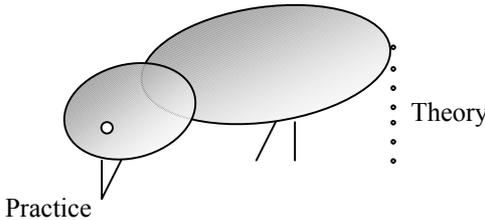


Figure 5: Theory and Practice I (Gummesson, 2002:10)

Or if we peck at theory and contribute to practice:

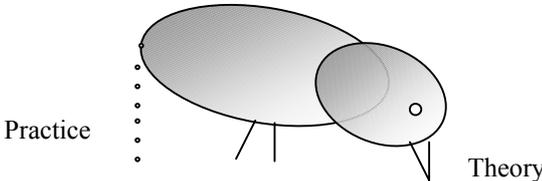


Figure 6: Theory and Practice II (Gummesson, 2002:10)

These questions highlight the fact that conclusions of a research project can be done in two ways: the inductive way (see glossary) and the deductive way (see glossary). We consider our thesis as being neither deductive nor inductive. This has the following reason: During our thesis we saw a need for discussing several times what theory and what practice in

Accounting is. The problem we face is that practice and theory of Accounting have no borders and frames but are interrelated. Remenyi et al. define theory as “*a scientifically acceptable general principle or set of principles offered to explain a phenomenon or a group of phenomena*” (Remenyi et al., 1998:280). However, in the field of Accounting these general accepted principles of theory are often used in practice. Hence, theory forms Accounting Practices and in reverse practice forms theory. So, for example, the basic principles in Accounting are not regulations issued from institutions<sup>1</sup> but were first used in practice from accountants. From this practical use, theories were applied. Because of this tight relationship between theory and practice it was sometimes hard for us to separate it from each other.

### 2.3.2 Questions to our thesis

In the following we will introduce questions, which approached throughout our work. These questions can give the reader an understanding of our thinking and explain, why we made the following choices.

#### **Why do we analyse the IASB in more detail than other actors?**

We discussed several times, if it is the right way to draw so much attention to the IASB and not to other actors. We decided that it is appropriate to focus on the IASB because of the following reasons. The IASB was formed as an international standard-setter in 1973. There is no other organisation in our view, with the same efforts. Furthermore, we realised that all our books (without exception) introduced the IASB and not other organisations like the FASB in order to analyse the harmonisation process. We knew from the beginning that the IASB is an international standard-setter. We decided not to pre-assume that the role of the IASB is only to develop standards. Therefore, to be open as much as possible, we asked what role the IASB plays in the harmonisation process.

#### **What do we mean with actors?**

We use often the term actors in our thesis. Therefore, it is appropriate to explain, what we consider to be an actor. As actors we understand organisations, which are involved in the

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<sup>1</sup> When we use the term institutions we refer to Hofmann and Suchanek who argue that institutions embody systems of rules that constrain human behaviour (Hofmann and Suchanek, 2000). Institutions consist of formal as well as informal rules, whereas the latter underlie and serve as appendages to formal rules. Further institutions embody enforcement mechanisms that are required to reach compliance with the rules. (North, 1990)

harmonisation process. The criteria for our selection of actors is influenced by Nobes. He distinguishes organisation with the following questions:

1. Is the organisation concerned with Accounting Standards or Auditing Standards?
2. Are the organisation's members of the government or professional accounting groups?
3. Is the organisation's effort regional or international scope? (Nobes et al., 1997)

As our thesis only deals with the harmonisation process of Accounting Standards at the international scope, we mainly considered organisation, which have these characteristics (international, harmonisation of Accounting Standards). The European Union and SEC are considered, although they are organisations, involved in the regional harmonisation process. The efforts of the SEC are only explained in context with its contribution to the international harmonisation process. The European Union is introduced because of its important decision to accept the IAS in the year 2005. The second criteria of Nobes had no influence on our choice of organisations. However, it has to be explained, that we use the word private body for actors, which are private funded and public bodies are called governmental institutions.

### **Why do we consider the harmonisation process from the perspective of actors?**

In general it would have been possible to consider the harmonisation process from the perspective of companies as well. For example, we could have examined how many companies use the U.S.-GAAP and how many use the IAS. From this we could have applied, how successful the IASB is as a standard-setter. Instead we decided for a description of the process, beginning with the different Accounting Philosophies between countries. Hence, we concentrated on the differences of countries instead of companies. However, we were more interested in the organisations supporting and pushing the harmonisation process.

### **Why do we have different spellings of the same terms ?**

The reader has probably realised that we write terms like International Accounting Standards sometimes with capital letters and sometimes with small letters (international Accounting Standards). This is our way to distinguish between, when the standards of the IASB are meant (big letters) and when we mean international Accounting Standards in general. Furthermore we write Accounting Standards, Accounting System (see glossary) or Accounting Practice (see glossary) in big letters, because we consider them as terms. They can as well be found in our glossary.

# 3 Differences in International Accounting Practices

The aim of this chapter is to describe the starting point of the harmonisation process, namely the differences in International Accounting Practices. We want to analyse in this chapter why those differ around the globe and which causes are responsible for it. Accounting Standards influence Accounting Practices, therefore both are interrelated with each other in our point of view. Simpler said different Accounting Practices result from different Accounting Standards. The reader shall understand that these differences in Accounting Practices and therefore also Accounting Standards are obstacles for the harmonisation. To make it clearer that Accounting Practices vary worldwide, classifications of Accounting Practices will be presented.

## 3.1 Causes of differences in International Accounting

The environment in which a country operates shapes its Accounting Practices (Nobes et al., 1997; Radebaugh and Gray, 1997). *“Just as nations have different histories, values, and political systems, they also have different patterns of financial accounting development”* (Nobes et al., 1997:2). According to Roberts et al. there are not two countries, which have the same Accounting Practices (Roberts et al., 1998). The following graphic gives an overview on variables, which can cause differences in Accounting Practices:



Figure 7: Causes of differences in Accounting Practices (source: changed from Roberts, 1998)

### 3.1.1 Legal system

The Accounting world can be divided into “*those countries which have a ‘legalistic’ orientation toward accounting and those with a ‘nonlegalistic’ orientation*” (Nobes et al., 1997:8). The non-legalistic approach can be found in countries, which use common law. In common law countries, Accounting does not depend upon law. Accountants (professional organisations) arrange accounting rules. Hence, it is the private sector, which determines Accounting and not the law (Choi et al., 2002). The task of the legal system is to give an answer to a specific case rather than to formulate general rules for the future (Choi et al., 2002).

The legalistic approach can be found in countries, which use the so called code (or codified) law. In contrary to the common law, the codified law system needs to develop rules in detail for the Accounting and financial reporting (Nobes, 1994). This means that “*Accounting rules are incorporated into national law and tend to be highly prescriptive and procedural*” (Choi et al., 2002:43). In these countries the role of law is to describe behaviour, which is considered to be acceptable in the society (Choi et al., 2002).

Nobes and Parker give an overview on legal systems, shown in the table below (Nobes and Parker, 2000).

<b>Common Law</b>	<b>Codified Law</b>
England and Wales	France
Ireland	Italy
United States	Germany
Canada	Spain
Australia	Netherlands
New Zealand	Portugal
	Japan (commercial law)

Table 2: Countries and legal systems (source: Nobes and Parker, 2000:19)

According to these authors the U.S., Canada or the U.K. belong to the common law countries and France or Germany for example to the codified countries. The laws of Scotland, Israel, South Africa, Quebec, Louisiana and the Philippines contain elements of both systems. The codified law system is as well used in South America. (Nobes and Parker, 2000)

### 3.1.2 Provider of finance

The three main sources for external capital are shareholders, banks and government (Hill, 1999). It varies from country to country, which of these three provides most of the financial capital to companies. In countries like Germany and Italy banks provide companies with capital. In countries like England and the United States shareholders provide companies with capital. The government is the provider of capital in countries like France and Sweden. (Hill, 1999)

This diversity of capital providers means that Accounting Practices differ in order to satisfy needs of capital providers. In the case of shareholder ownership, (e.g. in the U.K. and the U.S.), information disclosure will be more important than in countries, where capital is raised from banks or governments. This is explained by the fact that in the latter countries information will be transmitted more directly. (Radebaugh and Gray, 1997) It is impossible for a company to inform each shareholder with its specific information needs, because they are a big and unorganised group. Therefore financial statements in the US and UK are *“oriented toward providing individual investors with the information they need to make decisions about purchasing or selling corporate stocks and bonds”* (Hill, 1999:593). The Accounting Practices in countries with banks as main capital providers have an interest to protect bank’s investment. This led to more conservative methods, which are characterised by overvaluation of liabilities and underestimation of assets (Hill, 1999). In countries where capital is provided by the government, Accounting Practices are oriented towards needs of governmental planners (Hill, 1999).

### 3.1.3 Taxation

The key question here is to ask, how much taxation regulations determine Accounting measurements. In countries like the U.S., U.K. and Netherlands there is no interplay between tax and Accounting law. When Accounting Standards are developed, the only focus is how to conduce the information function. Questions about taxation are not considered in those countries (Achleitner, 2000).

In contrary, in nations as France and Germany, tax and Accounting Systems are ruled equal (Nobes and Parker, 2000). There is the principle of decisiveness in continental European

countries. This means that the profit of the balance sheet is at the same time the foundation to snap income taxes (Achleitner, 2000).

### 3.1.4 National culture

National culture of countries influences Accounting Practices as well. Authors like, for example, Nobes and Parker, Roberts et al. refer to the study of Hofstede in order to explain how national culture could influence Accounting Practices of countries. (Nobes and Parker, 2000; Roberts et al., 1998)

Hofstede compared cultural behaviour in an American company, which was represented in over 50 countries. His aim was to define characteristics of national culture with help of the four following dimensions (Hofstede, 1991):<sup>2</sup>

- Large versus small power distance,
- Strong versus weak uncertainty avoidance,
- Individualism versus collectivism and
- Masculinity versus femininity.

The importance of Hofstedes dimensions of national culture in the International Accounting field is, that national culture influences the behaviour of accountants and therefore the nature of Accounting Practices. According to Roberts et al. dimensions as individualism and uncertainty avoidance are most significant for Accounting. They argue that in a country with high uncertainty avoidance, efforts are made to minimise uncertainty. This means in the area of Accounting that rules and regulations tend to be rather explicit, detailed, prescriptive, all comprising and rigid. Individualism affects Accounting in terms of disclosure practices and income measurement rules. It depends on the dimension of individualism, how willing people are to accept rules and controls from above. (Nobes and Parker, 2000; Roberts et al., 1998)

Gray is another author, which studied national culture, as an important influence factor on Accounting. His work will be explained later in this chapter in order to classify Accounting Practices with national culture.

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<sup>2</sup> The dimensions of Hofstedes study are explained shortly in Appendix 8.1.

### 3.1.5 Other influences

Another influence on Accounting Practices can be called 'factor of accident of history'. Accidents of history refer to rules of practices of Accounting, which developed due to crisis or shocks of systems in general. To such kind of accidents of history belong for example collapses of companies or financial crisis like in the beginning of the 1920`s when the German and US stock markets collapsed. In the United States this accident of history resulted in the creation of the Securities Exchange Commission and stricter Accounting regulations in order to protect the shareholder. In Germany the same accident led to Accounting regulations, which protect the creditor. (Nobes and Parker, 2000)

In countries with high economic growth and hyperinflation, as for example in South American countries, inflation has a big influence on Accounting Practices as well. For example, a practice of general price-level adjustments instead of traditional practices of historical cost measurements<sup>3</sup> can be found there. (Nobes and Parker, 2000)

Political and economic ties with other countries play another important role in shaping Accounting Practices. Accounting Practices are not only used in the home country but have been exported since the earliest beginning of Accounting. For example, the movement of accountants between United States and Great Britain led to many similarities between these two countries. (Roberts et al., 1998) Furthermore, Hill mentions that the American and British Accounting Practices had enormous influence on other countries. Hill argues that America influenced Accounting Practices of Canada and Mexico. Britain influenced their former colonies like, for example, India and Pakistan. (Hill, 1999)

Several authors argue that Accounting problems vary dependent on the development of an economy. Hill points out that Accounting in developed countries might be more complex and sophisticated than in less developed countries. He argues that developed nations might have larger and more complex organisations with more educated workforce. He thinks that they have a need for more advanced Accounting Practices. (Hill, 1999; Radebough and Gray, 1997)

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<sup>3</sup> Historical cost measurement assumes that the currency does not lose value over time. Therefore it is a more useful Accounting Practice in countries with a stable currency.

## 3.2 Classification of Accounting Practices

Our aim with presenting classifications of Accounting Practices is to give an overview about the international diversity of them. We want to show, which characteristics (factors) are used to group Accounting Practices. We will examine whether these factors have changed throughout the time. National systems can be clustered. Both similarities and differences become clear with classifications.

### 3.2.1 Nobe`s Classification of Accounting Practices (1980)

Nobes classes measurement practices of fourteen western countries<sup>4</sup> into a hierarchy of three levels.

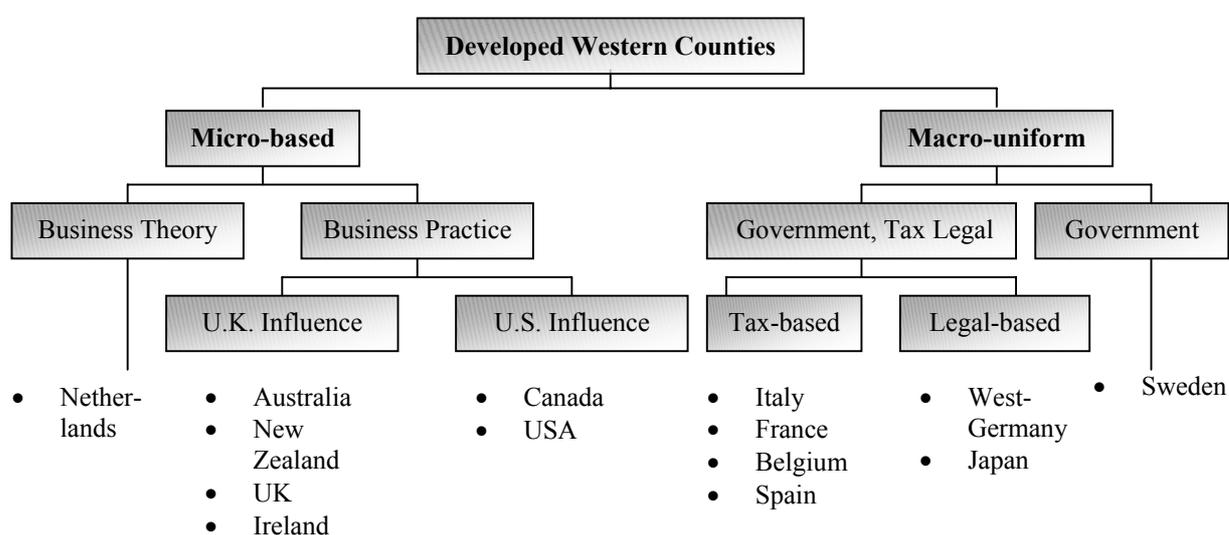


Figure 8: Nobe's classification of Accounting Practices in 1980 (changed from Radebaugh and Gray, 1997:70)

On the *first* level he distinguishes between the micro-based and the macro-uniform orientation. While the macro-uniform orientation corresponds with the code law, the micro-based corresponds with the common law. This marks the high importance of the legal system as a dominant factor in shaping Accounting Practices. (Choi et al., 2002) Radebaugh and Daniels argue that macro-uniform countries are shaped by more governmental influence than the micro-based ones (Radebaugh and Daniels, 2001).

On the *second* level Nobes analyses who influences Accounting Practices most. He differentiates between business theory<sup>5</sup> and business practice<sup>6</sup> under the micro-based

<sup>4</sup> The fourteen countries are: Netherlands, Australia, New Zealand, U.K., Ireland, Canada, USA, Italy, France, Belgium, Spain, West-Germany, Japan and Sweden.

classification. Under the macro-based one he considers influence factors as the government/tax/legal<sup>7</sup> orientation, in contrast to the government/economic<sup>8</sup> one. (Radebaugh and Gray, 1997)

As a last step he deviates between the U.K. and U.S. influence under the business practices orientation. Further, he differs between tax-based and law-based systems under the government/tax/legal orientation. (Gräfer and Demming, 1994)

From this figure can be seen for example that Australian Accounting, as a member of the U.K. family is closer to U.K. Accounting than it is to either Canadian or U.S. Accounting. However it is closer to these two than to Dutch Accounting, because all are influenced by business practice. Australian Accounting is still closer to Dutch Accounting than to French and German Accounting, which are in entirely different classes.

Radebaugh and Gray see problems with Nobes theory, when countries shall be allocated to these categories, for example when both aspects (e.g. tax-based or law-based categories) are influential (e.g. in France and Germany) (Radebaugh and Gray, 1997).

### 3.2.2 Nobe`s Classification of Accounting Practices (1998)

In 1998 Nobes proposed a new classification of Accounting Practices. In comparison to his first study he commits *“that the type of finance is now more important than the legal system in classifying financial reporting systems”* (Choi et al., 2002:53). Furthermore, he is aware that *“many companies modified their financial reporting to suit the information needs of international capital investors. In particular, companies from code law countries began to adopt shareholder oriented reporting found in common law countries”* (Choi et al., 2002:53). Therefore, he saw a need to focus his classification on financial reporting of companies instead of countries. Hence his new classification divides between strong equity and weak

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<sup>5</sup> In this pattern a fundamental orientation exists toward individual economic entities. (Radebaugh and Gray, 1997)

<sup>6</sup> There is respect for pragmatism and Accounting is derived from successful business practice under this approach. A full and fair disclosure is a very important generally accepted accounting principle under this approach. (Radebaugh and Gray, 1997)

<sup>7</sup> Accounting is standardised and employed as a too far administrative control by central government. Uniformity in measurement, disclosure and presentation makes it easier to control all types of business by government planers. (Choi et al., 2002)

<sup>8</sup> Under this approach of accounting, corporate Accounting Practices are derived from and designed to enhance national macroeconomic goals. (Choi et al., 2002)

equity reporting. With strong equity is meant a shareholder-oriented reporting. Additionally, his classification divides outsider from insider financiers. *“Outsiders are not members of the board of directors and do not have privileged relationship with the company (e.g., such as that enjoyed by a company’s banker who is also a major shareholder)”* (Nobes, 1999:166). But also the standards of the IASB (IAS/IFRS) belong to this class of more focus for shareholder orientation.

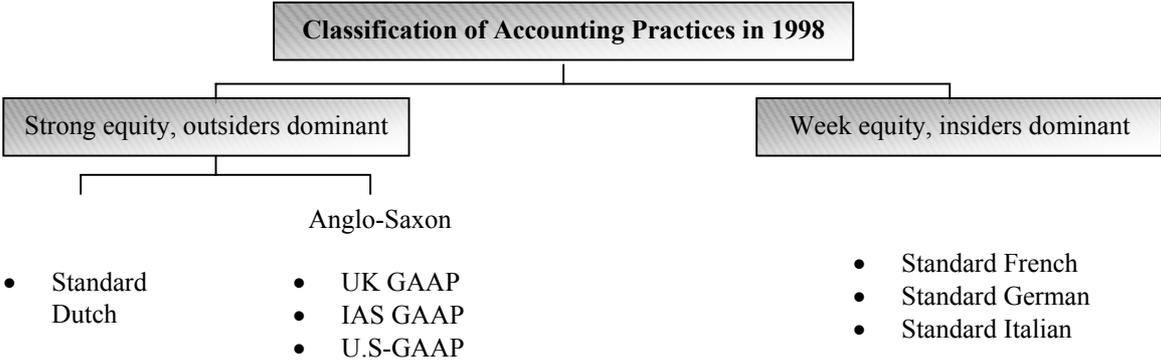


Figure 9: Nobe's classification of Accounting Practices in 1998 (changed from Choi et al., 2002:53)

Following from the graphic above the Accounting Practice are divided into two systems, which stand at the extremes. These two practices are the Anglo-American Model and the Continental- European Model.<sup>9</sup>

**Anglo–American–Model**

An orientation towards decision needs of investors is emphasised in the countries of this model (Mueller et al., 1991). The security of the creditor is of subordinated importance according to that approach. In foreground stand performance and financial position of the company. The financial statement shall be used in order to give information about the future development of the company. Accounting Practices are characterised in Anglo-American countries by more focus on the addressee in order to mobilise capital, because of the bigger influence of capital markets. Extensive disclosure and an attenuation of the prudence principle in favour of the accrual accounting (see glossary) are characteristic for Accounting Practices

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<sup>9</sup> Müller names as well the **South American Model**. This model includes most countries in South America, which share not only the language (with exception of Brazil) but also a common heritage (Mueller et al., 1991). The South American model differs from other models because of their continuously adaptation for inflation. Financial statements in these countries have to be restated because of permanent changes in the price level. (Epstein and Mirza, 2001) Furthermore, these Accounting Practices are oriented towards the needs of government planners, uniformed and tax-based Accounting is practised (Mueller et al., 1991) A list of countries belonging to this group can be found in Appendix 8.4.

of those countries. (Wollmert and Achleitner, 2002) Wolk et al. stress the strong Accounting profession, the limited role of government and the importance of stock markets in those countries (Wolk et al., 2001).

The standards of the IASB belong to the Anglo-American Model. (Wollmert and Achleitner, 2002) Countries as the UK, many members of the British Commonwealth, the US, the U.K., Australia, New Zealand, Canada, the Netherlands, Mexico, Pakistan or Kenya belong as well to this model (Wolk et al., 2001; Pellens, 2001). A complete list of the countries, which belong to this model, can be found in Appendix 8.2.

### **Continental-European Model**

Countries as Germany, France, Spain, Italy, Japan, Switzerland or Egypt belong to the Continental-European Model <sup>10</sup>(Pellens, 2001; Wolk et al., 2001). In contrast to the Anglo-American-Model, countries of this cluster rely on banks as capital providers and have therefore a close relationship with them (Mueller et al., 1991; Wolk et al., 2001). These countries rely less on public equity market than countries of the Anglo-American-Model (Epstein and Mirza, 2001). Hence, the task of financial statements is not in first line to provide information (to capital providers) but to please government imposed requirements (e.g. tax collection and to protect creditors). Accounting Practices can be characterised as legalistic and as highly conservative. (Mueller et al., 1991; Wolk et al., 2001) *“France and Germany, as continental model countries, are less concerned with the primacy of investors needs and more concerned with issues such as tax determination and the protection of creditors”* (Haller et al. in Wolk et al., 2001:729). The main tasks of Accounting according to that model are therefore the security of creditor as well as the long-term stability of the enterprise. The prudence principle can be called as the dominating accounting principle under this model and is more important than accrual accounting. (Wollmert and Achleitner, 2002)

Influence factors on Accounting Practices are diverse. It has been shown that Nobes theories emphasise the legal system. Nowadays, Nobes considers the provider of finance as a very important influence factor in terms of classification of Accounting Practices. Another factor in order to classify Accounting Practices is culture.

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<sup>10</sup> A complete list of the countries, which belong to the Continental-European Model can be found in the Appendix 8.3.

### 3.2.3 Gray's cultural classification of Accounting Practices

Gray proposed a theory how to link culture and Accounting. Gray discovered the following pairs of Accounting values, which can be used in order to describe a nation's Accounting Practices and how to distinguish them from each other. (Gray in Nobes and Parker, 2000)

- *Professionalism versus statutory control*

This dimension is concerned with attitudes towards regulations, in particular how Accounting control is done (Roberts et al., 1998). A high level of professionalism describes a system of self-regulation and a lower degree denotes high level of government regulation (Wolk et al., 2001).

- *Uniformity versus flexibility*

Uniformity versus flexibility describes the attitudes towards regulations, in particular how Accounting control is done (Roberts et al., 1998). It describes the preference for uniformity and consistency over flexibility in reacting to conditions (Choi et al., 2002). Wolk et al. describe this value as following: "*The higher the degree of uniformity, the more Accounting rules are applied in a – cook book – fashion and the less professional judgement is employed*" (Wolk et al., 2001:727).

- *Conservatism versus optimism*

Conservatism and optimism explains the attitudes towards measurement in financial reporting (Roberts et al., 1998). While conservatism aims at a more cautious approach to value assets and recognise income, optimism is a more risk taking and liberal approach to measurement (Choi et al., 2002).

- *Secrecy versus transparency*

Is concerned with the attitude how much information companies show the public in their disclosure (Roberts et al., 1998). Secrecy is consistent with a restricted information disclosure "*on a need-to-know basis*" (Choi et al., 2002:46). Transparency is characterised by a willingness to disclose much more open to the public (Choi et al., 2002).

Gray classes ten cultural areas<sup>11</sup> according to his four above described accounting values.<sup>12</sup> In Appendix 8.6 we included a list of countries, which belong to the culture areas.

As can be seen from the graphics below, Gray differentiates twice. First, he classes the cultural areas according to their attitudes towards regulations (shown in graphic 10). Hence, he puts the value *professionalism* versus *statutory control* and *uniformity* versus *flexibility* at extremes.

Second, he classes the cultural areas according to measurement and disclosure practices. For this, he takes the values *conservatism* versus *optimism* and *secrecy* versus *transparency*. Thus, in contrary to Nobes, who consider only measurement practices as classification characteristics, Gray differentiates between:

- Regulation authority in Accounting and
- Measurement and disclosure practices. (Choi et al., 2002)

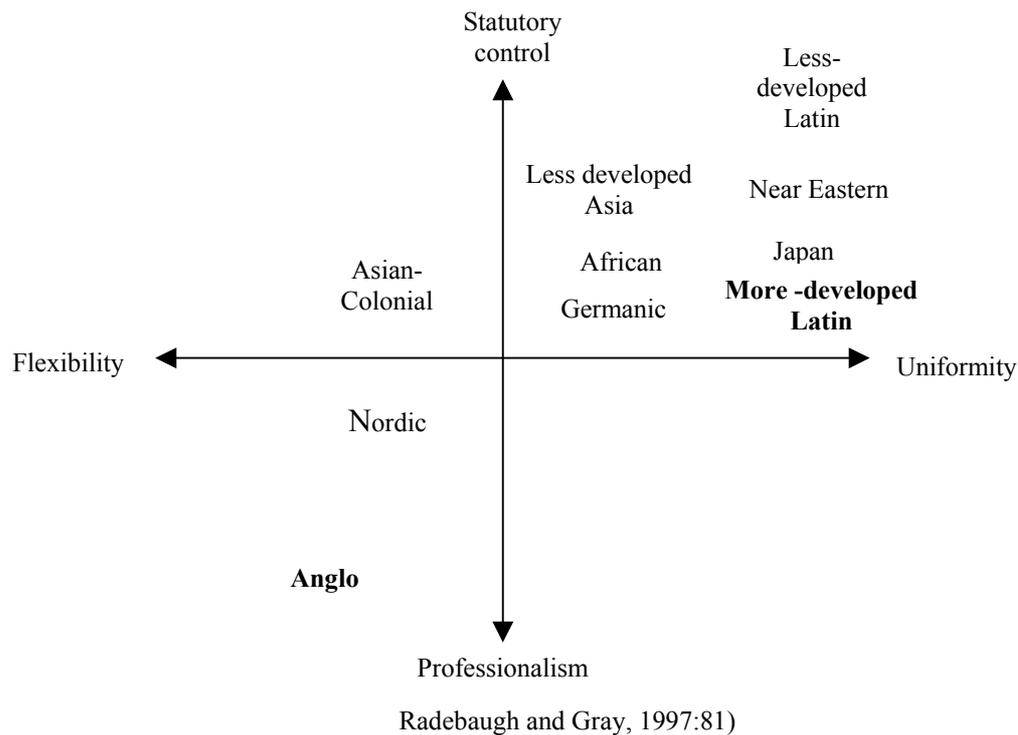
The following graphic shows the cultural areas classed with the help of the Accounting values according to regulation authority.

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<sup>11</sup> These ten cultural areas are the following: Asian colonial, Germanic, Less-developed Latin, Less-developed Asian, Near Eastern, Japan, African, More developed Latin, Nordic and Anglo.

<sup>12</sup> The grouping of countries into cultural areas goes back to Hofstede, who grouped 50 countries according to the scores on the four culture value dimensions. Appendix 8.6 shows, which countries belong to which cultural area. Gray assumed that there is a relationship between Accounting values and cultural values. Therefore the same cultural areas could be used, in order to classify Accounting Practices. (Gray in Radebaugh and Gray, 1997).

Figure 10: Classification of Accounting Practices according to Regulation and Enforcement (changed from



When considering this graphic it can be said in general that areas within the same quadrant are more similar to each other than countries in another quadrant. As an example countries like France and Spain, which belong to the **More-developed Latin** group, are characterised by uniformity. That can be explained with the imposition of tax rules for measurement purposes, and the focus “*to facilitate national planning and the pursuit of macroeconomic goals*“ (Radebaugh and Gray, 1997:78) in those countries. Furthermore, one can see that **Anglo** countries, as the U.K. or U.S., are characterised with a high degree of flexibility and a low degree of uniformity in their rulemaking. Countries in this cultural area are market by professionalism or the private sector, and a less degree of statutory control by the public sector when making regulations. (Choi et al., 2002) Figure 11 shows the distribution of the cultural areas concerning measurement and disclosure practices.

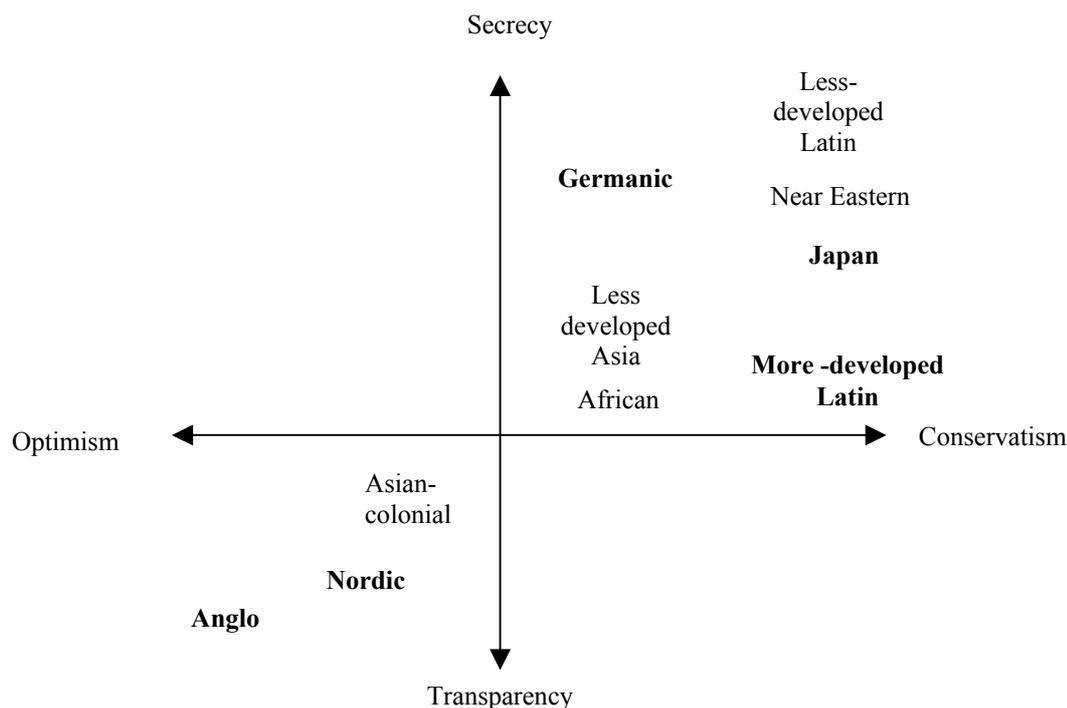


Figure 11: Classification of Accounting Practices according to Measurement and Disclosure (changed from Radebaugh and Gray, 1997: 82)

Again we have asked us, what can be seen from the above figure? Gary argues that the measurement and disclosure practices range according to the conservatism dimension from countries like **Japan**, with a very strong conservative approach, to much less conservative countries, characterised through less risk-taking approaches of accountants, found in the U.S., U.K. (**Anglo**) or Netherlands (**Nordic**).

To sum it up: Gray's classification makes clear that the **Anglo** and **Nordic** cultural areas have to be differentiated from the **Germanic**, **More-developed Latin**, **Japanese**, **Near Eastern**, **Less-developed Latin**, **less-developed Asian** and **African** cultural areas. (Radebaugh and Gray, 1997)

Radebaugh and Daniels detect according to Figure 11 that countries in the upper right quadrant (e.g. Germanic ones) are moving more towards optimism and transparency. This is a result, according to the authors, of the influence of capital markets, which require disclosure more in line with the Anglo-American Model. (Radebaugh and Daniels, 2001) Except from Radebaugh and Daniels none of the authors, who use Gray's theory in their textbooks, e.g. Choi et al. 2002, refer to possible changes in the theory of classification. We criticise this because we expect that there have been movements already. We assume that there are changes

due to the ongoing international harmonisation process of Accounting Standards. Therefore, we have doubts if the presented classification is still showing the reality.

### 3.3 Conclusion

Chapter three showed that Accounting Practices differ around the world. These national differences in accounting are, as introduced in this chapter, *“the product of a variety of environmental factors of an economic, political, and cultural nature”* (Naciri and Hoarau, 2001:231). In order to systemise these differences, classifications and clusters have been shown. As a conclusion the following table shows the combination of selected factors and the Anglo-American and Continental Model:

Variable	Anglo-American Model	Continental-European Model
Legal System	Common law; limited number of regulations, precedent cases are the centre of regulation.	Codified law; highly influenced by legal concepts.
Taxation system	Tax laws are independent from national accounting requirements.	Tax laws define methods of evaluation, methods of recording business transactions and financial statement presentation.
Provider of Capital	Mass shareholding.	Bank and government financing.

Table 3: Different philosophies in Accounting (changed: Achleitner, 2000:15)

On the one hand these differences are the reason for the need of a harmonisation process. On the other hand, they are considered to be the obstacles in the international harmonisation process. The reader should be conscious that it is difficult for each country to give up its own Accounting Philosophy in order to take part in the harmonisation process. *“As expected two worlds of accounting keep struggling to save their supremacy in their traditional environment and at the international level”* (Naciri and Hoarau, 2001:231).

The actors in the international harmonisation process have to understand these differences. They have to overcome those in order to develop a single-set of accounting rules (Choi et al., 2002). The next chapter shows how the actors proceeded the last 40 years in order to overcome these differences and to harmonise Accounting Standards.

## 4 Process of international harmonisation of Accounting Standards

The aim of this chapter is to describe the process of international harmonisation of Accounting Standards. Therefore, we give a definition of the term harmonisation and limit it from alternative ways. Also, we introduce reasons, which have triggered off the harmonisation process in first line. Major actors and their work will be illustrated in order to explain, what the process is about.

### 4.1 Harmonisation of Accounting Standards

Harmonisation is the attempt to bring together different systems (Samuels and Piper, 1985). Hence, international accounting harmonisation can be defined as *“the process of bringing international Accounting Standards into some sort of agreement so that the financial statements from different countries are prepared according to a common set of principles of measurement and disclosure”* (Haskins et al. 1996:29).

Wolk et al. describe harmonisation of Accounting Standards as *“the degree of co-ordination or similarity among the various sets of national Accounting Standards and methods and formats of financial reporting”* (Meek and Saudagaran in Wolk et al., 2001:729).

A similar definition we find in Roberts et al., who describe harmonisation as a process by *“which Accounting moves away from total diversity of practice”* (Roberts et al., 1998:116).

All explanations consider harmonisation as a condition in which only a limited number of related methods of Accounting Standards is available (Roberts et al., 1998:116). Harmonisation means that deviating rules, which do not exclude themselves, can continue to exist next to each other. That means harmonisation does not focus on the elimination of differences but on the reduction of contradicting rules. (Kleekämper et al., 2002) Kleekämper et al. explain, that the aim of the international harmonisation process of Accounting Standards is to reduce or overcome differences world-wide, in order to reach a better international comparability of financial statements. (Kleekämpfer et al., 2002; Choi et al., 2002:291) According to Rahman et al. harmonisation has been broken down into two aspects: material and formal harmonisation (Rahman et al. in Wolk et al., 2001).

- *material harmonisation*

Material harmonisation refers to research from a practical point of view. That means that the harmonisation of Accounting Practice applied by different enterprises, is regarded. It is about the consistency in actual application (Rahman et al. in Wolk et al., 2001).

- *formal harmonisation*

Harmonisation in terms of formal harmonisation is researched from a theoretical point of view, which means that the similarities and diversities between rules and regulations of different countries, clusters or groups are regarded (Rahman et al. in Wolk et al., 2001). This thesis considers only the formal aspect of harmonisation.

As alternative to harmonisation three other ways can be thought of, in order to make financial statements comparable:

#### 4.1.1 Mutual recognition

Mutual recognition means that national financial statements are accepted abroad, although they are not prepared in accordance with Accounting principles of the foreign country (Choi et al.; 2002 Kleekämpfer, 2002).

The possibility of mutual recognition exists already in some countries like, for example, between the United States and Canada. This means for American companies that their financial statements based on US-Generally Accepted Accounting Principles will be accepted through the Canadian stock exchange regulators. Furthermore, mutual recognition is as well possible between European countries. (Achleitner, 2000) The disadvantage of mutual recognition is that the user of financial statements has to be familiar with two different sets of standards. Further the questions, which result is right and which system is better, emerge (Kleekämpfer, 2002).

Achleitner argues that mutual recognition is only possible between countries, which have similar core Accounting principles. Therefore, she claims it is not probable that mutual recognition can be applied between the United States and Europe. Although all European stock markets accept financial statements based on U.S.-GAAP, the SEC prevents the

recognition of European companies in the United States. Therefore European companies can not access one of the most important capital markets without barriers (Achleitner, 2000).

#### 4.1.2 Reconciliation

Reconciliation allows foreign companies to prepare financial statements based on Accounting Standards of their home country. However, additionally they “*must provide a reconciliation between critical Accounting measures (such as net income and shareholders’ equity) of the one country and the country where the financial statements are being filed*” (Choi et al., 2002:294). The objective of reconciliation is to show major divergences between the Accounting Practices. Hence, thanks to reconciliation foreign investors receive data about assets and profits, which are based on their Accounting principles. (Achleitner, 2000) For example it is possible for companies using IAS to enter the American capital market, but only if they prepare reconciliation to U.S.-GAAP.

Reconciliation makes the comparison for investors easier. Another advantage of reconciliation is that it is less expensive, than preparing a full set of financial statements in accordance with foreign principles of Accounting. However, reconciliation is only a summary and cannot provide a full picture of the company. (Choi et al., 2002) Another disadvantage of this approach is that it is still combined with costs, which would not exist, if there would be one set of international accepted Accounting Standards. Still in the case of reconciliation there is the question, which result is the right one. (Kleekämper, 2002)

#### 4.1.3 Standardisation

Another term, distinguished from harmonisation, is standardisation. It describes “*a process by which all participants agree to follow the same or very similar Accounting Practices. The end result is a state of uniformity*” (Roberts et al., 1998). This state of uniformity is a condition in which everything is regular, homogenous or at least unvarying. (Samuels and Piper, 1985) Choi et al. claim that standardisation implies that all Accounting principles and practices are the same. He describe standardisation as “*imposition of a rigid and narrow set of rules, and may even apply a single standard or rule to all situations*” (Choi et al., 2002: 291).

The terms, harmonisation and standardisation, are often used in the same meaning. However, Kleekämper et al. detect that there is a difference between these two terms (Kleekämper et al.,

2002). Standardisation is a process in which all countries should adopt the method of one country. In contrary, harmonisation is understood as a reconciliation of different points of view. (Wilson in Riahi-Belkaoui, 2000) The following graphic shows the relationship of standardisation and harmonisation.

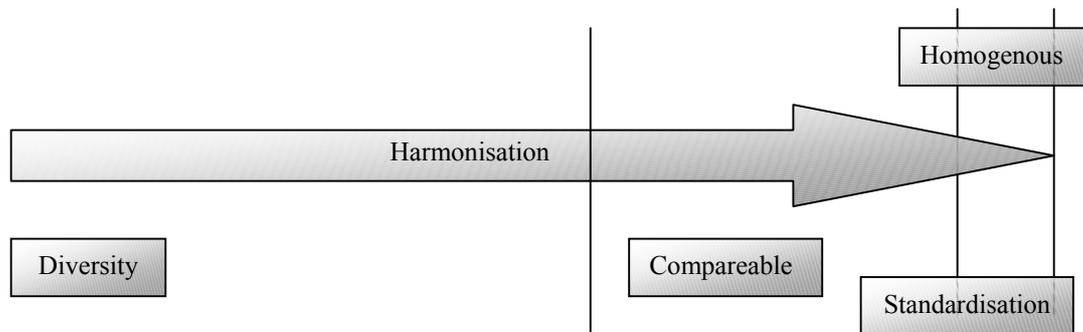


Figure 12: Harmonisation and Standardisation (source: changed from Pellens, 2001:387)

Harmonisation is a process starting from diversity. First, the different Accounting Systems are examined and compared. If points of agreement are noted, the work towards bringing these different systems together can start. (Samules and Piper, 1985) Throughout the process some degree of comparability should be achieved. This stage follows the production and implications of rigid standards. The final end is a standardised situation, in which homogeneity and uniformity exist. A condition of uniformity would mean that all Accounting principles and practices would be the same.

## **4.2 Reasons for the harmonisation process**

In the following part we want to describe which factors have triggered an international harmonisation of Accounting Standards. Nobes and Parker argue that “*the pressure for international harmonisation comes from those who regulate, prepare and use financial statements*” (Nobes and Parker, 2000:66).

### **4.2.1 Advantages for preparers**

Companies prepare financial statements. Therefore the following advantages can be seen from the standpoint of preparers of financial reports. It is quiet obvious to understand that international companies are not interested in dealing with a new set of Accounting Standards in each country they invest. Uniform Accounting Standards provide efficiency gains both internally and externally. (Epstein and Mirza, 2001)

Internally multinational companies would make savings if all their subsidiaries could use the same Accounting System. A similar internal reporting system gives the chance of better comparisons, less confusion and mistakes between the parts of the company. It allows uncomplicated communication and transfers of finance personnel. One set of Accounting Standards could be used in various jurisdictions and capital markets. Further cost savings can be realised, because the preparation of consolidated financial statements will be easier for companies. Because there are no longer costly changes from several different Accounting Systems of each subsidiary necessary, when the parts of the company are consolidated to one. With one set of Accounting Standards as well the credibility of the externally reporting could be raised. No longer different performance figures are shown for the same company in different countries. (Epstein and Mirza, 2001)

Furthermore, international companies can realise significant cost savings if they do not have to change their financial statements to conform to each country's rules, when listing on security exchanges. In other words the access to main financial markets will become easier for global acting companies and by this it will be possible to acquire capital simpler for them. The following example will make this more clear. Imagine a company, which has a subsidiary in Cuba, the parent company is located in Germany and the shares are listed on the NYSE. This company would have to prepare financial statements in Cuba, in Germany and in order to be listed on an U.S. stock exchange it would have to prepare also financial statements in accordance with U.S.-GAAP. Thus, its is easy to understand, which advantages a harmonised world-wide accepted set of Accounting Standards would have. (Epstein and Mirza, 2001)

#### **4.2.2 Advantages for users**

From the standpoint of the users of financial statements (e.g. investors, banks or owner) one can see the following advantages. Investors, banks or owners are interested in obtaining information, which enables them to make buy/sell/hold investment decisions. We argue, that similar financial statements would make it possible for users of financial statements to make useful comparisons between countries and companies. This can be explained with the circumstances that similar transactions are accounted for and reported in the same manner everywhere in the world. With other words, similar Accounting Standards lead to a better comparability between companies. It would enable investors, banks or financial analysts to make better decisions. Therefore, greater comparability results in better understanding, lower

risks and more efficient selections of investments. Choi et al. argue that *“financial statement users have difficulty interpreting information produced under non-domestic Accounting Systems. They claim that harmonisation will make it more likely that users will interpret the information correctly, and thus make better decisions based on that information”* (Choi et al., 2002:293).

For the society at large it can be said that harmonised Accounting Standards are important, because they lead to a well-developed and good functioning capital market. That is important in our view, because companies and others can raise money for investments there. This again is a pre-condition for a good economy and development. (Epstein and Mirza, 2001)

### **4.3 International Accounting Standard Board**

It is our aim to explain the role of the IASB, which is a part of the International Accounting Standard Committee Foundation (IASC Foundation). We would like to introduce this foundation, its structure and aims.

In order to co-ordinate international Accounting the International Accounting Standards Committee (IASC)<sup>13</sup> was founded by an agreement of the leading professional bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, Ireland, and the United States in 1973 (Nobes et al., 1997). The IASC has the autonomy to develop Accounting Standards and had 143 members in 104 countries in the year 2000 A list of those countries can be found in Appendix 8.14. (Kleekämper et al., 2002)

In April 2001 the IASC changed its former structure and legal identity. It is called since April 2001 International Accounting Standards Committee Foundation. The International Accounting Standard Board, based in London, is the standard setting body of the International Accounting Standards Committee Foundation. For simplicity reasons we use the term IASB for both the IASC Foundation but also for the standard setting body.

Choi et al. state, that the IASB is the driving force actor in the international harmonisation of Accounting Standards. (Choi et al., 2002) The IASC Foundation develops, in public interest, world-wide Accounting Standards for financial statements. (IASB, 2002 a) The compliance

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<sup>13</sup> The IASC is the predecessor organisation of the IASB. Those terms will be used interchangeably in this thesis.

with the standards of the IASB is voluntary, since it has no power to enforce them (Mueller et al., 1991). The work of IASB is funded by contributions from Accounting firms, private financial institutions, companies, banks and other organisations (IASB, 2002 a).

### 4.3.1 Structure

The structure of the IASC Foundation is explained here, in order to understand which organisations and members from which regions are involved in the IASC Foundation. The structure can be described and illustrated as the following. There are four main bodies, which together form the whole foundation:

- Board (IASB)
- Trustees,
- Standards Advisory Council (SAC) and
- International Financial Reporting Interpretations Committee (IFRIC).

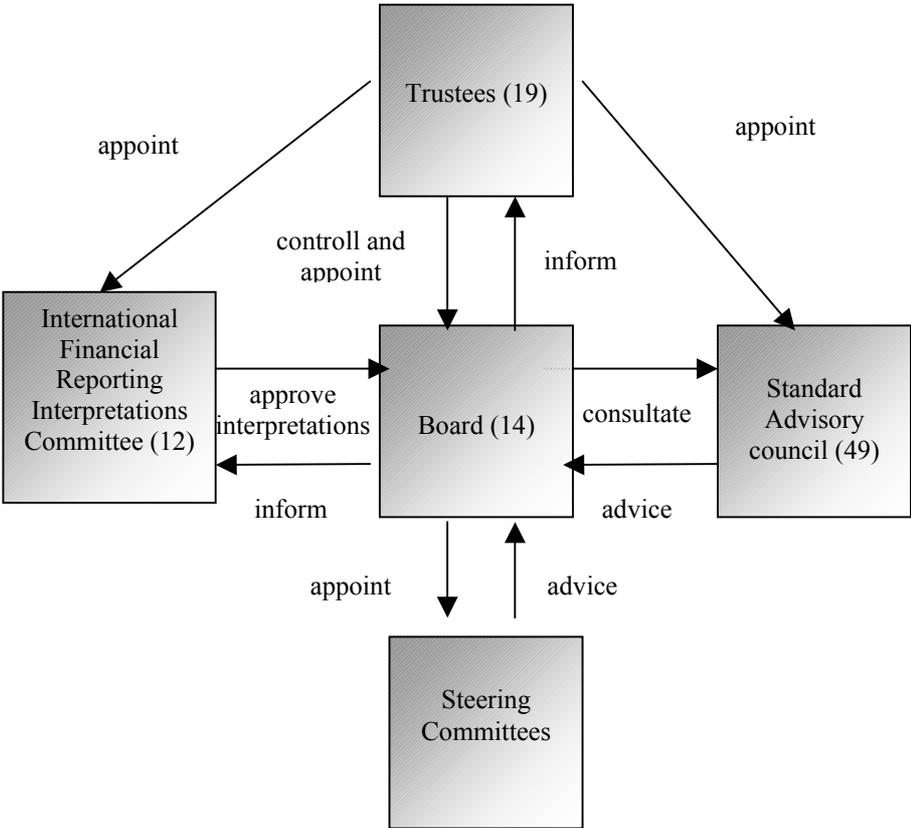


Figure 13: Structure of the IASC Foundation (source: IASB, 2002 q)

The standard-setting board (IASB) consists of 14 members. (IASB, 2002 b) Their tasks are to draw up Exposure Drafts, to permit publications of the International Financial Reporting Interpretations Committee, to announce new and to revise old Accounting Standards. Their work shall be done independently and in the public interest. (IASB, 2002 b) The IASB aims at adjusting national Accounting Standards. Therefore, national standard-setters are represented through a liaison person in the board. Seven members of the Board are contact persons to national standard-setters.<sup>14</sup> (Kleekämpfer et al., 2002)

The Trustees consist of 19 members, six from North America; six from Europe, four from Asia and three from any other area.<sup>15</sup> Trustees do not consider content questions of Accounting rules. They are mainly responsible to appoint members of the IASB, the Standard Advisory Council and the International Financial Reporting Interpretations Committee. When appointing members of the IASB the Trustees shall ensure that any constituency or regional interest does not dominate it. (Kleekämpfer et al., 2002; IASB, 2002 b)

The Standards Advisory Council consists of organisations (e.g. U.S. SEC) and interest groups from several regions (e.g. Asia, Europe).<sup>16</sup> The Standards Advisory Council meets the IASB three times a year and has approximately 49 members, who are nominated for three years. (Kleekämpfer et al., 2002) The aim of the Standard Advisory Council is to choose important projects, to advise the Board and the Trustees and to inform about the views of the member organisations. Furthermore it has to be consulted of Board and Trustees before decisions can be made. (Kleekämpfer et al., 2002)

The International Financial Reporting Interpretations Committee (IFRIC) has 12 members. They are responsible to give interpretations to application questions of the International Accounting Standards. (Kleekämpfer et al., 2002) An interpretation of an IAS/IFRS must be approved by the IASB before it can be adopted. In comparison to the U.S. system, one can see similarities and differences. The FASB's Emerging Issues Task Force (comparable to the IFRIC) first interprets U.S.-GAAP. Then on a second level they are interpreted on the regulatory level, done by the SEC. Ruder states that the SEC has made clear that it will review financial statements, in order to make sure that the Accounting Standards used, have

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<sup>14</sup> In Appendix 8.7 a table with the up to date members of the Board can be found.

<sup>15</sup> In Appendix 8.8 a table of actual members of the Trustees is available.

<sup>16</sup> In Appendix 8.9 a table with the members of the SAC can be found.

been properly applied. Such a process of review is not existing in other countries at the moment. (Ruder, 2001)

### 4.3.2 Aims

The IASC Foundation has the following objectives:

- *“to develop a single set of global Accounting Standards,*
- *to promote the use and rigorous application of those standards and*
- *to bring about convergence of national Accounting Standards and International Accounting Standards”* (IASB, 2002 b)

We would like to point at redefinition of IASB’s objectives. It stated in its constitution of the year 1992 that the IASB has the objective of *“to work generally for the improvement and harmonisation of regulations, Accounting Standards and procedures relating to the presentation of financial statements”* (Epstein and Mirza, 2001:11). In May 2000 the IASB revised its constitution and states *“to bring about convergence of national Accounting Standards”* (Epstein and Mirza, 2001: 11). No reasons, for the redefinition could be found.

### 4.3.3 International Accounting Standards

The IASC (predecessor of the IASB) has issued 40 international Accounting Standards of which 33 are in force and seven are under construction.<sup>17</sup> (Epstein and Mirza, 2001) With the restructuring of the IASC in 2001 it also changed the name of the new developed standards. Newly developed standards will no longer be called International Accounting Standards but International Financial Reporting Standards (IFRS). IAS/IFRS are in Wagenhofer’s eyes capital market oriented Accounting Standards, what means that the usefulness for the decision making is of high importance. (Wagenhofer, 2002) The standards are characterised through their principle-based set of standards. That means that not each single case is explained by the standards. The IAS/IFRS are a three-step regulation. There is the

- Framework,
- the Standards and
- the Interpretations.

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<sup>17</sup> A list of the 33 International Accounting Standards, which are in use, can be found in Appendix 8.10.

The Framework is the theoretical concept behind the standards. The Standards deal with single questions of Accounting (e.g. leasing). And the Interpretations give interpretations to the applications of the standards. (Wollmert and Achleitner, 2002)

An IFRS is developed through a so-called due process. It involves a variety of individuals and organisations as national standard-setters, financial analysts, stock exchanges or users of financial statements. It aims at including as much participants as possible in order to achieve a broad acceptance of the new standard at an early level. (Kleekämper, 2002) This due process will be explained shortly<sup>18</sup>

In a first step all issues related to the new problem (standard) are considered. There will be an exchange of ideas with the national standard-setters. The liaison persons, of the IASB support this. Afterwards the Board consults the Standards Advisory Council, whether it should deal with that problem and develop a new standard. Afterwards the Board names a Steering Committee, which will advice and support the IASB. A discussion paper will be prepared, which is shown to the public for commendation. After that phase the Board will develop an Exposure Draft, which will also include dissenting opinions of Board members. Afterwards the Exposure Draft is presented to the public again. If comments have been disused, there will be public hearings and field tests of the new standard. If the Exposure Draft is approved by 8 of the 14 Board members, a new IFRS will be published. (Kleekämper et al., 2002)

#### ***4.4 Harmonisation Process of Accounting Standards***

In the following we give an overview of the harmonisation process, starting back to its beginning in the 60's.<sup>19</sup> In the literature it is often written about three development stages of harmonisation, especially when the work of IASB is considered. (Epstein and Mirza, 2001) We have decided to follow these three stages in the structure of this part. However, we added a pre-stage, in order to find out the roots of harmonisation, and a stage beginning 1998 and onwards. This overview gives the reader an impression of the organisations (actors) involved in the process.

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<sup>18</sup> There is graphic in Appendix 8.11, which illustrates this due process.

<sup>19</sup> There is an overview about the whole process in Appendix 8.13.

#### 4.4.1 Pre-stage of the harmonisation process

It is not sure when the harmonisation of Accounting Standards began (Kleekämper et al., 2002). Jacob Kraayenhof, is considered as the ‘father’ of the harmonisation process. (Choi et al., 2002, Samuels and Piper, 1985). In the year **1959** he released a paper in which he supported the widest possible acceptance amongst countries. Kraayenhof was not advocating rigid uniformity. Hence, he argued for some degree of international uniformity on Accounting principles but realised the existence of differences between the countries. (Samuels and Piper, 1985) In order to analyse and to vanquish differences in Accounting between Canada, U.S. and U.K. the Accountants International Study Group (AISG) was formed in **1966** (Kleekämper et al., 2002). It was minted that “*if AISG proved to be a success, other nations might be invited to join later on*” (Samuels and Piper, 1985:65). According to Mueller the U.S. did not reflect much of interest in the subject of international harmonisation of Accounting Standards in the 1960s. (Mueller in Samuels and Piper, 1985) However, at a congress of Accountants held in Sydney in 1972, “*representatives of the profession in the UK, USA and Canada met and proposed that an international body should be set up which would write Accounting Standards for international use*” (Samuels and Piper, 1985:70). Later in **1972** further discussions took place and professional bodies from six other nations were invited to join the organisation. (Samuels and Piper, 1985)

#### 4.4.2 Harmonisation process between 1973 –1987

The period between 1973-1987 is also called the first stage of development of the International Accounting Standards Committee. In **1973** the IASC was formed. During that time the IASC established most of its standards. These were standards on major Accounting topics as for example accounting for inventory. (Epstein and Mirza, 2001) “*It was intended that the IASC would produce basic standards that would be rapid accepted and implemented world-wide*” (Samuels and Piper, 1985:70). During the time of 1973 and 1987 it was the main focus of the IASC to achieve compatibility between the IAS and the existing standards in the member states of the IASC. Further characteristics of this phase are the elimination of internationally uncommon measurement methods. However, if no consensus could be reached between different measurement methods, rights to chose between methods were allowed. (Kleekämper et al., 2002) Kleekämper et al. argue that the latter should have helped to make a parallel validity between the Anglo-American and the Continental-European Accounting Philosophies possible (Kleekämper et al., 2002). This approach was also called the lowest

common dominator approach. The strategy of IASC during that time could be described as “to endorse virtually all the mainstream methods used in any of the major nations of the world” (Epstein and Mirza, 2001:13). Pellens argues that the level of harmonisation, meaning the comparability of financial statements, could be considered to be low during that time. Pellens points to two reasons: first, because there were still a lot of options, second, because the enforcement of IAS by the IASC was not given. The IASC is an organisation of private character and therefore its standards have the character of recommendations. (Pellens et al., 1996) Once the IASC had been formed other countries<sup>20</sup> joined it. (Samuels and Piper, 1985)

Not only private bodies (like IASC) also certain international public bodies (like OECD, UN and the African Accounting Council) were interested in the development of the accounting area. (Samuels and Piper, 1985) In **1976** the Organisation for Economic Co-operation and Development issued a declaration which was a guideline on disclosure of financial information. (Choi et al., 2002). Following to this the OECD and MNE assigned a working group to consider Accounting Standards in **1979**. The aim was to improve “*comparability or to achieve harmonisation of Accounting Standards and to identify actual problem areas*” (Samuels and Piper, 1985:70). Hence, this working group was not an Accounting Standard setting body. (Samuels and Piper, 1985)

At the same time an expert expert group of the UN was working on problems of Accounting and disclosure. (Samuels and Piper, 1985) In **1977** the UN published a report, which proposed very substantial increases in disclosure information of financial and non-financial items by transitional companies (Choi et al., 2002). However, in contrary to the OECD working group „*which only includes specialists from industrial nations, the UN group includes as well experts from developing countries*” (Samuels and Piper, 1985:70). The UN founded the Intergovernmental Working group of Experts on International Standards of Accounting and Reporting (ISAR)<sup>21</sup>. It is involved among other things in initiatives to develop international Accounting Standards and promotes Accounting education in Russia and Africa. (Radebaugh and Gray, 1997) The Standards of ISAR are largely consistent with the ones of the IASB, although they are not widely known. (Nobes and Parker, 2000) “*The United Nations have also shown interest in international Accounting Standards, but it has definitely played a secondary role to the IASC*” (Wolk et al., 2001:736).

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<sup>20</sup> A list of member states of the IASC (predecessor of the IASB) can be found in Appendix 8.14.

<sup>21</sup> ISAR, created in 1982, is an intergovernmental working group devoted to Accounting and auditing at the corporate level. (Choi et al., 2002)

The EU aims at creating a unified business environment this means as well a harmonisation of company law, which is the basis of EU Accounting harmonisation (Mueller, 1997). In the **1970's** and the **1980's** the European Union put a lot of efforts in the development of closer agreements of the company laws in Europe (Roberts et al., 1998). The instruments in the European Union, to harmonise company law are directives (Mueller, 1997). The council of ministers, as the legislative body of the European Union, have issued 12 directives concerning company law. Two of these directives, namely the fourth<sup>22</sup> and the seventh<sup>23</sup> directive are essential contributions to the harmonisation process in the Accounting field in Europe. (Hulle, 2001)

In the end of the seventies and beginning of the eighties the IASC began a consultation with organisations, which are no members of the IASC in order to widen the input to international standard-setting. (Choi et al., 2002) In **1984** the London Stock Exchange professed that listed companies, not incorporated in the U.K. or Ireland, have to use accounts in accordance with IAS. (Choi et al., 2002)

#### 4.4.3 Harmonisation process between 1987 - 1993

The period between 1987 - 1993 is also labelled as the second stage of IASC development. This period starts with the membership of the International Organisation of Securities Commissions in the Consultative Group<sup>24</sup> of IASC in **1987**. One year later the FASB joined the Consultative Group of the IASC as well. One very important member of the IOSCO is the U.S. Securities and Exchange Commission. (Kleekämper et al., 2002) The second phase of IASC is characterised by a decrement of options within the IAS. This happened in Pollens eyes, because the IASC oriented itself more to the needs of the capital market and the hope to be accepted by the IOSCO.

Furthermore the IAS framework for the preparation and presentation of financial statements was established in 1989. This period is further characterised by the "*Comparability/Improvements Project*" of IASC. The objective of this project can be described as to narrow the range of alternative accounting treatments, which could be used in the same situation. (Epstein and Mirza, 2001) In 1989 IASC published Exposure Draft 32.

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<sup>22</sup> In 1978 the Council of Ministers issued the fourth directive, which applies directly to all individual European companies and deals with all aspects of the annual accounts. (Roberts et al., 1998)

<sup>23</sup> The Seventh Directive was issued in 1983 and addresses the issue of consolidation. (Roberts et al., 1998)

This draft contains the comparability of financial statements and aims at to improve comparability and to reduce rights to choose. Furthermore 10 standards have been revised during that period. (Kleekämper et al., 2002) In the **1990's** a discussion started that the EU should be more active in the international process of harmonisation. According to Hulle this was the reason, why the EU accepted the invitation of the IASB to participate as an observer in their work and to become a member of its Consultative Group. (Hulle, 2001)

#### 4.4.4 Harmonisation process between 1993 -1998

The period between 1993 –1998 is called the third development phase of IASC. In **1993**, IOSCO and the IASC Board (the IASB's predecessor) agreed on a list of core standards, for use in financial statements of companies, involved in cross-border offerings and listings. (IASB, 2002 m) In **1994**, the IOSCO had completed a review of the IASC standards and through this process identified a number of standards that required improvement, before IOSCO would consider endorsement of IAS. (Turner, 2001)

In **1995** both organisations agreed on a work plan,<sup>25</sup> whose successful completion would result in that the IOSCO recommends the IAS to its members for cross-border capital raising and listing purposes in all global markets. The working plan contained that the IASC had to develop a comprehensive set of core standards in accordance with the wishes of IOSCO. The Work Plan was completed in **1999**. (Epstein and Mirza, 2001)

In **1995** the European Commission proposed to support the IASC initiative and work to bring the EU Accounting requirements in link with IAS. (Mueller, 1997) Choi argues *“The EU has concluded that IASC Standards are the preferred option as new standards are developed in EU countries”* (Choi et al., 2002:736). The European Commission stated its policy in 1995 as *“Rather than amend existing directives, the proposal is to improve the present situation by associating the EU with the efforts undertaken by IASC and IOSCO towards a broader international harmonisation of Accounting Standards”* (Epstein and Mirza, 2001:21). Furthermore, the European Commission made the decision not to create own European Accounting Standards in 1995. (Helleman and Slomp, 2002)

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<sup>24</sup> The predecessor of the Standards Advisory Council was the Consultative Group.

<sup>25</sup> This work plan is also referred to as the “Core Standards project”.

In **1996** the SEC manifested that it “*supports the IASC’s objective to develop, as expeditiously as possible, Accounting Standards that could be used for preparing financial statements that could be used in cross-border offerings*” (Choi et al., 2002:296).

Furthermore the IASC undertook initiatives to find a new strategic alignment and organisational structure in 1998. This new structure has already been explained under point 4.3.1. It has been shown that the IASC was the predecessor organisation of the IASB. The aim with the restructuring of the IASC was to make activities of harmonisation more clear on a world-wide scope. Kleekämper et al. argue that the IASC tried to take over the central role as a global player in standard-setting process. (Kleekämper et al., 2002)

#### 4.4.5 Harmonisation process 1998 and onwards

In May **2000**, the IOSCO recommended its members to permit incoming multinational issuers to use 30 IAS<sup>26</sup> to prepare their financial statements for cross-border offerings and listings. (IOSCO Endorsement) On the other hand IOSCO members could still require from companies to provide supplementary information “*such as reconciliation showing the effect of Accounting Standards other than IAS or additional disclosures or implementation of specific interpretations where IAS is unclear or silent*” (Helleman and Slomp, 2002:217). Helleman and Slomp argue that the position of IOSCO was without doubt strongly influenced by the SEC (Helleman and Slomp, 2002).

In **2000** the SEC issued the project “*The International Concept Release*”. It contained a questionnaire with 26 questions on the acceptability and quality of IAS/IFRS in the U.S. market. The main question was should the U.S.-SEC modify its present position to and to allow IAS without reconciliation? The SEC received almost 100 comments to it. The result of the comments can be summarised as the following: “*On the issues of whether or not IAS are now of sufficiently high quality and whether the SEC should accept IAS without reconciliation to U.S.-GAAP, most Europeans said "yes, definitely" while most U.S. respondents say "not yet"* (SEC, 2000 d). Nevertheless the SEC stated in 2000 that they will not accept the core standards without reconciliation to U.S.-GAAP unless:

- the core standards constitute a comprehensive body of accounting,
- are of high quality and result in comparability and transparency and provide for full disclosure and
- can and will be rigorously interpreted and applied. (Cooke et al., 2001)

Helleman and Somp argue that the SEC has taken a position that international standards should be developed and applied in a global financial reporting structure similar to that in the US. (Helleman and Slomp, 2002)

With the introduction of the Euro in 1999 and thereby the fulfilment of the last stage of the European Monetary Union the pressure for further integration of capital markets grew. (Helleman and Slomp, 2002) In March **2000** the European Commission took a further step in the harmonisation process. It proposed a regulation, which requires that all enterprises listed on a regulated market in the European Union would have to prepare their consolidated accounts in accordance with IAS/IFRS by 2005. (Kleekämper et al., 2002) This proposal was supported by the European Parliament in 2002 and the council of ministers issued a regulation in June **2002**. (Helleman and Slomp, 2002) The regulation will require the use of IAS/IFRS by the 01.01. **2005** after a formal EU endorsement process. Temporary exceptions are made for companies traded in the U.S. and are therefore doing their financial statements in accordance with U.S.-GAAP. Those companies will be required to comply with international standards by 01.01. **2007**. Member states have the option of extending the requirements of this regulation to unlisted companies and to the production of individual accounts. This regulation will directly concern around 7000 listed EU companies. Currently about 275 listed European companies use IAS for financial reporting. Seven member states allow listed companies to prepare their consolidated financial statements in accordance with IAS.<sup>27</sup> (IASB, 2002 f)

When it comes to the relationship with the SEC the European Commission has tried several times to find an agreement about mutual recognition of financial statements with the US. The SEC argued that *“the directives would not produce sufficient detailed financial information to meet the requirements of US users”* (Helleman and Slomp, 2002:219). On the other hand the

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<sup>26</sup> The IOSCO recommended 30 IAS. Excluded have been IAS 3, 5, 6, 9, 13, 15, 25, 26, 30 and 40. (Kleekämper et al., 2002)

<sup>27</sup> These member states are Austria, Belgium, Finland, France, Germany, Italy and Luxembourg.

European Union had already accepted financial statements of American companies for listings on European stock exchanges. (Helleman and Slomp, 2002)

In order to achieve conformity between the IAS/IFRS and the EU directives and in order to secure the political aims of the EU, the EU introduced a formally procedure of acceptance. (Endorsement mechanism) (Kleekämper et al., 2002) In that process the EU is supported by a private sector organisation called European Financial Reporting Advisory Group (EFRAC), founded in **2001**. EFRAC advises the European Commission, assess the conformity between IAS and EU directives and co-ordinates the Accounting ideas of the EU in confrontation to the IASB. Furthermore, the European Commission suggests the IAS/IFRS to the Accounting Regulatory Committee (ARC), which is representing the member states. The ARC has to permit or to abolish the standard within one month. (Helleman and Slomp, 2002)

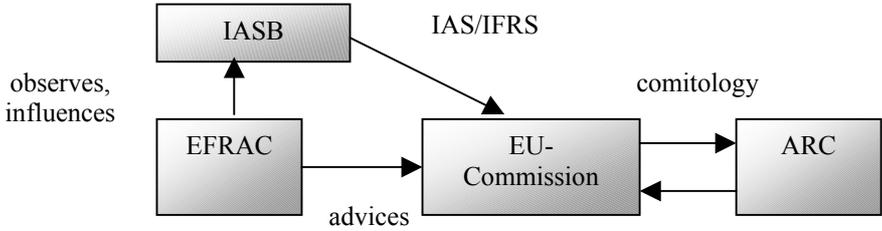


Figure 14: Enforcement process of IAS/IFRS in EU (source: changed from Deutsche Bundesbank, 2002:46)

Not only the IASB but also the Financial Accounting Standards Board is committed to working towards the standardisation of Accounting Standards. Hence, another major player in harmonisation process is the Financial Accounting Standards Board. Riahi-Belkaoui describes this organisation as *“the authoritative, independent body charged with establishing and improving financial Accounting and reporting standards”* (Riahi-Belkaoui, 2000:87).

The standards of the FASB are of importance in the United States, because they govern the preparation of financial reports for American companies (FASB, 2002 b). Furthermore, these standards are officially recognised by the Securities and Exchange Commission and the Institute of Certified Public Accountants (FASB, 2002 b). This increases the importance of them even more, because all American and foreign companies have to apply these standards, when listed at the U.S stock exchanges. Hence, attention has to be drawn to the aspect that the FASB is directed (but not restricted) to the American private sector (FASB, 2002 b). In October **2002** the IASB and the FASB met in Norwalk<sup>28</sup>. The Boards committed to make

<sup>28</sup> The agreement between IASB and FASB is therefore also called *“The Norwalk Agreement”*.

existing financial reporting standards fully compatible and to co-ordinate their future work programs. They will start this co-operation by identifying main differences between the two systems by 2003 and to remove most of these differences by 2005. (Investors Relations Business, 2002 a; IASB, 2002 e). The deadline of 2005 is significant because it is then when the listed companies in the European Union are required to use IAS. However, the IASB and the FASB have announced that they will continue to work together in order to smooth their regulations after this deadline of 2005 (Investors Relations Business, 2002 a; IASB, 2002 e).

In **2002** the Canadian Securities Administrators proposed that certain foreign listed companies in Canada are able to use the IASB’s Standards without reconciliation to Canadian GAAP beginning 2005. As well the Financial Reporting Council of Australia endorsed formally the adoption of IAS and IFRS for Australian reporting entities by the first of January in 2005. (IASB, 2002 k)

**4.5 Conclusion**

This chapter gave an overview on the harmonisation process over the last 40 years. From this long duration it can be seen that the harmonisation process is complex, which needs its time to be accepted and manifested. It seems to us that the process was slow, full of disagreements and conflicts between the actors involved. However, important agreements were made in the past and are shown in the below figure.

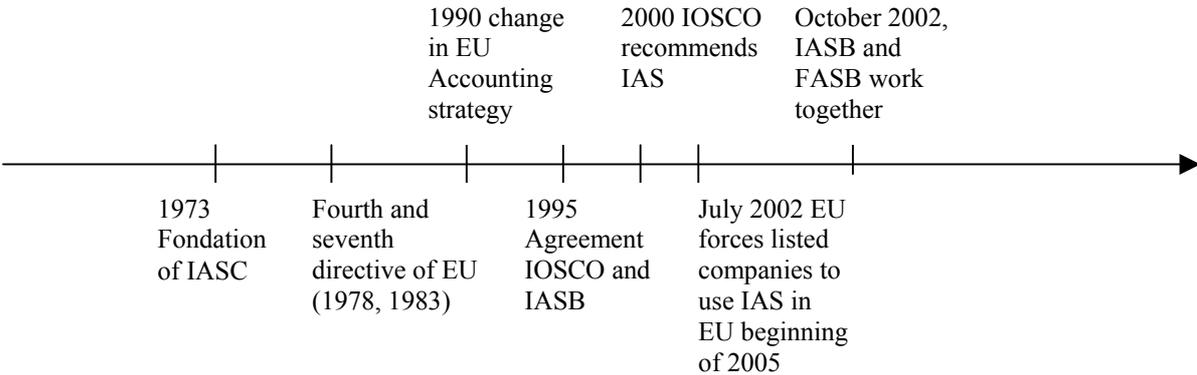


Figure 15: Overview of the main events in the harmonisation process

This graphic shows several very important steps towards a world wide harmonised set of Accounting Standards. In particular we would like to draw attention to the year 2000 when

the IOSCO recommended the IAS to its members and the year 2002, when the EU decided that IAS has to be used for listed companies, beginning in the year 2005.

Further, this chapter introduced international organisations involved in the harmonisation of Accounting Standards. It got obviously that a lot of actors are involved. The IASB was formed to develop a set of worldwide accepted Accounting Standards. The FASB can be considered as the American counterpart to the IASB. The overview on the harmonisation process showed that the following international organisations are involved in it:

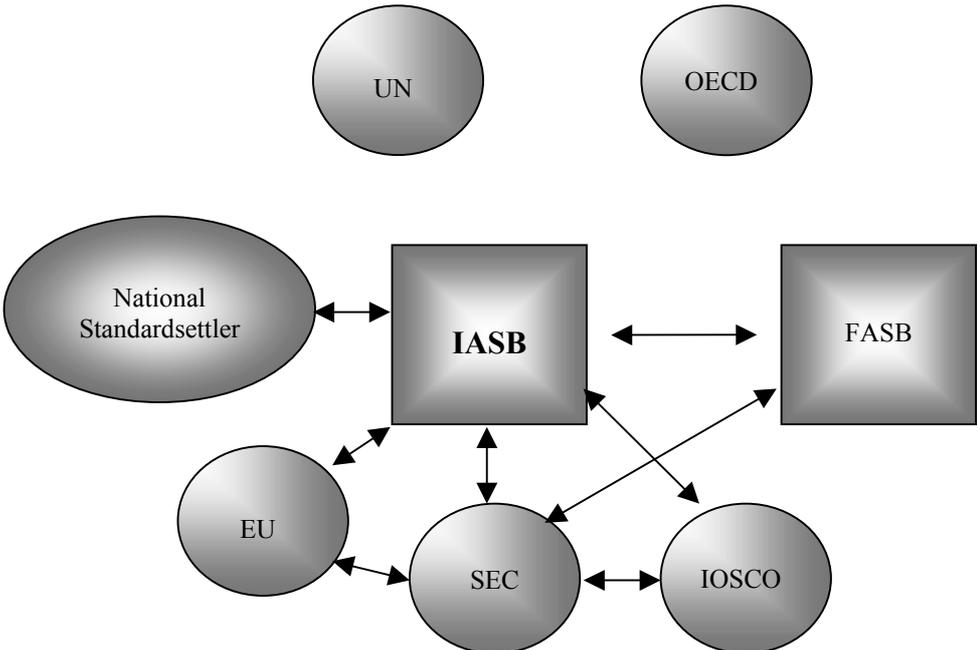


Figure 16: Relationships between the actors involved in the harmonisation process

## 5 Discussion about the harmonisation process

Whereas chapter three gave an overview on the outgoing situation of the harmonisation process, chapter four illustrated the last 40 years of it. The aim of this chapter is to discuss the harmonisation process with focus on the role of the IASB.<sup>29</sup> The result of this discussion will be the status quo of the harmonisation process and future perspectives.

### 5.1 Role of the IASB in the harmonisation process

In the used literature (e.g. Choi et al., 2002, Kleekämper et al., 2002) it was stated several times that the IASB plays an important role in the harmonisation process. However, in the following we want to critically analyse the role of IASB in the harmonisation process. The work, the challenges and the weaknesses of the IASB will be considered.

#### 5.1.1 Work efforts and achievements

The following points will describe the work efforts and achievements of the IASB:

- Development of 33 Accounting Standards.
- Co-operation with national standard-setters.
- IOSCO Endorsement.
- EU regulation.
- Co-operation of IASB and FASB.

#### Development of 33 Accounting Standards

The IASB has developed so far 33 standards, which are used on a rather broad level.<sup>30</sup> It encourages countries without Accounting Standards to use IAS and to eliminate differences to IAS. In Appendix 8.12 one can see those countries, which already accept the IAS for preparing financial statements. On the one hand many Latin American or Asian countries do still not allow the usage of IAS. On the other hand with the regulation of the EU the IAS will be accepted in 15 countries.

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<sup>29</sup> Find a discussion about the role of other actors in Appendix 8.15.

### **Co-operation with national standard-setters**

As could be seen in chapter four, the IASB has several approaches to work close together with national standard-setters. First, we have the eight national standard-setters which are represented in the Board of the IASC Foundation. Here, they have the possibility to take actively part in the announcing and revising of International Standards. Second, we have the SAC, which invites organisations and interest groups, not represented in the Board, to take part in the process. Third, as explained above, the approach of the due-process enables the participation of a variety of individuals and organisations as national standard-setters, financial analysts, stock exchanges or users of financial statements. The IASB Constitution envisages a "*partnership*" between IASB and national bodies as they work together to achieve the convergence of Accounting Standards world-wide (IASB, 2002 n). The logic behind the establishment of liaison relationships with national standard-setters is, that the IASB hopes, that national standard-setters will adopt identical standards and that they will co-ordinate their agendas. (Ruder, 2001) As the IASB is a private body and can not enforce its standards, it needs the support of national standard-setters for the implementation of the IAS.

### **IOSCO Endorsement**

The recommendation of the IOSCO to its members to allow multi-national companies to use IAS for cross-border offerings and was a rather important step for the world-wide acceptance of the IAS. It opened the door for IAS to be used of companies for listings on international capital markets. All member organisations (e.g. U.S.-SEC, Financial Services Authority of the U.K. or Australian Securities and Investments Commission) had to accept companies that prepared their financial statements in accordance with IAS. On the other hand the members of the IOSCO could still require supplementary information (e.g. reconciliation or additional disclosure) As already explained, the IAS have only the character of recommendations. Therefore, the IASB needs the support of other organisations to make an acceptance of their standards possible, this was done by the IOSCO Endorsement in 2000.

### **EU regulation**

The EU will require from all listed European companies to prepare consolidated statements in accordance with IAS by 2005. In chapter four one could observe a continuously movement of the EU towards the IAS. The first time in 1995, when the EC decided to support the IASB, by joining its Consultative Group and by its decision, not to develop own standards. Several

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<sup>30</sup> Find a table of countries, which use IAS in Appendix 8.12.

factors might have been the reasons for this decision. First, it can be seen as a no of the EU to U.S.-GAAP in Europe. This decision can be first explained by the fact that there is no possibility, to influence U.S.-GAAP from the European position. In contrary, as explained in chapter four, the EU has some possibility to influence the work of the IASB (e.g. liaison with three national standard-setters in the IASB). Second, it can be interpreted as an European answer to the denying attitude of the U.S. regulators (e.g. SEC, FASB). The U.S.-GAAP have been accepted without reconciliation in Europe. European companies in contrary could only be listed on American stock exchanges with a full preparation of financial statements according to U.S.-GAAP, or according to IAS with a reconciliation to U.S.-GAAP.

### **Co-operation of IASB and FASB**

The announcement of IASB and FASB to work together in order to design a single set of global accounting rules in 2002 is another breakthrough for the acceptance of IAS. The U.S. capital market is considered to be the most important in the world (Turner, 2001). An acceptance of IAS on that market without reconciliation would in our view motivate companies as well as regulators of other countries to further consider the use of IAS. As the IASB needs consistent support from other organisations to be able to fulfil its tasks, it is not surprising that the IASB agreed to add to its agenda a short-term joint project with the FASB. It aims at the elimination of differences between standards (IAS versus U.S.-GAAP) of both boards. In the medium term, IASB and FASB resolved to work on a range of individual projects that would reduce further those differences. Finally, they agreed about to work closer together and to make their agendas more similar in future. (IASB, 2002 g) However, this co-operation is surprisingly, considered from the FASB's side. It can be considered as a change in the thinking of the FASB and the U.S. regulators. Until the announcement of a closer work, the FASB insisted that a convergence would take place only on the basis of U.S.-GAAP. It stated as well that the U.S. standards are the best in the world and that it could not accept any other standards of less quality (e.g. IAS). (Investors Relations Business, 2002 a; IASB, 2002 e, SEC, 2002 i) However, it seems that the FASB and U.S. regulators (e.g. SEC) are more flexible in this issue now. Or, we could imagine that the IASB will have to make a lot of compromises, in order to achieve an acceptance of the IAS in the United States.

In our point of view two factors have convinced the FASB to co-operate with the IASB. First, there is the decision of the EU to use the IAS. With that regulation the IAS will be the official Accounting Standards for almost 7000 EU listed companies in 2005. Second, we think that

the scandals (e.g. Enron<sup>31</sup>, Woldcom) of the US decreased the faith of Americans in their own Accounting Practices. (Investors Relations Business, 2002 a) Hence, less believe of the Americans in their own rules and the strong support of the EU might make a compromise on internationalisation of Accounting Standards possible.

### 5.1.2 Weaknesses of the IASB

We consider the following points as weaknesses of the IASB:

- Close relationship of IASB to philosophies of the Anglo-American Model
- Convergence means only to harmonise IAS and U.S.-GAAP
- Developing countries are neglected.

#### **Close relationship of IASB to philosophies of the Anglo-American Model**

As stated in chapter four, the standards of the IASB belong to the Anglo-American Model. The organisation was formed in 1973 out of initiatives from Canada, the United States and the United Kingdom in order to prevent that Accounting Philosophies of the Continental-European Model gain too much power (Dörner and Wollmert, 1995). Therefore, it seems not astonishing that the IASB is criticised for having a too close relationship with the United States. It is argued that the IASB spread in a hidden way, principles of the British-American model. (Maier-Siegert, 2001) The IOSCO Endorsement exemplifies the argument. Kleekämper et al. state that the IOSCO Endorsement was only possible, because mainly Continental-European rights of choice had been eliminated and because U.S.-American rules were preferred. (Kleekämper et al., 2002) Continental-European options have been abolished, because at the time of the IOSCO Endorsement the IASC (predecessor of the IASB) was strongly influenced of American members. The IOSCO was mainly influenced of the SEC. (Kleekämper, 2002) Achleitner is of the opinion that the IASB has been closer to (or favoured) the American Accounting Philosophy in order to get the Endorsement of the IOSCO. (Achleitner, 2000)

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<sup>31</sup> The collapse of the US-energy company Enron in 2001 shocked investors, employees, but also auditors and the rest of the world. The collapse of Enron lead to a loss of trust in the publication of financial statements. Even if in the case of Enron there could be deceitful practices and methods of intended disobey of rules found, one could also explain the failure of Enron with lacks in Accounting Standards of the US. (Deutsche Bundesbank, 2002:55-56)

A further aspect, which supports our feeling that Americans and other countries of the Anglo-American Model mainly influence the IASC Foundation, can be seen, when the members of the Board and the Trustees are considered. The structure of the IASC Foundation has been introduced in chapter four. As explained before the Trustees name the Board members and the Board members have the main authority in changing and developing Accounting Standards. When we take a look at the 19 members of the Trustees, one can see that there are alone five from the U.S. All other nations<sup>32</sup> are represented by only one member, except from Japan, which is represented by two members. Although the influence of the United States is obvious, it has to be stated that the Trustees represent a fair representation of the Anglo-American Model and the Continental-European Model (6 of the 19 members are European). What can be seen from the 14 Board members? There are alone four members from the U.S., all other countries<sup>33</sup> are only represented with one member, except from the U.K., which is represented as well with four members. Here, we have no fair representation of the members of the Anglo-American Model and the European-Continental Model (4 of the 14 members are European). The countries of the Anglo-American Model represent 10 voices, whereas the others have 4. Further we found out that all four Board members, from the U.S., have been involved in some kind with the Financial Accounting Standard Board, before they were appointed. For example Thomas Jones, Vice-Chairman of the IASB, has served as a Trustee at the Financial Accounting Foundation, which oversees the activities of the FASB. (IASB, 2002 p) Therefore we see contradictions to the in chapter four stated rules about appointing members of the IASB. There it was said that the Trustees shall appoint Board members to ensure that it is not dominated by any constituency or regional interests.

### **Convergence means only to bring IAS and U.S.-GAAP closer together**

Several authors (for example Buchheim, 2002) talk of a convergence of IAS/IFRS and U.S.-GAAP as the main activity of the IASB in the future. We see the risk of such development that it would be against the aims of the IASB, „*to bring about convergence of national Accounting Standards*“ (Epstein and Mirza, 2001:11). It would neglect standards of other nations. In our opinion such development would be not positive for an international acceptance of IAS.

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<sup>32</sup> Other nations represented in the Trustees only by one member are Canada, U.K., Germany, France, Denmark, Italy, Netherlands, South Africa, Brazil and Switzerland. See Appendix 8.8.

<sup>33</sup> One member in the Board only represents France, Australia, Germany, Japan, Switzerland and Canada.

U.S.-GAAP are not conform to the directives of the EU. (Kleekämper et al., 2002) If IAS and U.S.-GAAP will actually converge, there will be critics from the European side, because then the IAS will not be conform with the EU directives. Such a development would therefore conflict the area of harmonisation. On the other hand we think that in order to achieve a harmonised global set of Accounting Standards all participants have to accept changes to their old systems.

### **Developing countries are neglected**

Members of the IASB as well as of the Trustees are mainly from the western world (e.g. Europe, the U.S., Canada and Australia).<sup>34</sup> Therefore one can criticise the underrepresentation of developing countries in the development of international standards. Attention has to be drawn to the apparent overrepresentation of the interests of developed nations on the Board of the IASC Foundation. Questions have been raised, as to whether the views and evidence of the developing countries, are being heard and considered. (Wallace in Roberts et al., 1998)

Hence, there are some points, which can be considered as weaknesses of the IASB. Challenges of the IASB, will be introduced in the next part.

### **5.1.3 Challenges of the IASB**

After having considered the work and the weaknesses of the IASB, we would like to further discuss challenges of the IASB. Those are the following in our view:

- Heterogeneous Accounting Philosophies between countries.
- Interpretation and supervision of IAS/IFRS.
- Aims of the IASB.
- Acceptance of the IAS/IFRS by the SEC.
- Lobbying the IASB.

#### **Heterogeneous Accounting Philosophies between countries**

A challenge within the international harmonisation process, which the IASB has to overcome, are the differences between nations. Those are based in the diverse Accounting Philosophies explained in chapter three. These alteration in Accounting Practices are results of specific

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<sup>34</sup> Please find an overview of the Board and Trustees members enclosed in Appendix 8.7 and 8.8.

environmental factors, which have shaped them. Therefore, we agree with Naciri and Hoarau that the result of the harmonisation process could neither be a copy of the Anglo-American Model nor one of the Continental-European Model. (Naciri and Hoarau, 2001) The Anglo-American Model is too difficult to implement for most economies of the world at least in the short run. For example, it would be difficult for Germany to apply its diverse company law to the American system, which considers only a division between listed and non-listed companies. (Maier-Siebert, 2001) The Continental-European Model would not be accepted either because of its non-managerial orientation or its legal constraints. (Naciri and Hoarau, 2001)

Moreover, in chapter three we explained that in most Continental-European countries, professional accounting organisations do not have the responsibility or authority to set Accounting Standards. Such matters are largely the responsibility of governments and the law. This can be contrasted with the situation in most Anglo-American countries, where the accountancy profession is much more influential in the standard-setting process. To overcome these problems an International Model, containing elements of several Accounting Practices, was suggested. (Naciri and Hoarau, 2001) In our view an international organisation, such as the IASC, was necessary, in order to combine the different Accounting Philosophies and to develop an International Model (IAS). Hence, we agree with Kleekämper et al. that one of the future tasks of the IASB is to further minimise differences between Accounting Standards, in specific the ones between IAS and U.S.-GAAP. The United States is one of the most important capital markets and we think, that it would time that this market is open for the IAS without reconciliation. (Kleekämper et al., 2002)

### **Interpretation and supervision of IAS/IFRS**

*“It is one thing to write an Accounting Standard. It is quite another thing to have to interpret it and apply the guidance in the standards to the billions of actual transactions that occur in the business world. This is especially true if the standards provide broad general principles“* (Turner, 2001:13). In chapter four we explained that the IFRIC is responsible at the IASC Foundations for interpreting IAS/IFRS. One critical fact of the standards of the IASB, resulting from the SEC Concept Release Project was the unsatisfying interpretation of IAS/IFRS. As IAS/IFRS are principle based standards there is even more interpretation necessary. Such could be provided by preparers, auditors or regulators as the SEC. Here, we criticise that with interpretations being made by various interpretative bodies, preparers,

auditors and regulators, a challenge exists with respect to ensuring convergence with interpretations of the standards as well. Imagine the following: the IAS/IFRS would be expected of the SEC as Accounting Standards for listings on U.S. capital markets. First, the standards would be interpreted at the IFRIC. And on a second level, the SEC would interpret them as well, because it wants to assure investors protection and efficient functioning of the capital market. Therefore we see another challenge for the IASB to answer the question: What steps can be and should be taken that IAS/IFRS will be interpreted effectively and globally uniform?

Another essential precondition for the acceptance of IAS is that they are not only standards of high-quality but also that their application is supervised. If there is no organisation, which observes the application of the standards then there is the risk that the standards are interpreted and applied differently in our opinion. The problem of supervision can not be solved from the IASB alone, because it has no power of sanction. We agree with Turner, who suggests a supportive infrastructure in order to solve the problem of supervision. Such a supportive infrastructure should consist of:

- High-quality accounting and auditing standard-setters,
- Active regulatory oversight and
- Audit firms with quality controls world-wide (Turner, 2001).

We further agree with Turner that efforts of interpretation and supervision of IAS/IFRS require the co-ordination of public companies, auditors, standard-setters, regulators and governments (Turner, 2001).

### **Aims of the IASB**

Talking about the challenges of the IASB includes as well considering the aims of this organisation critically. We have shown the objectives in chapter four. The IASB aims to develop a single-set of global Accounting Standard and it works for the world-wide use and application of IAS. So far it has published 33 Accounting Standards. However, in our view it would be too premature and therefore not justified to talk about a global acceptance of IAS. First, the access to the American market (without reconciliation) is not possible for companies using IAS at the moment. Second, as shown in Appendix 8.12, the IAS are not allowed in several Asian countries (for example, Korea, Japan, Malaysia, Singapore or Indonesia), in

some South-American countries (for instance, Argentina, Brazil, Chile, Columbia or Mexico) and they are not accepted in certain African countries (for example Burkina Faso or Ghana). However, as can also be seen in Appendix 8.12 the IAS are permitted in many countries. We assume, that the EU regulation and the announcements of Australia and Canada to accept IAS by 2005 will attract further countries. This would bring the IASB a big step further to achieve its goals.

The third aim of the IASB is its commitment to converge national Accounting Standards and International Accounting Standards. Like the first two objectives, we consider this aim as very challenging, too. It will be difficult, to bring all opinions of all national standard-setters, representing different Accounting Philosophies, under one umbrella. In summary one can say that the aims of the IASB are very challenging and we are curious about the achievement of those objectives.

#### **Acceptance of the IAS/IFRS at the SEC**

Because high quality of financial information ensures an efficient market, Security market regulators are in particular interested in the presentation of Accounting information. They can accept or refuse a company's access to the market. We have already argued that the IAS are not fully accepted in U.S. capital markets. The SEC already accepts IAS with reconciliation to U.S.-GAAP. This is consistent with IOSCO's Endorsement. Other events like, for example, Enron, EU regulation and the improvement of the quality of the IAS have led as well to a more open opinion of the SEC to the IAS. (Pellens et al., 1996) However, the SEC is of the opinion that the U.S. capital market is very efficient, because of its high quality of financial reporting. Therefore, it is not possible for it to accept standards of less quality. (Wagenhofer, 2002) It will be interesting to see, when and if the SEC will accept the IAS without reconciliation. Furthermore, time will show if the SEC accept them all at once or if it will accept them step by step as long as they are consistent with the U.S.-GAAP. The SEC will reconsider the need for foreign private issuers from EU member countries to continue to reconcile from IAS to U.S.-GAAP, if by 2005, there has been sufficient progress in

- the improvement and short-term convergence of Accounting Standards,
- the development in a consistent interpretation and application of IAS, and
- the enhancement of financial reporting infrastructure. (SEC, 2002 h)

To achieve these requirements of the SEC, will be a challenge for the IASB.

### **Lobbying of the IASB**

In order to defend their own interest, many actors (national standard-setter, companies, governments) try to influence the work of the IASB. We will give two examples of what kind those lobbying activities could be.

A good example is the Swiss company Novartis which considered to switch from the IFRS to the U.S.-GAAP, if the IASB does not change its standard *“that will require the amortisation of goodwill over 20 years. It was said that Novartis was concerned that it will be placed at a strategic disadvantage if the IASB does not adopt a standard about goodwill that converges with the FASB’s statement of Financial Accounting Standards 142”* (Zeff, 2002:44).

Another possible political intrusion in the work of the IASB might come from the EU screening mechanism (Zeff, 2002), which was introduced in chapter 4. This mechanism assesses international standards, adopted by the IASB, to give them legal endorsement for use within the EU. The legislative backing of IAS in the European Union can be seen as a challenge for the IASB, because the EU may rewrite IAS to suit the regional need in the European countries. In our view this would defeat the objective of the IASB to develop unified international Accounting Standards. Furthermore it is likely that other regulators, considering how they will interact with the IASB, will adopt an endorsement mechanism as well. (Turner, 2001) Therefore, we see the danger of political influence of the EU.

### **5.1.4 Conclusions about the role of the IASB**

On one hand we see the ‘official’ role of the IASB, which is the development of world-wide accepted Accounting Standards. Even if the global acceptance of them is not achieved yet, we believe that they will gain importance the next years. Opponents of the IASB might doubt that the IASB is the most important actor in the field of harmonisation. However, it cannot be denied that they play an important role in the harmonisation process, because its standards are supported by major organisations as the EU, the IOSCO. In our view an acceptance of the SEC and FASB is probable in the future.

On the other hand we see the role of the IASB as a mediator between different Accounting Standards and Philosophies. We consider the efforts of the IASB as an important attempt, to overcome differences of national Accounting Standards. It tries to combine opinions of several national standard-setters by inviting them to take part in its organisation as well as in the due process. It tries to converge different national Accounting Standards and wants to develop one globally accepted set of Accounting Standards. However, we are aware that the IASB needs consistent back up, in order to be able to fulfil its role. The IASB have no legal empowerment. Therefore, the compliance with its standards is voluntary. Hence, the IASB depends on organisations and national standard-setters for the acceptance of the IAS world-wide. In this we see the main weakness of the IASB. Here, we can find as well the reasons, why the IASB is trying to work so close together with other organisations. With each agreement it strengthens its importance and the acceptance of its standards.

## ***5.2 Status quo of harmonisation process and future perspectives***

The year 2002 was a very busy but successful period for the harmonisation process. Hence, it seems interesting to summarise, what has been achieved so far in the process. In June 2002 the EU council of ministers issued a regulation that all enterprises listed on a regulated market in the European Union are supposed to prepare their consolidated accounts in accordance with IAS by 2005. Furthermore, a big hope for the harmonisation was the decision of the FASB and the IASB to work closer together, which was announced in September/October 2002. We think that International standards which are accepted from the United States without reconciliation would be an enormous breakthrough in the harmonisation process. However, time will show how successful the co-operation between these accounting bodies will be. Those two main recent developments, going on in the Accounting world, are shown in the graphic below:

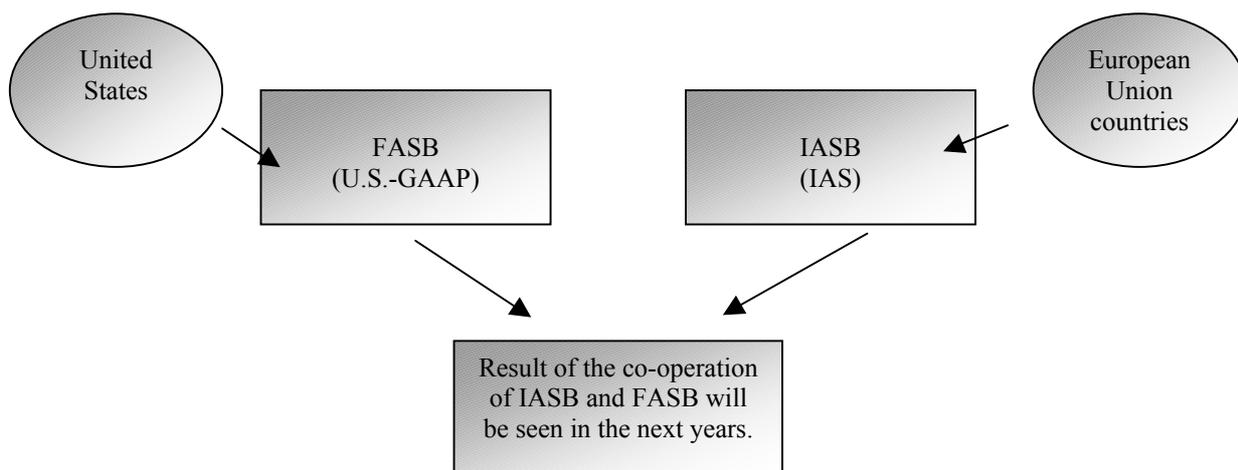


Figure 17: Recent developments in the international harmonisation process

Our thesis has shown that the IASB has an important role in the harmonisation process. As this organisation uses standards, it is justified to ask, if it is still appropriate to use the term harmonisation for this process. As we explained in chapter four, standardisation does not take into account national differences. Each country has its own set of rules and Accounting Philosophy, it will try to protect their procedures against a set of unknown standards, which they will be obliged to use. We see the advantage of harmonisation in the fact that it recognises national resources of each country and tries to conceal them with other countries. This process can achieve a high degree of acceptance in our opinion. However, as there are still options within the IAS and it is not possible to enforce the IAS in every single country, we agree with Kleekämper et al. not to talk about a standardisation process. (Kleekämper et al., 2002) At least we think that this consideration is true for the international process. The development of the EU, which prescribes IAS with the beginning of the year 2005 can be already considered to be a standardisation process from our point of view.

However, we already mentioned that we see the risk that convergence means that the IASB will only converge their IAS with the U.S.-GAAP. Further we believe that if this will be done, other countries are forced to use such standards. In our view a development of this kind would be more similar to standardisation, with the above described disadvantages.

When discussing the harmonisation process one should also consider future prospects of it. There is a comment of the American Institute of Certified Public Accountants (AICPA), which gives a good idea of future prospects in the field of Accounting: *"All accounting regimes, including U.S. GAAP, evolve over time and require improvement. With convergence*

*of IAS and national regimes around high quality standards, fewer reconciling items will exist over time, and at a future date, reconciliation will become unnecessary” (SEC, 2002 b).*

In our opinion the IAS/IFRS have a good chance to be the global standards for consolidated financial statements. First, they are already excepted at some capital markets (e.g. Germany, Austria or Hong Kong)<sup>35</sup> and will be excepted at other ones, because in our view the democratic work of the IASB will further support an acceptance of IAS/IFRS. Secondly, we think the advantages of one single set of Accounting Standards, presented in chapter four, will convince further preparer and user as well as regulators. We expect further acceptance of the IAS/IFRS in the U.S. after differences between U.S.-GAAP and IAS are overcome. International recognition will be achieved by a further co-operation between standard-setters in our view. National options in measurement/valuation methods, as well as national characteristics as the coupling of taxation law and commercial law should be dropped in our thoughts, in order to reach international similarity and comparability of financial statements.

### **5.3 Critics on the harmonisation process**

A discussion about the harmonisation process should as well include a consideration of the advantages and disadvantages of the harmonisation process. In chapter four we have already written about the benefits of the harmonisation process, here critics of it will be considered. We have indicated in chapter three that national Accounting Standards are a part of the national environment, which is different for every nation. Among others, Wagenhofer, (2002) and Nobes (1994) are afraid that international Accounting Standards are not compatible to the specific national environment. It is unsure, whether international standards can handle differences grounded in different national backgrounds as traditions and economic environments. This is because the global standard is not to the same extent included in the national environment as national standards are and can therefore not react to national circumstances. Different Accounting Practices have developed, to serve different needs of different users. (Nobes, 1994; Wagenhofer, 2002) Therefore, its efficiency will be reduced.

In chapter four we argued that the main advantage for users of financial data would be the better comparability of financial data. In contrary Pellens asks, whether harmonised Accounting Standards are actually necessary for participants of the capital market. He argues

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<sup>35</sup> For a complete list of countries, which use IAS, see Appendix 8.12.

that for understanding such rules, detailed knowledge of those is necessary. Maybe Pellens is right that not all analysts will understand the rules of IAS. Therefore, we think it is important for the IASB to further work for an understanding of their standards. He argues further that national comparisons with competitors and branch information are in first line necessary, for analysts to make comparisons. He is of the opinion that only in second line international comparisons with foreign companies are made, which would mean that international Accounting Standards are not needed. (Pellens, 2001) We consider his last argument only to be true for small enterprises. International comparisons are in our view of high importance for the evaluation of the performance of global acting companies.

Another statement, made by Goeltz, is that global capital markets would even have developed without international Accounting Standards. (Goeltz in Choi et al., 2002) We agree with Goeltz on that aspect. On the other hand it is obvious that the need for reconciliation or a full preparation of financial statements according to foreign Accounting Standards are barriers to the free competition of capital.

## **5.4 Conclusion**

Work achievements, challenges and weaknesses of the IASB were introduced. From this we concluded, that the IASB plays an important role in the field of international harmonisation. This could be explained with the achievements of it. As a main challenge of the IASB we see the need for a global enforcement to promote the uniform application of IAS/IFRS. We claimed that in order to achieve that goal a uniform interpretation and supervision of the standards is necessary. This supposes that all involved actors (companies, auditors, governments, regulators and standard-setters) work together. We think that it is the harmonisation/convergence of Accounting Standards, which will lead to a globally accepted and unified set of Accounting rules. We claim that all standard-setters should agree on a single, high-quality answer. In order to achieve that goal, preparers and users of financial statements must be willing to accept that harmonisation/convergence of Accounting Standards will involve changes to all existing systems. As one major advantage of unified Accounting Standards an international comparison of financial statements was described. On the other hand one can ask, whether an international harmonisation of Accounting Standards is possible, without harmonising the socio-economic environment at the same time.

## 6 Our contribution

In chapter one we stated the purpose of our thesis, as well as our contribution to the knowledge would be the answer to the following three questions:

- What is the international harmonisation process of Accounting Standards?
  - What is the status quo of the harmonisation process?
  - What is the role of the International Accounting Standard Board in the harmonisation process?

In order to answer these questions we applied a structure, explaining the process on three steps. First the outgoing situation of the harmonisation process was considered (Chapter three), then the process of development of harmonised Accounting Standards was described (Chapter four). In the last part of our thesis (Chapter 5) we considered the status quo and the role of the IASB in the process. A short summary of our findings is given in the following.

### **What is the international harmonisation process of Accounting Standards?**

The international harmonisation process was defined as the bringing together of national Accounting Standards to achieve some sort of international accepted principles, according to which financial statements can be prepared. Due to this set of accepted standards international comparability of financial data should be achieved. Comparable, transparent and reliable financial information is fundamental for an efficient and integrated capital market. Lack of comparability will discourage cross border investment because of uncertainty about the credibility of financial statements. It has been explained that advantages (e.g. cost savings, better comparability) for users and preparers of financial reports have created a need for world-wide harmonised Accounting Standards on which financial reporting can be based.

The starting point of the harmonisation process can be found in the differences of Accounting Practices. We have differed between the following two worlds: the Anglo-American and the Continental-European one. We claimed that the movement to uniformity in Accounting Standards, has to deal with the solving of conflicts resulting from differing Accounting Philosophies. The harmonisation process started in the 1960's and is still going on. From this we assume that it is a very complex process, which was and is still full of controversy

opinions and attitudes between the countries and organisations involved in it. In 1973 the predecessor of the International Accounting Standard Board was formed. This international body was assigned to develop Accounting Standards for international use. These Accounting Standards are called the International Accounting Standards. Most of them have been developed in the time between 1973 and 1987. During 1987 and 2000 the work efforts in the harmonisation process have been mainly influenced by the agreement of the IASB and IOSCO to develop a list of IAS, allowed for cross-border listings of companies at international stock exchanges. The IOSCO advised its members this list of Core Standards in 2000. This was an important step for the harmonisation process. The IASB has achieved major results in the harmonisation process, but is still struggling and searching for acceptance of its standards. However, for us, it seems that we have never been so close to harmonised Accounting Standards than in the year 2002. This leads us to discover the status quo of the harmonisation process, our Subpurpose I.

### **What is the status quo of the harmonisation process?**

In the year 2002, the organisations involved in the international harmonisation process, can offer some promising agreements. Those give hope that it will be easier for investors, regulators and companies to read the financial statements around the world in future. First, we had the announcement of the European Union that all enterprises listed in the European Union have to prepare their consolidated accounts in accordance with IAS 2005. That means for 7000 European companies to use IAS, beginning 2005. Furthermore, the long existing rejection of IAS/IFRS of the U.S. seems to change. Co-ordinations of agendas of both standard-setting boards have been announced. Furthermore, the IAS/IFRS will be accepted at Australian and Canadian stock exchanges without reconciliation in the year 2005. Therefore, we conclude that IASB's standards are more accepted and are considered to be of higher quality than they have been before.

### **What is the role of the IASB in the international harmonisation process?**

The official role of the IASB is to develop world-wide accepted Accounting Standards. Its purpose is to formulate the standards and to promote its global use and acceptance. The predecessor of the IASB was not very successful and the standards were not globally accepted. Therefore, in the 1990's it undertook a co-operation with the IOSCO to develop a core set of standards, which would be accepted for world-wide listings. At the end of 1990's the IASC reorganised its structure and process of developing Accounting Standards. The

IASB focuses a lot on a co-operation with national standard-setters and a high involvement of interested persons and organisations, when IAS/IFRS are developed. Therefore, we believe that the IASB has the role of a mediator between the two Accounting Philosophies, namely the British-American and the European-Continental Model. Both Accounting worlds want to prevent a predominance of the other side and therefore, the IASB should find solutions and compromises, which satisfies both Accounting sides. However, we have illustrated, that the IASB is highly influenced from the Anglo-American side. Hence, it is doubtful if the IASB can serve its role of a mediator.

The IASB has achieved important accomplishments in the comparability of financial statements. We think that the myopic view of the U.S. not to accept the IAS for a long time had been negative for a further development of the harmonisation process. We consider the achievements of the IASB (regulation of the EU, agreement between FASB and IASB) as major breakthroughs in the international harmonisation process. And therefore the role of the IASB is a very important one in it.

## ***6.1 Reflections***

We have decided to use a qualitative approach, namely a descriptive research for our study. In general, we believe that this approach was reasonable, in order to illustrate the harmonisation process (main purpose) to our target group. However, in order to fulfil our Subpurpose I (Status quo of harmonisation process) we had to realise that this question was very hard to answer without doing a quantitative study. Next time, we would for example also examine in more detail, which Accounting Standards (IAS, U.S.-GAAP or national GAAP) are used at which and how many security exchanges. We could image three stages to describe the status quo: Number of countries in which IAS are accepted fully, accepted with reconciliation, not accepted at all.

In our view, subpurpose II (role of the IASB) was as well reasonable to answer with the used method. On the other hand, we believe that some interviews would have helped us, to find out even more diverse opinions about the IASB. We could have asked individuals and organisations as for example companies, accountants or national standard-setters.

Reflections on the findings of this thesis, indicate us, that it is hard to find out, with a qualitative analysis, how far the harmonisation of Accounting Standards actually *is*. Main focus in the literature is on the acceptance of IAS in the EU and the U.S., therefore we are rather unsure about the acceptance in other continents as for example Africa. Knowledge about the acceptance of IAS in those areas would be necessary, in order to evaluate the real world-wide harmonisation of Accounting Standards. Further we think that the process is very complex and difficult. Everyone knows how difficult it is to bring just two different opinions together. Now one should think of a process, where opinions according to Accounting Standards of the whole world should be brought to one solution. The aims of the IASB can be therefore considered as very challenging and we are unsure, whether a global harmonisation/convergence of Accounting Standards would be ever possible

From the beginning we have decided that this thesis should give an overview on the process, but do not regard the harmonisation process from a more technical point of view. We chose this broad frame, because we were interested in the whole picture. However, it is difficult to comprise the whole process, to explain everything but not to go too deep in one of the topics.

A critical point in our thesis might be that we decided, to analyse the IASB in more detail. This was because we wanted to analyse the role of the IASB in the harmonisation process. We learnt that the IASB is a very interesting organisation (e.g. structure, aims), which has except from the American standard-setting board no real competitor. This maybe explains as well why the description of the process mainly is about the IASB.

## ***6.2 Further Suggestions***

We explained the harmonisation process only until the year 2002. Therefore, we suggest observing further developments in that area. In particular the next years will show how effective the agreement between IASB and FASB will be. The following years will illustrate, if the two organisations will be able to keep to their agreements of a closer relationship, or if nothing will change. Therefore, another study should be done in maybe 5 or 10 years from now on to show further developments.

Our study was done from the perspective of involved actors. Another possibility could have been to consider issues of affected companies. With other words, it could have been also

interesting to find out, how companies prepare themselves for such developments in the Accounting area. Differing opinions between small enterprises and international enterprises could have been considered also.

A neglected topic in the international harmonisation process is the participation of developing countries. The literature does rather not consider Asian or African countries and their role in the process. Therefore, we see a need for further research. However, such a study would need a lot of resources and time. Furthermore, it might be helpful in such studies to have a basic knowledge not only about the culture, but also about the Accounting Practices of the researched countries.

### ***6.3 Concluding Remarks***

It is done! Finally! The harmonisation of Accounting Standards is described and discussed. Now, the reader got the whole picture of the process. We hope, that we were successful in explaining the character of the process, the status quo as well as the role of the International Accounting Standard Board.

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# 8 Appendix

## 8.1 Hofstede's cultural dimensions

- *Large versus small power distance*

The dimension of power distance should measure the degree of inequality in society (Hofstede, 1991) and to what extent members of a society accept that the power in an organisation is distributed unequally. (Helgesson, 1996)

- *Strong versus weak uncertainty avoidance*

The basic assumption behind this dimension is that humans are unsure about their future and therefore tend to use rules, laws and rituals to a certain degree to reduce uncertainty (Hofstede, 1991:113). This dimension is therefore the level to which people are uncomfortable with ambiguity and an uncertain future (Choi et al., 2002:45).

- *Individualism versus collectivism*

This dimension describes whether members of a society have a very close relationship in the collective or if members of a society care for themselves and their family first (Helgesson, 1996). This dimension asks whether the I or we prevails (Choi et al., 2002:45).

- *Masculinity versus femininity*

This dimension measures whether a society is more determined by masculine values as for example performance and achievement or by feminine values as relationships and caring (Helgesson, 1996; Choi et al., 2002:45).

## **8.2 Members of the Anglo-American Model**

Australia	Hong Kong	Panama
Bahamas	India	Papua New Guinea
Barbados	Indonesia	Philippines
Benin	Ireland	Puerto Rico
Bermuda	Israel	Singapore
Botswana	Jamaica	South Africa
Canada	Kenya	Tanzania
Cayman Islands	Liberia	Trinidad & Tobago
Central America	Malawi	Uganda
Colombia	Malaysia	United Kingdom
Costa Rica	Mexico	United States
Cyprus	Netherlands	Venezuela
Dominican Republic	New Zealand	Zambia
Fiji	Nigeria	Zimbabwe
Ghana	Pakistan	

Members of the Anglo-American Model (sources: Nobes et al., 1997)

## **8.3 Members of the Continental-European Model**

Algeria	France	Norway
Angola	Germany	Portugal
Austria	Greece	Senegal
Belgium	Guinea	Sierra Leone
Burkina	Italy	Spain
Cambodia	Ivory Coast	Sweden
Cameroon	Japan	Switzerland
Denmark	Luxembourg	Togo
Egypt	Mali	Turkey
Finland	Morocco	Zaire

Members of the Continental-European Model (source: Nobes et al., 1997)

## **8.4 Members of the South American Model**

Argentina	El Salvador	Paraguay
Bolivia	Guatemala	Peru
Brazil	Guayana	Uruguay
Chile	Honduras	
Ecuador	Nicaragua	

Members of the South American Model (source: Nobes et al., 1997)

## 8.5 Members of the Mixed Economy Model

Albania	Georgia	Russia
Armenia	Hungary	Serbia
Azerbaijan	Kazakhstan	Slovak Republic
Belorussia	Kirgizia	Slovenia
Bosnia-Herzegovina	Latvia	Tadzhikstan
Bulgaria	Lithuania	Turkmenistan
Croatia	Moldavia	Ukraine
Czech Republic	Poland	Uzbekistan
Estonia	Romania	Vietnam

Members of the Mixed Economy Model (source: Nobes et al., 1997)

## 8.6 Cultural areas for classifying Accounting Practices

More-developed Latin	Less-developed Asian	Germanic	Less-developed Latin	Near Eastern	Anglo	More-developed Asian	African	Asian-colonial	Nordic
Belgium	Indonesia	Austria	Colombia	Arab countries	Australia	Japan	East African	Hong Kong	Denmark
France	Pakistan	Israel	Ecuador	Greece	Canada		West African	Singapore	Finland
Argentina	Thailand	Germany	Mexico	Iran	Ireland				Netherlands
Brazil	Taiwan	Switzerland	Venezuela	Turkey	New Zealand				Norway
Spain	India		Costa Rica	Yugoslavia	U.K.				Sweden
Italy	Malaysia		Chile		U.S.				
	Philippines		Guatemala		South Africa				
			Panama						
			Peru						
			Portugal						
			Salvador						
			Uruguay						

Cultural areas (source Hofstede in Radebaugh and Gray 1997:74)

## 8.7 Members of the IASB

<b>Auditor</b>	<b>Preparer</b>	<b>User</b>	<b>Other</b>	<b>Academic</b>
David Tweedie <b>(U.K.)</b> (Chairman of IASB)	Hans-Georg Bruns <b>(Germany)</b> (Liaison with the German standard setter)	Anthony Cope <b>(U.S.)</b>	James Leisenring <b>(U.S.)</b> (Liaison with the U.S. standard setter)	Mary Barth <b>(U.S.)</b>
Gilbert G�elard <b>(France)</b> (Liaison with the French standard setter)	Thomas Jones <b>(U.K.)</b> (Vice-Chairman of IASB)	Robert Garnett <b>(U.K.)</b>	Warren McGregor <b>(Australia)</b> (Liaison with the Australian and New Zealand standard setters)	
Partricia O'Malley <b>(Canada)</b> (Liaison with the Canadian standard setter)	Harry Schmid <b>(Switzerland)</b>	Geoffrey Whittington <b>(U.K.)</b> (Liaison with the UK standard setter)		
John Smith <b>(U.S.)</b>				
Tatsumi Yamada <b>(Japan)</b> (Liaison with the Japanese standard setter)				

Distribution of Board members (IASB, 2002 d)

## 8.8 Members of the Trustees

North America	Europe	Asia-Pacific	Other
John H. Biggs (USA)	Guido A. Ferrarini (Italy)	Toru Hashimoto (Japan)	Roy Andersen (South Africa)
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Philip A. Laskawy (USA)	Hilmar Kopper (Germany)	Kenneth H. Spencer (Australia)	Robert Teixeira Da Costa (Brazil)
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Distribution of Trustees (IASB, 2002 c)

## 8.9 Members of the Standards Advisory Council

Members from Region	International Organisation	Observer
Africa (2)	World Bank	European Commission
Asia (6)	International Monetary Fund	Financial Services Agency, Government of Japan
Australia and New Zealand (2)	IFAC Public Sector Committee	U.S. SEC
Central and Eastern Europe (2)	IOSCO	
European Union (12)	Basle Committee on Banking Supervision	
Japan (2)		
Latin America (3)		
Middle East (2)		
U.S. and Canada (12)		

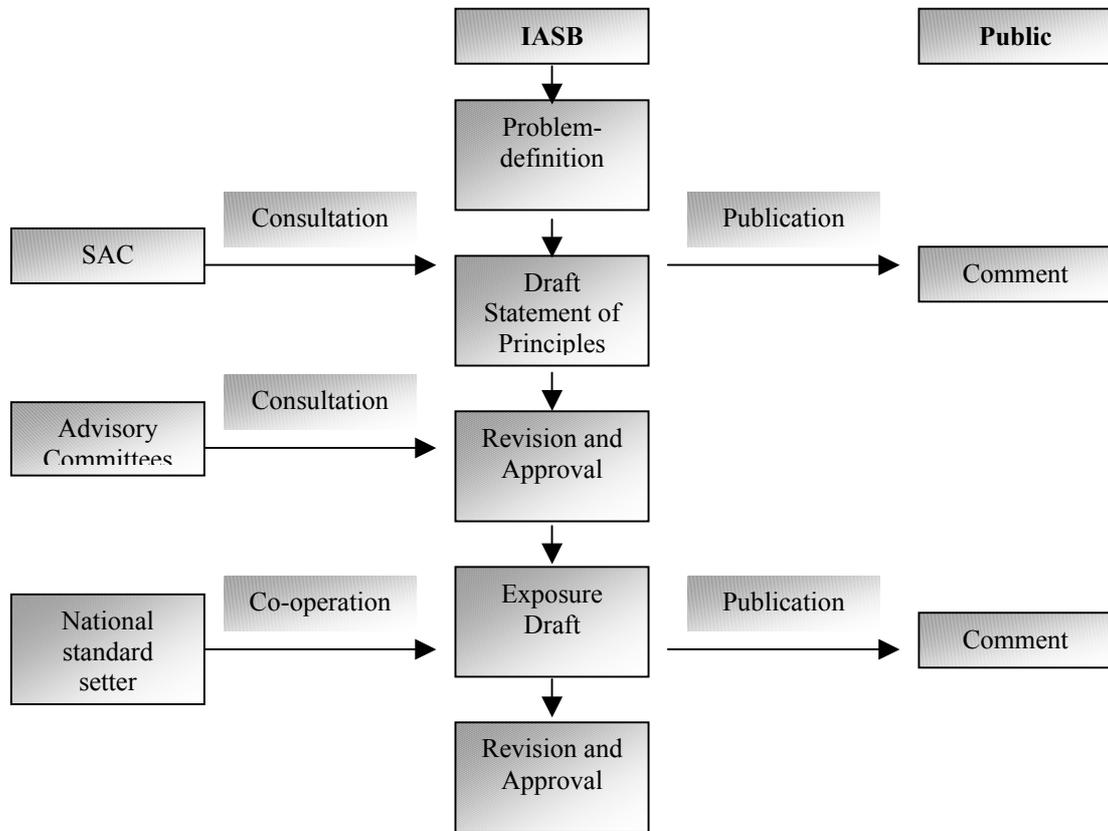
Members of the SAC (source: IASB, 2002j)

## 8.10 Summary of International Accounting Standards

IAS	Standard
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting
IAS 10	Events After the Balance Sheet Date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 14	Segment Reporting
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 22	Business Combinations
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosure
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	Disclosure in the Financial Statements of Banks
IAS 31	Financial Reporting of Interests in Joint Ventures
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 35	Discontinuing Operations
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture

Summary of IAS (source: Kleekämper et al., 2002:33-34)

## 8.11 Process - how IFRS are developed



Process – how IFRS are developed

## 8.12 Acceptance of IAS/IFRS world-wide

Code	Country	IFRS/IAS not permitted for foreign companies	IFRS/IAS permitted for foreign companies	Required for some domestic listed companies	Required for all domestic listed companies
AR	Argentina	X			
AM	Armenia				X
AW	Aruba		X		
AT	Austria		X		2005
AU	Australia	X			2005 (proposed)
BH	Bahrain			Banks	
BB	Barbados				X
BD	Bangladesh				X
BE	Belgium		X		2005
BJ	Benin	X			
BM	Bermuda		X		
BO	Bolivia		X		
BW	Botswana		X		
BR	Brazil	X			
BN	Brunei Darussalam				X
BG	Bulgaria		X		
BF	Burkina Faso	X			
KH	Cambodia	X			
KY	Cayman Islands		X		
CA	Canada	X			2005 (proposed)
CL	Chile	X			
CN	China			X	
CI	Cote D'Ivoire (Ivory Coast)	X			
CO	Colombia	X			
CR	Costa Rica				X
HR	Croatia (Hrvatska)				X
CY	Cyprus				X
CZ	Czech Republic	X			
DK	Denmark		X		2005
DO	Dominican Republic				X
EC	Ecuador				X
EG	Egypt				X
SV	El Salvador		X		
EE	Estonia	X			
Code	Country	IFRS/IAS not permitted for foreign companies	IFRS/IAS permitted for foreign companies	Required for some domestic listed companies	Required for all domestic listed companies
FI	Finland		X		2005

<b>FJ</b>	Fiji	<b>X</b>			
<b>FR</b>	France	<b>X</b>			<b>2005</b>
<b>DE</b>	Germany		<b>X</b>		<b>2005</b>
<b>GE</b>	Georgia				<b>X</b>
<b>GH</b>	Ghana	<b>X</b>			
<b>GR</b>	Greece	<b>X</b>			<b>2003</b>
<b>GT</b>	Guatemala	<b>X</b>			
<b>GY</b>	Guyana				<b>X</b>
<b>HT</b>	Haiti				<b>X</b>
<b>HN</b>	Honduras				<b>X</b>
<b>HK</b>	Hong Kong		<b>X</b>		
<b>HU</b>	Hungary		<b>X</b>	<b>X</b>	
<b>IS</b>	Iceland	<b>X</b>			<b>2005</b>
<b>IN</b>	India	<b>X</b>			
<b>ID</b>	Indonesia	<b>X</b>			
<b>IE</b>	Ireland	<b>X</b>			<b>2005</b>
<b>IL</b>	Israel	<b>X</b>			
<b>IT</b>	Italy	<b>X</b>			<b>2005</b>
<b>JM</b>	Jamaica				<b>X</b>
<b>JP</b>	Japan	<b>X</b>			
<b>KE</b>	Kenya				<b>X</b>
<b>KR</b>	Korea (South)	<b>X</b>			
<b>KW</b>	Kuwait				<b>X</b>
<b>KG</b>	Kyrgyzstan				<b>2003</b>
<b>LA</b>	Laos		<b>X</b>		
<b>LV</b>	Latvia		<b>X</b>		
<b>LS</b>	Lesotho		<b>X</b>		
<b>LT</b>	Lithuania		<b>X</b>		
<b>LU</b>	Luxembourg		<b>X</b>		<b>2005</b>
<b>Code</b>	<b>Country</b>	<b>IFRS/IAS not permitted for foreign companies</b>	<b>IFRS/IAS permitted for foreign companies</b>	<b>Required for some domestic listed companies</b>	<b>Required for all domestic listed companies</b>
<b>MK</b>	Macedonia				<b>X</b>
<b>MW</b>	Malawi				<b>X</b>
<b>ML</b>	Mali	<b>X</b>			
<b>MT</b>	Malta				<b>X</b>
<b>MY</b>	Malaysia	<b>X</b>			
<b>MX</b>	Mexico	<b>X</b>			
<b>MD</b>	Moldova	<b>X</b>			
<b>MM</b>	Myanmar		<b>X</b>		
<b>NA</b>	Namibia		<b>X</b>		
<b>NL</b>	Netherlands		<b>X</b>		<b>2005</b>
<b>AN</b>	Netherlands Antilles		<b>X</b>		
<b>NP</b>	Nepal				<b>X</b>
<b>NZ</b>	New Zealand	<b>X</b>			
<b>NE</b>	Niger	<b>X</b>			
<b>NO</b>	Norway	<b>X</b>			
<b>OM</b>	Oman				<b>X</b>
<b>PK</b>	Pakistan	<b>X</b>			
<b>PA</b>	Panama				<b>X</b>
<b>PG</b>	Papua New Guinea				<b>X</b>

<b>PE</b>	Peru				<b>X</b>
<b>PH</b>	Philippines	<b>X</b>			
<b>PL</b>	Poland	<b>X</b>			
<b>PT</b>	Portugal	<b>X</b>			<b>2005</b>
<b>RO</b>	Romania			<b>Companies of National Importance</b>	
				<b>In 2005 for All Large Companies</b>	
<b>RU</b>	Russian Federation		<b>X</b>		
<b>Code</b>	<b>Country</b>	<b>IFRS/IAS not permitted for foreign companies</b>	<b>IFRS/IAS permitted for foreign companies</b>	<b>Required for some domestic listed companies</b>	<b>Required for all domestic listed companies</b>
<b>SA</b>	Saudi Arabia	<b>X</b>			
<b>SG</b>	Singapore	<b>X</b>			
<b>SI</b>	Slovenia	<b>X</b>			
<b>SK</b>	Slovak Republic	<b>X</b>			
<b>ZA</b>	South Africa		<b>X</b>		
<b>ES</b>	Spain	<b>X</b>			<b>2005</b>
<b>LK</b>	Sri Lanka	<b>X</b>			
<b>SE</b>	Sweden	<b>X</b>			<b>2005</b>
<b>SY</b>	Syria	<b>X</b>			
<b>SZ</b>	Swaziland		<b>X</b>		
<b>CH</b>	Switzerland		<b>X</b>		
<b>TW</b>	Taiwan	<b>X</b>			
<b>TJ</b>	Tajikistan				<b>2003</b>
<b>TZ</b>	Tanzania			<b>2004</b>	
<b>TH</b>	Thailand	<b>X</b>			
<b>TG</b>	Togo	<b>X</b>			
<b>TT</b>	Trinidad and Tobago				<b>X</b>
<b>TN</b>	Tunisia	<b>X</b>			
<b>TR</b>	Turkey		<b>X</b>		
<b>UG</b>	Uganda		<b>X</b>		
<b>UA</b>	Ukraine			<b>Banks</b>	<b>2003</b>
<b>AE</b>	United Arab Emirates			<b>Banks</b>	
<b>UK</b>	United Kingdom	<b>X</b>			<b>2005</b>
<b>US</b>	United States	<b>X</b>			
<b>UZ</b>	Uzbekistan	<b>X</b>			
<b>VE</b>	Venezuela	<b>X</b>			
<b>VN</b>	Vietnam	<b>X</b>			
<b>YU</b>	Yugoslavia				<b>X</b>
<b>ZM</b>	Zambia		<b>X</b>		
<b>ZW</b>	Zimbabwe		<b>X</b>		

Acceptance of IAS/IFRS world-wide (source IAS, 2002)

## 8.13 Harmonisation process throughout the years

<b>Pre-stage of the harmonisation process</b>	
1959	Kraayenhof, father of the movement, releases his paper in which he was not advocating rigid uniformity but argued for some degree of international uniformity on accounting principles. (Samuels and Piper, 1985)
1961	The Groupe d'Etudes was founded in order to support the European Union authorities in Accounting questions. (Choi et al., 2002).
1966	Accountants' International Study Group was formed in order to analyse and to vanquish differences in Accounting between Canada, U.S. and U.K. (Kleekämper et al., 2002).
<b>Harmonisation process 1973-1987</b>	
1973	Foundation of the IASC
1976	The Organisation for Economic Co-operation and Development issued a declaration on investment in MNE's implying guidelines on disclosure of information (Choi et al., 2002).
1977	An experts group nominated by the United Nations published a report on international standards of Accounting and Reporting for transitional corporations (Choi et al., 2002).
1978	The Council of Ministers issued the fourth directive, which applies directly to all individual companies and deals with all aspects of the annual accounts.
1981	The IASC began a consultation with organisations, which are not members of the IASC in order to widen the input to international standard setting.
1983	The Seventh Directive was issued in 1983 and addresses the issue of consolidation. (Roberts et al., 1998)
1984	The London Stock Exchange professes that listed companies not incorporated in the U.K. or Ireland have to comply accounts in accordance with international Accounting Standards. (Choi et al., 2002)
<b>Harmonisation process between 1987-1993</b>	
1989	The IASC published Exposure Draft 32.
<b>Harmonisation process between 1993-1998</b>	
1995	Agreement between the International Organisation of Securities Commissions and IASC; the European Commission proposed to support the IASB initiative and work to bring the EU accounting requirements in link with IAS.
1996	The SEC manifested that it <i>"supports the IASC's objective to develop, as expeditiously as possible, Accounting Standards that could be used for preparing financial statements that could be used in cross-border offerings."</i> (Choi et al., 2002:296)
<b>Harmonisation process 1998 and onwards</b>	
1998	The IOSCO publicised a report <i>"International Disclosure Standards for Cross Border Offerings and Initial Listings by Foreign Issuers"</i> . (Choi et al., 2002:296); the IASC undertook initiatives to find a new strategic alignment and organisation structure in 1998.
March 2000	During a meeting in Lisbon the European Commission took a further step in the harmonisation process and proposed a regulation, which requires that all enterprises listed on a regulated market in the European Union would have to prepare their consolidated accounts in accordance with IAS by 2005.
Mai 2000	The IOSCO recommended its members to accept the IAS.
March 2001	EFRAC was founded in order to support the EU in his new Accounting strategy.
2002	In 2002 the Canadian Securities Administrators proposed that certain foreign listed companies in Canada are able to use the IASB's Standards without reconciliation to

	Canadian GAAP beginning 2005.
October 2002	The IASB and the FASB announced co-operation.

## 8.14 Members of the IASC

Australia	Iceland	Paraguay
Austria	India	Peru
Bahamas	Indonesia	Philippines
Bahrain	Iraq	Poland
Bangladesh	Ireland	Portugal
Barbados	Israel	Saudi Arabia
Belgium	Italy	Singapore
Bolivia	Jamaica	South Africa
Botswana	Japan	Spain
Brazil	Jordan	Sri Lanka
Canada	Kenya	Sudan
Chile	Korea	Swaziland
Colombia	Kuwait	Sweden
Croatia	Lebanon	Switzerland
Cyprus	Lesotho	Syria
Czech Republic	Liberia	Taiwan
Denmark	Libya	Tanzania
Dominican Republic	Luxembourg	Thailand
Ecuador	Malawi	Trinidad and Tobago
Egypt	Malaysia	Tunisia
Fiji	Malta	Turkey
Finland	Mexico	United Kingdom
France	Netherlands	United States of America
Germany	New Zealand	Uruguay
Ghana	Nigeria	Zambia
Greece	Norway	Zimbabwe
Hong Kong	Pakistan	
Hungary	Panama	

Members of the IASC (Nobes 1997:42)

## **8.15 The role of other international actors**

The role of the **FASB** should not be underestimated in the harmonisation process. FASB is the “*principal body that writes the generally accepted Accounting principles (GAAP) by which the financial statements of the U.S. companies must be prepared*” (Nobes et al., 1997:39). These standards are officially recognised by the **Securities and Exchange Commission and the Institute of Certified Public Accountants** (FASB, 2002 b) In a comparison between the IAS and the U.S.-GAAP, this strengthens the importance of the U.S.-GAAP , because the SEC does not allow the IAS without reconciliation to U.S.-GAAP. However, we believe that it is the division and rivalry between the American-British model and the European-continental model, which will prevent that the U.S.-GAAP take over the role as an international Accounting standard. At least officially we believe that U.S.-GAAP will not be the International Accounting Standard. However, attention has to be drawn on the argument, that the IAS is influenced from the standards of the FASB.

The **UN** and the **OECD** are both international public bodies which are interested in the financial statements of companies. Both have established working groups. Whereas the OECD includes only experts from industrial countries, the United Nation has as well experts from developing countries. As the United Nations is heavily represented by developing countries it has to protect their rights and ensure, that they are provided with enough information. The UN released as well Accounting Standards. However, in contrary, to the Accounting Standards of the IASB, the standards of the UN are rather unknown. (Wolk et al., 2001). The OECD had never the attention to write generally accepted Accounting principles. The role of the OECD is more the one of a catalyst. (Nobes et al., 1997). That means that it is looking at the Accounting practices of member countries in order to encourage greater harmonisation and comparability of financial statements (Nobes et al., 1997).