

EFFECT OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) ON VARIATIONS IN ACCOUNTING REGULATIONS AND PRACTICES AMONG COUNTRIES IN THE WORLD: ISSUES AND CHALLENGES

Ehiriudu Jude Alaoma (BSc Acc. MSc. Fin(Nig) MSc. Acc (UK) Ph.D Nig NMIN),
Lecturer @Department of Accountancy, Institute of Management Technology, (IMT) Enugu,
Enugu State, Nigeria

Nwankwo Bobby Godwin (Ph.D, M.Sc, B.ScFCNA), Lecturer @ Department of
Accountancy Caritas University, Emene Enugu & Institute of Management Technology, (IMT)
Enugu, Enugu State.

Abstract

This study examined the effect of International Financial Reporting Standards (IFRS) on variation in accounting regulations and practices: Issues and Challenges. The research is aimed at harmonizing the accounting practice by regulating the financial reporting standards being used by European companies, American companies and other countries in the world. This is done by measuring the degree which different companies in the world uses International Financial Reporting Standards in reporting their assets. The objective of the study is to demonstrate the existence of harmonizing tendencies between European Union member states and other countries in the world, as a result of International Reporting Standards (IFRS) adoption. The methodology used involved the Index computation for a sample of 51 listed companies that develop their activity in five European countries. The study revealed that the influence of International Financial Reporting Standards on accounting practices, as evidenced by high harmonization level for assets cannot be overstressed. Finally, many of the analysed situations recorded maximum harmonizing values at least in visible tendencies. The study concluded that IFRS has gone along way in unifying accounting practice in the world.

Key words: accounting practice, harmonization, reporting standards, measurement

Introduction

Although the origin of financial accounting dates back to hundreds of years ago, the development of accounting regulation did not commence until the early twentieth century, a period when the capital market became predominant in some advanced economies (Deegan 2013). With the expansion of capital size, the increasing tendency of separating ownership and stewardship make financial reporting significant for shareholders to obtain information about the entity's performance. In response to this reporting requirement, the regulation of financial accounting commenced.

As investment and trade grow rapidly with the active stock market, wide ranges of stakeholders request transparent accounting information to be fully disclosed on a comparable basis for decision-making during the investment process, engendering the standardisation of accounting rules. The American Institute of Accountants collaborate with the New York Stock Exchange (NYSE) firstly established a set of accounting principles in 1930 and codified the Generally Accepted Accounting Principles in 1936. Furthermore, the irreversible tendency of globalisation brought about increasing numbers of multinational enterprises, leading to the demand of setting globalised accounting standard. In 1973, International Accounting Standards Committee (IASC) and the Financial Accounting Standards Board (FASB) were formed successively to bring mandatory standards into general use (Zeff, 2005).

Although the IASB has endeavoured to harmonize accounting rules in different countries, it was not until January 2005 that new-phase progress was made. Thus, all listed entities in European Union are required to prepare their consolidated financial statements in accordance with IFRS (the International Financial Reporting Standards published by the IASB) (Baker & Barbu, 2007). Based on IFRS's report in 2018, 87% of accountable entities adopt IFRS as prescribed standards.

However, not least countries represented by the USA still insists on the national GAAP, even countries within the adoption of IFRS have variations in the practical use which originated from differential domestic environment (Klug, 2009). This essay will deal with the main reasons for the differences in accounting regulations and practices, explaining why these differentiations survive under the wide application of IFRS. Factors that might affect the accounting regulations and practice are developed in this section, including legal system, taxation system, provision of finance, accounting profession status, and culture values.

The legal system plays a significant role in elaborating the differences in accounting regulation between countries. Gray (1988) pointed out that legal systems have a strong influence on the development of the accounting system, which involved accounting regulation, practices and standards. Based on the number of criteria and similarities in some aspects, jurists are used to classifying the legal system into two types. One is civil law (or code law), the other is common law (Glendon et al., 1992; La Porta et al., 1996). Civil law originated from ancient Rome is adopted by most countries in the world, such as most Asian countries, Latin America and continental Europe. This law focuses on statutes and comprehensive codes, specifically, on detailed provisions which codified desired behaviours (Merryman, 1969). Regarding the countries treated civil law as their legal system, the government rather than private organizations, set accounting rules to regulate all the commercial behaviours of private or public organizations (Roberts et al, 2008). In other words, it is suggested that the corporate law or commercial law has already contained almost all the detailed accounting and taxable regulations in the civil law countries. As a result, due to comprehensive provisions, the government can entirely intervene in the economic activities by means of legal measures. In

addition, creditors and tax authorities are regarded as important users of financial statements; hence, accounting regulations in civil law countries are the primary protectors of the creditors.

The other legal system is common law which was originated from England and exported to many colonized nations in the world (La Porta et al., 1996). Anglo-Saxon countries and some Commonwealth countries, like the New Zealand, Australia and the United Kingdom, are usually recognized as common law countries (La Porta et al., 1996). The philosophy of common law, which is totally different from code law, is to prohibit undesired behaviours (Dainow, 1966). Thus, common law countries pay more attention to the legal precedents or specific cases that have been used to deal with specific problems in social and economic activities. In those countries, the private sectors usually develop accounting regulations and standards, such as Committee on Accounting Procedure (CAP) which formulates the US generally accepted accounting principles (GAAP), IASB which set IFRS for listed or multinational corporations (Pattberg, 2007). Furthermore, Robert (2008) believed that the legislature cannot exert much more impact on the accounting regulation compared with civil law countries. For instance, the US government authorised power to the Securities and Exchange Commission (SEC) at beginning. Accordingly, Financial Accounting Standards Board (FASB) in the U.S. has delegated authority to take responsibility for establishing accounting standards (Elliott and Elliott, 2019). Consequently, the governments in common law countries lack rights to excessively intervene economic activities. The UK is also a typical example. Because of accounting regulation executed by independent supervising bodies, it is flexible for the companies in the UK to choose their own accounting approaches and procedures according to self-situation so that the enterprise can protect their own interests (Alexander et al., 2017).

To some extent, different legal systems lead to different taxation systems. In accordance with Elliott's view, it is helpful to recognize the law system of a country in order to understand its influence on the way in which taxation and financial reporting are regulated (Elliott and Elliot, 2019). Based on the legal system, in the common law countries, the government has taxation and financial reporting while civil law countries prone to develop common system for taxation and financial reporting. Take the UK as the example of the first type of taxation system, depreciation in the UK financial statement is required to 'reflect as fairly as possible the pattern in which the asset's economic benefits are consumed by the entity' with the basis on Financial Reporting standard (FRS 15). Nevertheless, in tax declaration, depreciation depends on predetermined tax rate which is corresponding to the economic objectives (Roberts et al, 2008). Some developing countries (commonwealth countries) which are highly affected by the culture of colonial nations adopt common law, which determined their taxation and accounting system. (Hove, 1986). However, due to underdeveloped governance and lack of professional staff, their current taxation is either not set or not as complex and exhaustive as those in developed countries. In consequence, their tax authorities must use some data in financial reporting to calculate tax liabilities of the enterprise (Roberts et al., 2008).

The alternative is commonly used systems for taxable and financial reporting in civil law countries. Roberts et al. (2008) indicated that rules formulated by tax authority shall be obeyed both in tax returns and external financial statements. Austria is a good example to explain the dependence between tax rules and financial accounting rules. Its financial reporting is regulated by commercial law (Wagenhofer, 2001). Telekom Austria is commanded to disclose two types of untaxed reserves in its balance sheet. One is special depreciation reserve, which is calculated based on 'Continuation of special depreciation as per section 8 and 122 of the Austrian Income Tax Act 1972' and 'Transfer of hidden reserves as per Section 12 of the Austrian Income Tax Act'. The other one is simple investment allowance according to section 10 of the Austrian Income Tax Act, which has shown consistency between tax and financial reporting rules (Telekom Austria annual report, 2003). The objectives of formulating uniform accounting standards are increasing tax returns. However, it leads to pursuing pragmatism in order to decrease tax returns by making more reverse accounts to conceal assets. Moreover, most companies are unwilling to reveal some key accounting information so as to protect the interest of companies.

One of the factors is how the company raises funds when deciding on relevant financial information to users. According to Nobes and Parker (2003, pp. 21), "This difference in providers of finance (creditors) versus (equity) is the key cause of international differences in financial reporting". Due to differences in fund providers, the information needs of stock investors will be different from those of loan creditors. In the United Kingdom and the US, for example, they rely more on shareholders to obtain additional funds. Financial information systems in these countries have developed to meet prudent and conservative regulatory needs and to meet the requirements for fair information in capital markets so that all parties can trade on the principles of accrual basis and substance is more important than form. As a consequence, in countries where companies are mainly financed with their funds, the financial statements will be aimed at investors or shareholders. This means that the financial statements must provide information that allows potential shareholders to make the best investment decisions. Financial information can convey the company's basic economic performance on time, allowing investors to make those investment decisions, called "high quality" accounting information. If the revenues allow users of accounting information to evaluate current and future performance, the taxes will have a higher accounting quality (Chaney et al., 2011).

However, in Germany, France, Italy and Belgium, banks are the leading suppliers of new capital. Companies in these countries depend more on debt than on capital to raise money. Therefore, in states where companies depend more on debt financing, the financial statements are oriented to creditors. In these countries, the annual account information should be useful in determining whether a company can pay its debts. In this sense, the protection of creditors will be important and accounting practices will be more conservative. For instance, in German, the percentage of completion method is prohibited in general when recognizing revenue while IFRS accepts only if the criteria of recognition is met (PWC, 2010).

With the development of the capital markets, creditors have increased the requirements for reliable, relevant and timely financial information. Many countries have legislation that requires companies to prepare and review their annual accounts. This has led to the development of a mature and respected accounting profession that requires the ability to generate reports and perform audits to demonstrate its reliability (Elliott and Elliott, 2019).

On the contrary, the existence of an influential profession has affected the development of accounting regulations. The accounting profession is responsible for issuing accounting standards and recommendations in countries such as the United Kingdom, the United States, Canada, Australia and so on. However, in countries that do not need to offer market-sensitive information (such as Eastern Europe in the 1980s), accountants are considered as pure bookkeepers and have a low status (idib).

Besides, if the accounting profession is not powerful enough, the government will take charge of setting accounting standards, which means that the uniformity of financial statements is higher with much more requirement in detail. On the contrast, considering the United Kingdom (IOMSCA, 2016), for example, the advanced development of the accounting profession gives the company much greater flexibility in formats.

Cultural value affects the way that accountants interact with accounting (Chand at al., 2012). It is also believed to play a significant role in the application of accounting standards (Gray, 1988; Chand at al., 2012) which would potentially contribute to creating a harmonized global accounting environment (Tsakumis, 2007). Studies found that International Accounting Standards (IAS) are lack of sufficiency although they are necessary for financial statements comparison. According to Tsakumis (2017), the application of the same regulation is likely to result in a variety of decisions which are influenced by cultural background. Thus, to vary the standards based on countries can efficiently reduce the divergence of accounting decision which are made based on similar financial resources.

Objectives of Accounting Standards

Accounting is often considered the language of business, as it communicates to others the financial position of the company. And like every language has certain syntax and grammar rules the same is true here. These rules in the case of accounting are the Accounting Standards (AS). They are the framework of rules and regulations for accounting and reporting in a country. Let us see the main objectives of forming these standards.

1. The main aim is to improve the reliability of financial statements. Now because the financial statements have to be made following the standards the users can rely on them. They know that not conforming to these standards can have serious consequences for the companies.

2. Then there is comparability. Following these standards will allow for inter-firm and intra-firm comparisons. This allows us to check the progress of the firm and its position in the market.
3. It also looks to provide one set of accounting policies that include the necessary disclosure requirements and the valuation methods of various financial transactions.

Benefits Of Accounting Standards

Accounting Standards are the ruling authority in the world of accounting. It makes sure that the information provided to potential investors is not misleading in any way. Let us take a look at the benefits of AS.

1] Attains Uniformity in Accounting

Accounting Standards provides rules for standard treatment and recording of transactions. They even have a standard format for financial statements. These are steps in achieving uniformity in accounting methods.

2] Improves Reliability of Financial Statements

There are many stakeholders of a company and they rely on the financial statements for their information. Many of these stakeholders base their decisions on the data provided by these financial statements. Then there are also potential investors who make their investment decisions based on such financial statements.

So it is essential these statements present a true and fair picture of the financial situation of the company. The Accounting Standards (AS) ensure this. They make sure the statements are reliable and trustworthy.

3] Prevents Frauds and Accounting Manipulations

Accounting Standards (AS) lay down the accounting principles and methodologies that all entities must follow. One outcome of this is that the management of an entity cannot manipulate with financial data. Following these standards is not optional, it is compulsory.

So these standards make it difficult for the management to misrepresent any financial information. It even makes it harder for them to commit any frauds.

4] Assists Auditors

Now the accounting standards lay down all the accounting policies, rules, regulations, etc in a written format. These policies have to be followed. So if an auditor checks that the policies have been correctly followed he can be assured that the financial statements are true and fair.

5] Comparability

This is another major objective of accounting standards. Since all entities of the country follow the same set of standards their financial accounts become comparable to some extent. The users of the financial statements can analyze and compare the financial performances of various companies before taking any decisions.

Also, two statements of the same company from different years can be compared. This will show the growth curve of the company to the users.

6] Determining Managerial Accountability

The accounting standards help measure the performance of the management of an entity. It can help measure the management's ability to increase profitability, maintain the solvency of the firm, and other such important financial duties of the management.

Management also must wisely choose their accounting policies. Constant changes in the accounting policies lead to confusion for the user of these financial statements. Also, the principle of consistency and comparability are lost.

Limitations of Accounting Standards

There are a few limitations of Accounting Standards as well. The regulatory bodies keep updating the standards to restrict these limitations.

1] Difficulty between Choosing Alternatives

There are alternatives for certain accounting treatments or valuations. Like for example, stocks can be valued by LIFO, FIFO, weighted average method, etc. So choosing between these

alternatives is a tough decision for the management. The AS does not provide guidelines for the appropriate choice.

2] Restricted Scope

Accounting Standards cannot override the laws or the statutes. They have to be framed within the confines of the laws prevailing at the time. That can limit their scope to provide the best policies for the situation.

The results of studies show that participants from a low degree of individualism like China exhibit a greater conservatism than those from Australia (Gray, 1988; Chand et al., 2012). That implies accountants from lower individualistic cultural backgrounds are less likely to overstate income and assets although the same standards are applied. Because the cultural values contribute to accountants' judgments in the process of evaluating the measurement of a company's income and assets. So, customized accounting regulations based on nations are believed necessary for decreasing the cultural background influences on professional accountants' judgments on the financial decision-making process (Tsakumis, 2007).

Tsakumis (2007) states national culture impacts disclosure decision making significantly. The study of the application of IFRS suggests that when evaluating the probabilities of an event, professional accountants of a greater conservatism background are less likely to disclose the event while more cautious on assigning it into a numerical probability (Chand et al., 2012). To a certain extent, applying different standards across countries can reduce the impact of cultural differences on accounting decision making, improving comparability of accounting statements in different countries (Chand et al., 2012), as well as reducing the scope of possible disagreement among counties (Alexander et al., 2017).

Similarly, conservatism has a vital effect on contingent assets and liabilities (Tsakumis, 2007; Gray, 1988; Kvaal and Nobes, 2013), since the financial reporting about all the events and transactions happened in a company is based on the attitudes of professional accountants toward the accounting standards. It is said that professional accountants from U. S. who are less conservative than accountants from Greek have a far high likelihood of reporting the existence of contingent assets and contingent liabilities, although cultural values do not affect the recognition of contingent assets and liabilities (idib). Since an international accounting standard may cause different results across countries, to apply varied accounting standards in different countries is essential for reducing the negative accounting consequences of cultural values which can cause fraud and creative accounting (Alexander, 2017; Tsakumis, 2007).

Gray (1988) assumes that the attitude towards secrecy and confidentiality which is crucial to financial reporting is importantly influenced by cultural backgrounds, as these two

fundamental factors are closely related to the preference of measurement of financial information. In the process of measuring companies' assets and liabilities, professional accountants, who are from a certain cultural background that are less sensitive to disclosure tasks, are more likely to result in neglecting the importance of the financial information. Due to the variation of disclosure decisions resulting from common accounting standards, differentiated accounting standards across countries are believed necessary (idib).

Conclusion

As globalization progresses, the convergence of accounting standards is a historical trend to solve the comparability issues for multinational investment. However, based on the research of several scholars (Deegan and Unerman, 2011; Alexander et.al., 2017), even in countries adopting the same international accounting standards—the IFRS, their implementation could be different, let alone those countries use their domestic regulation instead of IFRS. From the theoretical explanations in various literature, the factors that lead to the variances could be extensive. And the reasons mentioned mostly are in terms of legal system, taxation, financing mode, role of accounting profession and cultural influence, which are discussed specifically in this context.

Concluded from the macroscopic perspectives, the differences arise from particular domestic conditions in politics, economic and cultural values. In terms of politics, the flexibility of law enforcement and the dominating role of professional accounting institutions will allow more professional judgement in accounting practice, giving more scope for discrepancy. In the aspect of economy, the degree of freedom in the capital market will determine who is mainly the fund provider and whether accounting regulation is independent of taxation and legal system or not, thus reporting objective could vary from investors to creditors. Viewed from cultural characteristic, the cultural values formed in national history could lead to different decision-making preference oriented by conservatism and individualism. More importantly, these factors could interact with each other and present differentiation with the changing circumstances. Concerning the impact, there are advantages and disadvantages. Undoubtedly, it is unfavourable to generalise the IFRS and hampers the commonly used of financial statements between enterprises across border. Nevertheless, these variations reflecting regional difference are able to make general standards more applicable to specific conditions, hence financial reports are given on a more understandable basis.

Therefore, in our opinion, the existence of these differentiations does more good than harm. Looking into the underlying cause, all of reasons root from the diversity of national background. Since general standards cannot consider all kinds of circumstances, national interpretation can complement to the international standards, alleviating the work of accountants as well as preventing manipulative and fraudulent behaviours. In addition, as Perera (1989, cited in Deegan and Unerman, 2011)'s argument, to adopt the accounting

regulation according to the national background could make the accounting information more relevant and effective, since international accounting standards are profoundly affected by Anglo-Saxon accounting models and those countries use a Roman law system will encounter obstacle to impose the other system unsuitable for them. Moreover, for countries that are small and underdeveloped, the cost will outweigh benefits to internationalize the standards (Chand and White, 2007, cited in Deegan and Unerman, 2011).

All in all, to suit divergent circumstances among countries, variances in accounting regulations and practice are useful. As for the cross-border financing, it might be applicable to prepare two sets of financial reports in accordance with domestic and international rules respectively.

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