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THE CHALLENGE OF CULTURE TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) CONVERGENCE

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Abstract

In accounting, the importance of culture and its historical roots is now increasingly being recognized. With increased globalization of world economy, harmonization of international standards has become the focus of increasing attention among accounting academics, researchers and practitioners. There is the internationalization of accounting and auditing standards by IASB and IFAC which are both involved in harmonization consistent, even if the same standards are followed across nations. Differences in application of standards will reduce comparability and transparency. This paper identifies the cultural factor as a possible reason for reporting entities applying IFRS in different ways. It establishes the accounting values. It expounds on how cultural values and accounting values relate to each other in the development of accounting standards world-wide. It adopts the secondary data methodology which is hinged on the institutional theory literature. This information sharpens the ability to describe, analyze and predict the development of accounting standards. It finds that national cultures, traditions and practices will be increasingly challenged in the years ahead as the pressures for global convergence increasingly impact accountants and accounting practices. The paper concludes that since accounting is culturally determined as such peculiarities of culture should be adequately provided for convergence. It recommends the understanding of cultural diversities before converging with international financial reporting standards.
Keywords: Culture, Financial Reporting, IFRS

1.0 Introduction

The rapid development of global financial markets demands harmonization of accounting standards and approaches around the world. In 1999 the European Commission presented its Financial Services Action Plan, the implementation of which should contribute to the realization of an integrated market for financial services in the European Union (EU) by 2005 Communication, 1999). In the area of financial reporting, the Action Plan proposed that all listed companies report under the same accounting framework. Rather than develop a distinct European accounting framework, it was decided to boost International harmonization by putting the full weight of the EU behind the efforts of the International Accounting Standards Committee (IASC) in its drive to develop International Accounting Standards (IAS).

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The convergence of many national Generally Accepted Accounting Principles (GAAP) with International Financial Reporting Standards (IFRS) (Fontes et al, 2005) promises transparent, comparable and consistent financial information to guide investors in making optimal investment decisions (Jacob and Madu, 2004). Developing countries have recognized their need to participate in the opportunities offered by globalization (United Nations General Assembly, 2004), and in consequence, have led the way in adopting IFRS. However, numerous studies question the relevance of IFRS to developing countries (Mir and Rahaman, 2005) and draw attention to the need for contextualized studies of accounting (Reiter, 1998). While emerging economies typically enjoy greater wealth than developing countries, and therefore do not face the same financial constraints, they nevertheless face many similar challenges in adopting IFRS in terms of changing culture.

A growing number of countries have adopted International Financial Reporting Standards (IFRSs) developed by the International Accounting Standard Board (IASB), and other countries plan to adopt or converge with IFRSs in the future. One goal of International Accounting convergence is the comparability of financial statements across countries. Adoption of a common set of accounting standards is necessary, but not sufficient, condition to achieve this goal. Accounting in different countries also must interpret and apply the common standards similarly.

Before now, researchers considered how regulation can shape the practice of financial reporting. We learned that various factors can influence the actions of regulators (for example, their own perception about what is in the 'public interest', or about the economic implications of newly proposed accounting standards), and that various theoretical perspectives can be applied when making a judgment about the factors that will be more likely to impact on a regulators' ultimate decision to support or oppose particular financial accounting requirements. (For example, some perspectives may promote a view that regulators will adopt a public interest perspective, while other theoretical perspectives might provide a view that regulation are ultimately drive be self-interest.

In this paper we shall be considering factors that might influence financial reporting. Specifically we consider the impacts that factors such as national culture might have on the practice of financial reporting and we see that there is some evidence that differences in the financial reporting practices between countries can, at least in part, be explained by underlying differences in various cultural attributes of the people of that country. That is, we consider arguments that the culture and beliefs of the community directly impact on how they elect to account.

We see that some countries, including some of those less developed economically, have elected to adopt accounting standards issued by the IASC. We consider the appropriateness of this action, particularly given that International Accounting Standards (IASs) are developed generally on the basis of accounting rules that exists in countries such as the United States, United Kingdom, Australia, Canada and New Zealand. We question whether such rules are appropriate in a different cultural setting or conversely, whether similar accounting rules can be applied in countries with vastly different economics, political and cultural settings.

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Gray (1988) develops a theoretical framework of the influence of culture on accounting that posits causal relations between cultural values and accounting values, Gray completes the theory by developing directional hypotheses that relate cultural values to each of the four accounting values, and by predicting how different cultural area will rank on each of the accounting values. The framework predicts, for example, that a country that ranks high on the cultural dimension of uncertainty avoidance will rank high on the accounting value of secrecy, which will result in less disclosure being provided in financial reports in that country. The framework implies that cultural differences could cause accountants from different countries to apply a common accounting standard differently, thus possibly affecting the cross-national comparability of financial statements.

Having considered issues of culture and the efforts of the IASC, we conclude by considering recent attempts to harmonize accounting standards throughout the world. We consider the perceived benefits of such actions, as well as whether efforts towards harmonization, and ultimately standardization, are likely to succeed.

The remainder of the paper is divided as follows: the second section review extant literature that highlight differences in culture amongst nation the third section reveal global move towards IFRS conversion while the fourth section highlight differences in accounting practices around the world. The fifth section highlights the recommendation. The sixth summarizes and concludes the paper.

2.0 LITERATURE REVIEW

2.1 THE GLOBAL MOVE TOWARDS IFRS

Since 2001, approximately 120 nations and reporting jurisdiction permit or require IFRS for domestic listed companies. Approximately 90 countries have fully conformed to IFRS as promulgated by the IASB and include a statement acknowledging such conformity in audit reports. The remaining major economies have established timelines for convergence with, or adoption of, IFRSs **(Ahmed Zakari)**

i. The Australian Accounting Standard Board (AASB) has issued 'Australian equivalents to IFRS' (A-IFRS), numbering IFRS standards as AASB1-8 and IAS standards as AASB101-141.
ii. All listed European Union companies have been required to use IFRS since 2005
iii. Turkish Accounting Standards Board translated IFRS into Turkish in 2006. since 2006 Turkish companies listed in Istanbul Stock Exchange are required to prepare IFRS reports
iv. The use of IFRS will be required for Canadian publicly accountable profit-oriented enterprises for financial periods beginning on or after 1 January, 2011
v. The Institute of Chartered Accountants of India (ICAI) has announced that IFRS will be mandatory in India for financial Statement for the periods beginning on or after 1 April 2011.
vi. All companies listed on the Johannesburg Stock Exchange have been required to comply with the requirements of IFRSs since 1 January, 2005.
vii. The U.S. Securities and Exchange Commission has proposed to move to IFRSs by 2014.
viii. Nigeria's NASB is yet to make public its decision whether or not to accept IFRS and the timeline for its adoption.

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2.2 EXPLANATIONS OF DIFFERENCES IN ACCOUNTING PRACTICES EMPLOYED IN DIFFERENT COUNTRIES

We first consider the second branch of International Accounting identified by Weirich, Avery and Anderson (1971), the branch that examine International differences in accounting practices. If we look at the accounting rules in place in different countries we see that there are typically numerous differences between them. Authors such as Perera (1989) have argued that accounting practices within particular countries evolve to suit the circumstances of a particular society, at a particular tie. While there is a large variation in accounting systems adopted in different countries, it has been commonly accepted that there are two main models of financial accounting that have evolved within economically developed countries: the Anglo-American Model and the Continental European Model (Mueller, 1967; Nobes, 1984). The Anglo American Model is characterized by a system of accounting that is strongly influenced by professional accounting bodies rather than government, emphasizes the importance of capital markets (the entities within the countries that use this model of accounting are typically very reliant on public sources of equity and debt finance), and relies upon terms such as true and fair or presents fairly, which in turn and based upon considerations of economics substance over and above legal form (legal form being bund by legislation).

The Continental European Model of Accounting, on the other hand, typically is characterized by relatively small input from the accounting profession, little reliance upon qualitative requirements such as true and fair, and stronger reliance upon government. The accounting methods tend to be heavily associated with the tax rules in place, and the information tends to be of a nature to protect the interest of creditors, rather than investors per se (the entities within countries that use the Continental European Model tend to obtain most of their funds from lenders, often banks).

Over time, numerous reasons have been given for differences in the accounting methods of different countries. Muller (1968) suggests that such differences might be caused by differences in the underlying laws of the country, the political system in place (for example a capitalistic/free market system versus a centralized/communistic system), or their level of development from an economics perspective. As Muller (1968) explains:

In society, accounting performs a service function. This function is put in jeopardy unless accounting remains, above all, practically useful. Thus, it must respond to the over-changing need of society and must reflect the social, political legal and economic condition within which it operates. Its meaning fullness depend on its ability to mirror these conditions

Other reasons such as a tax systems; level of education, and level of economic developments have also been suggested to explain differences in accounting practices (Doupnik and Salter; 1995).

At present there is no clear theory that explains international diffe5rent in accounting practices. .Many confirmed that numerous reasons have been proposed to explain the differences.

2.3 EVIDENCES OF DIFFERECES IN ACCCOUNTING PRACTICE AS REGARDS CULTURE

The reason for the differences in accounting practice and regulation is due to the role financial accounting play in the various countries. In the Anglo-Saxon accounting group the role of financial reporting is to provide information for decision-making. Conversely the traditional role of financial reporting in the Continental accounting group is to regulate companies. As

seen above the traditional role of financial reporting in Continental countries is shifting toward a decision making role similar to that of the Anglo-Saxon orientation.

Nobes (1988) classifies different financial reporting systems rather than classifying countries. This was done because of the different systems that could operate in one country. For example US GAAP is used by SEC-registered companies but not by all US companies. Similarly some Japanese companies are allowed to follow US GAAP for their consolidated accounts for both US and Japanese companies are allowed to follow US GAAP for their consolidated accounts for both US and Japanese purposes (Nobes, 1998). Another example is that IFRS are permitted for domestic listed companies in Germany in the preparation of consolidated statements.

In Nobes (1998) IFRS are classified as being in the Anglo-Saxon group of financial reporting systems. IFRS, although not set entirely by Anglo-Saxon countries, are dominated by the Anglo-Saxon approach to accounting. This may be partly due to its involvement in Anglo-Saxon groups such as the G4+1 group of standard setters. It also makes sense because the purpose of accounting at an International level is to provide information for decision making, rather than providing information for regulating. The purpose of having standardized accounting worldwide is so that financial statements can be compared between companies in different countries. This is to facilitate the free movement of debt and equity capital worldwide. IFRS therefore have a decision making, rather than regulating role.

All of the Anglo-Saxon countries look likely to extend regulation by either permitting or requiring the use of IFRS for individual and unlisted entity financial statements. This is an expected result because accounting regulation and practice in these countries is similar to that of IFRS. Prohibiting companies from extending the regulation to individual accounts would put unnecessary costs on companies because then they would have to use two sets of rules when producing their financial statements. Unlisted companies may also want to produce their financial statements in accordance with IFRS.

It would make no sense prohibiting companies from choosing this option because in most of the Anglo-Saxon countries, accounting standards are being converged with IFRS anyway. Allowing companies to choose this option just means that they adopt sooner.

Many of the continental countries which include Germany, Tunisia, Mali, Japan, France etc. have permitted the use of IFRS for unlisted entities, but only for consolidated reports. This may appear unusual given the significant differences in the financial reporting systems of the two countries but is not that extraordinary. If it is feasible for unlisted companies to use IFRS in their consolidated reports then there is no reason to forbid it. Most of the Continental countries do not intend to extend the regulation to individual financial reports, although there are some exceptions. In many of the Continental countries it is not possible to prepare individual reports using IFRS because of tax links and regulatory factors. Consolidated financial statements are not affected by tax links and regulatory factors because it is the individual companies that are taxed and regulated, not the group as a whole.

In Germany non-listed companies will be permitted to use IFRS to prepare their consolidated it is not possible to prepare individual reports using IFRS because of tax links and regulatory factors. Consolidated financial statements are not affected by tax links and regulatory factors because it is the individual companies that are taxed and regulated, not the group as a whole.

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In Germany non-listed companies will be permitted to use IFRS to prepare their consolidated financial statements starting in 2005. However, no companies will be permitted to use IFRS for statutory (individual) financial statements; these will continue to follow German GAAP. Companies may present additional individual accounts that comply with IFRS. The German Accounting Standards Board has revised its work programme to make cooperation with the IASB and other major national standard setters its primary objective. This may bring German GAAP closer to IFRS over time. France is yet to make a decision on whether they are going to extend the regulation but they expect that non-publicly traded companies will be free to use IFRS for consolidated accounts if they wish. However, as in Germany, firms will not be allowed to use IFRS for individual company accounts (Eurostat, 2003). Spain has the same intentions. Non publicly traded corporations would be given the option to use IFRS for consolidated financial reports, but individual financial reports are to be prepared under Spanish GAAP for tax and trade reasons (Eurostat, 2003)

In 2002 the Greek Government passed legislation that adopted IFRS from 2003. the legislation applies to annual financial statements beginning after 31 December 2002 and is compulsory for all companies listed on the Athens Stock Exchange. The new legislation applies to both individual and consolidated financial statement and may be optionally applied by any other enity that is audited by the Institute of Certified Accountants and Auditors of Greece. This is an unusual move for a Continental accounting country. However it shows that Greek GAAP may be closer to IFRS than other Continental countries. It also shows that they do not have the same tax links as other countries do because the law also applies to individual accounts.

The most surprising announcement amongst the Continental countries has come from Belgium. The Belgian Commission for Accounting Standards proposed that IFRS should be mandatory for all consolidated annual accounts from 2007. This move would affect more than 600 unlisted Belgian entities. It has also proposed an ambitious plan to converge Belgian GAAP with IFRS as from 2007. it intends to put all adaptations into effect simultaneously on 1 January 2007. These proposals are very surprising considering the differences between Belgina GAAP and IFRS. Italy for the present time does not intend to make any extensions to the regulation and Finland only intends to extend the regulation to the financial sector (Eurostat, 2003)

Other Continental countries in the EU have yet to make proposals or make their intentions public. It would be expected that if the other countries did extend the regulation it would only permit the use of IFRS rather than require. In addition, they would most likely only permit the use of IFRS for consolidated reports because of the function which individual reports play in Continental countries. It has been seen above that there is clear differences between the Anglo-Saxon and Continental groups of counties and what they propose to do in relation to regulation, with the exceptions of Greece and Belgium.

IFRS are largely based on Anglo-American accounting models and international accounting literature provides further evidence that-American dominance in the political economy contributed to this significant influence on defining the specificities of IFRS (Perry and Noelke 2006). Specifically, Perry and Noelke (2006) argue that the fair value accounting approach reinforces the importance of the financing over the productive sector, which is more compatible with the Anglo-American Economies. Moreover, growing internationalization and control of US and British multinational in the world markets has benefited large Anglo-American

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accounting firms. Indeed, the concentration of accounting services with only four big players benefiting from an increasing demand for global accounting services has further strengthened Anglo-American dominance in International Accounting (Cooper et al. 1998; Jang 2005; Suddaby et al. 2007; Data Monitor 2008). This dominance allows influencing the standard setting process and importantly may contribute to Anglo-American biases against the German accounting model.

Biases and political power may influence the direction of the standard setting process to an extent that is completely unrelated to critical assessments. Indeed, the following sarcastic statement provides interesting insights into the standard setting process and emphasizing that it is only important who is pushing an accounting approach.

We have demonstrated that professional judgment is an important element in both IFRS and traditional German accounting. However, it is important to differentiate between explicitly stated options and implicit discretion in regards to undefined expressions and criteria such as "materiality" and "control" and estimations in relation to the fair value approach. Both the traditional German accounting model and IFRS include these explicitly stated options and implicit discretionary decisions. However, IFRS require implicit discretionary decisions to a greater extent, while the German accounting system has a stronger focus on explicit options. As discussed earlier, the strict historical cost approach of the German accounting model has limited implicit discretion regarding fair value estimates at least. Moreover, German tax law has further limited discretion regarding undefined criteria for single entity statements. As such, IFRS are likely to require greater professional judgment regarding implicit discretionary decisions, which may influence comparability of accounting standards. Importantly, this differentiation and its influence on comparability and reliability of financial information were pointed out and considered important by all interviewees:

Consistent with accounting literature, our analysis reveals that German accountants and accounting academics critically judge the complexity of IFRS, which is in their opinion further reinforced by the extensive use of professional judgment. This complexity may further limit usefulness as only experienced analysis are perceived as being able to interpret and critically evaluate the accounting information provided (Haller 2002; Larson and Street 2004; Baetge 2005; Jermakowics and Gornik-Tomaszewski 2006; Committee on Economic and Monetary Affair 2008). As a consequence, the complexity of IFRS was also perceived to further contribute to a concentration process on the audit market as only leading audit companies have the capabilities to assess and implement international guidelines and interpretations. Related to issues of complexity are cost concerns regarding preparation and auditing of financial reports prepared consistent with IFRS. The findings point out that it remains arguable whether the increased costs of financial reporting and auditing under IFRS are balanced by increased benefits. This assessment is reinforced by the perception that the complexity of standards is often not required nor used by financial analysis, who are often only analyzing small parts of the information provided in the notes for example.

RECOMMENDATION

An understanding of the diversity of culture amongst countries will give an insight on how convergence should be seen. For example the Anglo-Saxon model which Nigerian is classified in as a result of being colonized by the British is characterized with fair presentation and full disclosure which protects investors' interest as management performance. The Anglo American

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model as discussed by (Ball, 1995; Gernon and Meek, 2001; Okoye and Enahoro, 2004 comprises over 30 countries that are determined largely in the private sector and have been oriented toward disclosure across an arm's-length market to interested parties who are presumed by the courts to rely entirely on publicly disclosed information because they have no close ties to the corporation. This model is common in the United Kingdom, the Netherlands, Niger, Hong Kong, Mexico, and South Africa.

The continental European group as argued by (Ball, 1995; Gernon and Meek, 2001; Okoye and Enahoro, 2004) comprises of countries in which the legal system and accounting rules are codified by government ministries as such the environment is characterized by a few, large banks satisfying most of the capital needs of business as against the British American Model where the finance of business is largely determined by the organized shareholders. Countries that operate under this model are Belgium, France, Germany, Italy, Sweden, Switzerland, and Japan.

The South American model as highlighted by (Ball, 1995; Gernon and Meek, 2001; Okoye and Enahoro, 2004) is developed in response to high inflation in many countries. It also reflects significant government control over business accounting practices because it is geared mostly toward the reporting of taxable income. As such, accounting guidelines are strict so the government ensure that business pay the tax for which they are responsible. Most countries in South American subscribe to this model, including Argentina, Brazil and Chile.

Again, whether the imported regulation provide relevant information is a point of some debate. Perhaps it could be argued that with the increasing globalization of business, international cultural differences will be reduced-but this is clearly speculative. Zarzeski (1996), however, provides evidence that business enterprises that operate on an international scale do appear to adopt a 'global market culture' (as discussed previously in this chapter) indicating that harmonization efforts perhaps should be directed at larger international organization, rather than organizations that operate domestically.

Apart from the attraction of foreign capital, other perceived benefits of the convergence process include:

i. It is cheaper for developing countries to establish a national system of accounting (however, again we must consider issues of cultural relevance);
ii. It can lead to a reduction in costs for companies seeking listing on international stock exchanges – the costs necessary to restate financial statement to local generally accepted accounting standards would be lower.
iii. It would enable increased comparability between entities operating in different countries (which is important if we accept that comparability is an important qualitative characteristics, as is indicated in various conceptual framework projects;
iv. It would enable multinational corporations located in different countries to coordinate their efforts more efficiently and would allow the consolidation of foreign entities; financial statements to be done at less cost.

The whole arm of convergence and the related issues of culture is an interesting area to study. Over time we can perhaps expect more refined measures of culture and more sophisticated analysis of the implications of cultural differences on accounting practice. It will be interesting to monitor the various current convergence efforts to see whether they lead to the benefits expected by the standard-setters, and whether cultural differences (however measured) do provide ongoing obstacles to the process.

SUMMARY AND CONCLUSION

In this paper, we identified and considered international differences in accounting practices and we have seen that numerous reasons (generated from different theoretical perspectives) have been advanced to explain such differences (including differences in culture, religious as a subset of culture and financial systems). Much of the existing research into comparative international accounting questions whether it is appropriate to expect that we will ever have one system of accounting adopted uniformly throughout the world (which has been stated as a long-term objective of IASC).

While many researchers questions the relevance of Western style' accounting standard across all countries, efforts by a number of international organization are nevertheless counting to encourage quite culturally-disparate countries to adopt International Accounting Standards. This implies that the members of the international organizations (such as IASC, UN, OECD, IOSCO) are either ignorant of the literature, or alternatively, choose to reject it as irrelevant. As efforts by a number of countries, such as Australia, continue in relation to harmonizing domestic accounting standards with International standards, it is to be expected that this debate will continue.

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