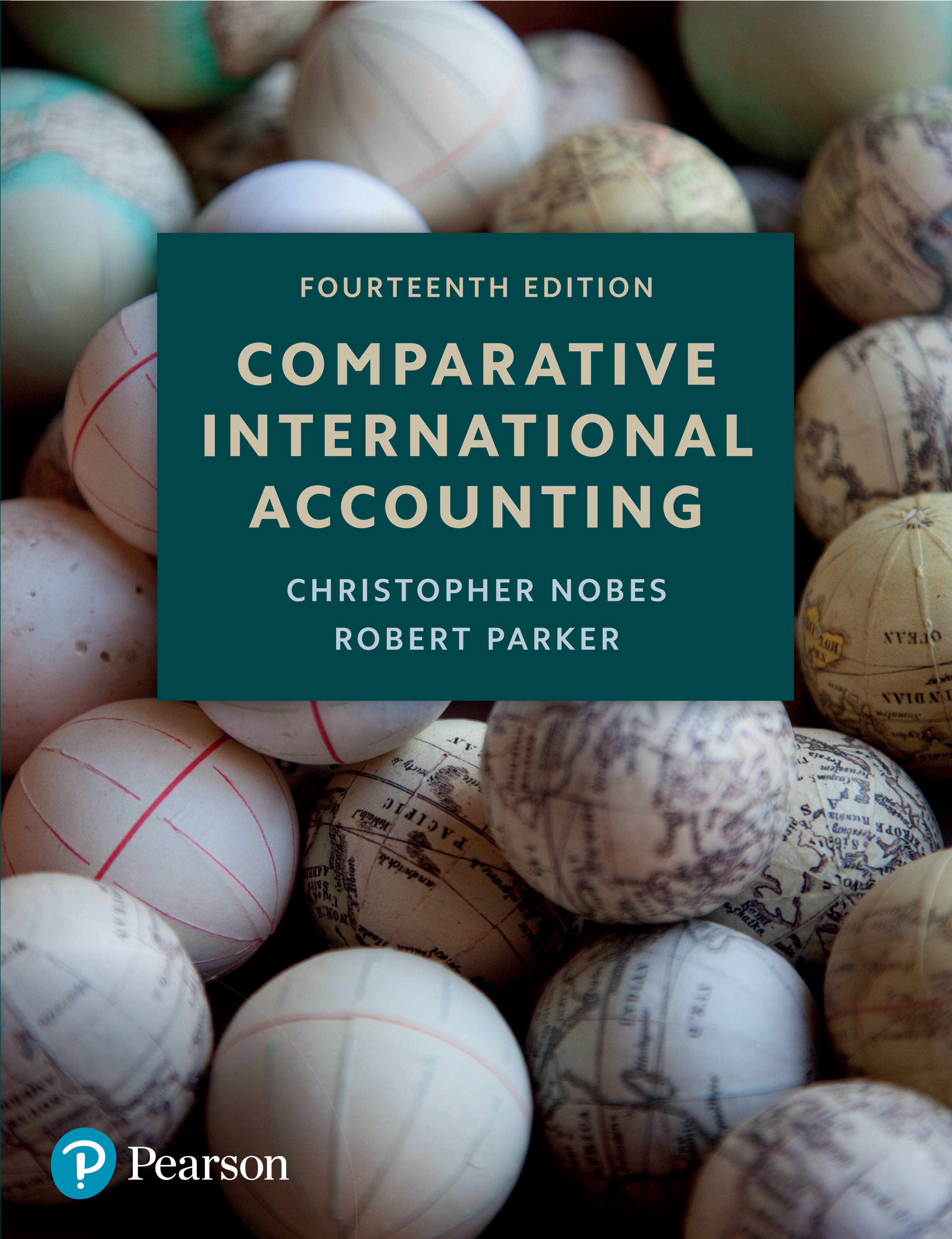

FOURTEENTH EDITION

COMPARATIVE INTERNATIONAL ACCOUNTING

CHRISTOPHER NOBES
ROBERT PARKER

Pearson

COMPARATIVE
INTERNATIONAL ACCOUNTING

14th Edition

COMPARATIVE INTERNATIONAL ACCOUNTING

Christopher Nobes

and

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Web: www.pearson.com/uk

First published 1981 (print)
Thirteenth edition published 2016 (print and electronic)
Fourteenth edition published 2020 (print and electronic)

ISBN: 978-1-292-29646-3 (print)
978-1-292-29648-7 (PDF)
978-1-292-29650-0 (ePub)

British Library Cataloguing-in-Publication Data
A catalogue record for the print edition is available from the British Library

Library of Congress Cataloging-in-Publication Data
Names: Nobes, Christopher, editor.
Title: Comparative international accounting / Christopher Nobes.
Description: 14th edition. | Harlow, England ; New York : Pearson, 2020. | Includes bibliographical references and index. | Summary: "Comparative International Accounting is intended to be a comprehensive and coherent text on international financial reporting. It is primarily designed for undergraduate and postgraduate courses in comparative and international aspects of financial reporting. A proper understanding requires broad overviews (as in Part I), but these must be supported by detailed information on real countries and companies (as in Parts II to IV) and across-the-board comparisons of major topics (as in Parts V and VI). This book was first published in 1981. Until this present edition (the fourteenth), the book was jointly written by Christopher Nobes and Robert Parker. However, Bob Parker died shortly after the thirteenth edition was published in 2016. This edition is dedicated to his memory; see obituaries in the 2016 volumes of Accounting and Business Research and Accounting History. Bob's last publication was a review of the development of the contents of this book (and therefore of the world of international accounting) over its thirteen editions from 1981 onwards. Readers can consult this in Volume 21 (Issue 4) of Accounting History"— Provided by publisher.
Identifiers: LCCN 2019047248 (print) | LCCN 2019047249 (ebook) | ISBN 9781292296463 (paperback) | ISBN 9781292296487 (ebook)
Subjects: LCSH: Comparative accounting.
Classification: LCC HF5625 .C74 2020 (print) | LCC HF5625 (ebook) | DDC 657—dc23
LC record available at https://lccn.loc.gov/2019047248
LC ebook record available at https://lccn.loc.gov/2019047249

10 9 8 7 6 5 4 3 2 1
24 23 22 21 20

Cover: Robert Decelis Ltd/Taxi/Getty Images

Print edition typeset in 9.5/12.5pt Stone Serif by SPi Global
Print edition printed and bound in Malaysia

NOTE THAT ANY PAGE CROSS REFERENCES REFER TO THE PRINT EDITION

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Preface

Purpose

Comparative International Accounting is intended to be a comprehensive and coherent text on international financial reporting. It is primarily designed for undergraduate and postgraduate courses in comparative and international aspects of financial reporting. A proper understanding requires broad overviews (as in Part I), but these must be supported by detailed information on real countries and companies (as in Parts II to IV) and across-the-board comparisons of major topics (as in Parts V and VI).

This book was first published in 1981. Until this present edition (the fourteenth), the book was jointly written by Christopher Nobes and Robert Parker. However, Bob Parker died shortly after the thirteenth edition was published in 2016. This edition is dedicated to his memory; see obituaries in the 2016 volumes of *Accounting and Business Research* and *Accounting History*. Bob's last publication was a review of the development of the contents of this book (and therefore of the world of international accounting) over its thirteen editions from 1981 onwards. Readers can consult this in Volume 21 (Issue 4) of *Accounting History*.

This edition is a complete updating of the thirteenth edition. For example, since that edition, the International Accounting Standards Board (IASB) issued a revised Conceptual Framework in 2018; many Japanese companies have volunteered to adopt International Financial Reporting Standards (IFRS); major new standards on lease accounting have been issued by the IASB and in the United States (thereby creating new international differences); and much relevant academic literature has been published.

In addition to the extensive updating, I have also:

- added a discussion of international differences in public sector accounting (in Chapter 4); and
- completely re-arranged the material on the content of IFRS (by reworking the material previously in Chapters 6, 9 and 16 as the new topic-focused Chapters 6, 7 and 8).

A revised manual for teachers and lecturers is available from go.pearson.com/uk/he/resources. It contains several numerical questions and a selection of multiple-choice questions. Suggested answers are provided for all of these and for the questions in the text. In addition, there is now an extensive set of PowerPoint slides.

Authors

In writing and editing this book over many editions, Bob Parker and I tried to gain from the experience of those with local knowledge. This is reflected in the nature of those thanked below for advice and in the note on contributors. For example, the original chapter on North America was co-authored by a Briton who had been assistant research director of the US Financial Accounting Standards Board; his knowledge of

US accounting was thus interpreted through and for non-US readers. The amended version of the US chapter is by this book's author, who has taught in several US universities. This seems the most likely way to highlight differences and to avoid missing important points through overfamiliarity. The chapter on political lobbying is written by Stephen Zeff, an American who is widely acknowledged as having the best overview of historical and international accounting developments. The original chapter on currency translation was written by John Flower, who taught in UK universities but then worked in Brussels for the EU Commission, and now lives in Germany. The chapter on auditing has been written and revised by those directly involved in international audit regulation and practice.

The two original main authors had, between them, been employed in nine countries. Christopher Nobes currently holds university posts in Australia and the UK.

Structure

Part I sets the scene for a study of comparative international financial reporting. Many countries are considered simultaneously in the introductory chapter and when examining the causes of the major areas of difference (Chapter 2). It is then possible to try to put accounting systems into groups (Chapter 3) and to take the obvious next step by discussing the purposes and progress of international harmonisation of financial reporting (Chapter 4).

All this material in Part I can act as preparation for the other parts of the book. Part I can, however, be fully understood only by those who become well informed about the contents of the rest of the book, and readers should go back later to Part I as a summary of the whole.

Part II examines financial reporting by listed groups. In much of the world this means, at least for consolidated statements, using the rules of either the International Accounting Standards Board or the United States. There are three chapters on the main requirements of IFRS, written in an internationally comparative way. Then, Chapter 9 examines whether different national versions of IFRS exist. After that, Chapter 10 compares US GAAP with IFRS, and Chapter 11 examines political lobbying about accounting standards.

Part III of the book deals with financial reporting in the world's second and third largest economies (China and Japan). They share much in common, including having Roman-based commercial legal systems and having requirements for the consolidated statements of listed companies that are separate from those for other types of reporting. Neither country directly imposes IFRSs or US GAAP, although the influences of those systems have been strong. It is therefore clearer to deal with these major countries (as we do in Chapter 12) separately from those countries using IFRS or US GAAP.

Part IV concentrates on the point raised above: that many countries have separate national rules for unlisted companies or unconsolidated statements. Chapter 13 examines a number of issues relating to the context of reporting by individual companies, for example the relationship between accounting and tax. It also looks at the IFRS for SMEs. Chapters 14 to 16 concentrate on Europe, where the world's next three largest economies (after the US, China and Japan) are located. EU harmonisation is studied in Chapter 14. Then, Chapters 15 and 16 look at the making of the rules for reporting by individual companies in France, Germany and the UK, and at the content and exercise of those rules.

Part V (Chapters 17 and 18) examines, broadly and comparatively, two major accounting topics for multinational companies: foreign currency translation and segment reporting. Part VI (Chapters 19 and 20) looks at two matters that come at the end of the financial reporting process: external auditing and the enforcement of the rules.

At the end of the book, there are three appendices: a synoptic table of accounting differences across eight GAAPs, a glossary of abbreviations relevant to international accounting, and suggested outline answers to some end-of-chapter questions. Finally, there are two indexes: by author and by subject.

Acknowledgements

In the various editions of this book, we have received great help and much useful advice from many distinguished colleagues in addition to our contributors. We especially thank Sally Aisbitt (deceased); Ignace de Beelde of Ghent University; Dr Ataur Rahman Belal, Aston Business School, Aston University; Véronique Blum of Universtité Grenoble Alpes; Andrew Brown of Ernst & Young; Emmanuel Charrier of Paris Dauphine; John Carchrae of the Ontario Securities Commission; Terry Cooke of the University of Exeter; John Denman and Peter Martin of the Canadian Institute of Chartered Accountants; Brigitte Eierle of Bamburg University; Sheila Ellwood of the University of Bristol; Maria Frosig and Niels Brock of Copenhagen Business School, Denmark; Simon Gao of Edinburgh Napier University; Michel Glautier of ESSEC, Paris; Christopher Hossfeld of ESCP, Paris; Dr Jing Hui Liu, University of Adelaide, Australia; Horst Kaminski, formerly of the Institut der Wirtschaftsprüfer; Jan Klaassen of the Free University, Amsterdam; Christopher Koch of the University of Mannheim; and Stéphanie Tulleau Kontowicz of the University of Bordeaux; Yannick Lemarchand of the University of Nantes; Ken Lemke of the University of Alberta; Klaus Macharzina of the University of Hohenheim; Rania Uwaydah Mardini of Olayan School of Business, American University of Beirut; Malcolm Miller and Richard Morris of the University of New South Wales; Geoff Mitchell, formerly of Barclays Bank; Jules Muis of the European Commission; Ng Eng Juan of Nanyang Technological University of Singapore; Sue Newberry of the University of Sydney: Graham Peirson of Monash University; Sophie Raimbault of Groupe ESC, Dijon; Jacques Richard of the University of Paris Dauphine; Alan Richardson of York University, Toronto; Alan Roberts of ESC Rennes School of Business; Paul Rutteman, formerly of EFRAG; Etsuo Sawa, formerly of the Japanese Institute of Certified Public Accountants; Hein Schreuder, formerly of the State University of Limburg; Marek Schroeder of the University of Birmingham; Patricia Sucher, formerly of Royal Holloway, University of London; Christian Stadler of the University of Lancaster; Lorena Tan, formerly of Price Waterhouse, Singapore; Ann Tarca of the University of Western Australia; Stéphane Trébucq of the University of Bordeaux; Peter van der Zanden, formerly of Moret Ernst & Young and the University of Tilburg; Gerald Vergeer of Moret Ernst & Young; Ruud Vergoossen of Royal NIVRA and the Free University of Amsterdam; Jason Xiao, Cardiff University; Dr Yap Kim Len, HELP University College, Malaysia; and Eagle Zhang of the University of Sydney. We are also grateful for the help of many secretaries over the years.

For this fourteenth edition, Stephen Zeff provided much useful advice on large parts of the draft. Despite the efforts of all these worthies, errors and obscurities will remain, for which I am culpable.

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Royal Holloway
(University of London),
and University of Sydney

Publisher's acknowledgements

Text Credit(s):

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Part I

SETTING THE SCENE

1 Introduction

CONTENTS

OBJECTIVES

After reading this chapter, you should be able to:

- explain why international differences in financial reporting persist, in spite of the adoption of International Financial Reporting Standards (IFRS) by Australia, Brazil, Canada, Russia, South Korea, the member states of the European Union and more than a hundred other countries;
- illustrate the ways in which accounting has been influenced by world politics, the growth of international trade and foreign direct investment, the globalisation of stock markets, varying patterns of share ownership, and the international monetary system;
- outline the nature and growth of multinational enterprises (MNEs); and
- explain the historical, comparative and harmonisation reasons for studying comparative international accounting.

1.1 Differences in financial reporting

If several accountants from different countries, or even from one country, are given a set of transactions from which to prepare financial statements, they will not produce identical statements. There are many reasons for this. First, the accounting rules may differ both between countries and within countries. In particular, the rules for the consolidated statements of groups may differ from the rules for individual companies. Multinational enterprises (MNEs) which operate as groups in more than one country may find inter-country differences particularly irksome. Also, although all accountants follow a set of rules, no set covers every eventuality or is prescriptive to the minutest detail. Thus, there is always room for professional judgement, the exercise of which depends in part on an accountant's environment (e.g. whether or not the tax authorities are seen as the main users of financial statements).

In this context of this book, 'accounting' means published financial reporting to users outside the entity. Awareness of the differences in financial reporting has led to impressive attempts to reduce them, particularly by the International Accounting Standards Board (IASB) and the European Union (EU). The IASB issues International Financial Reporting Standards (IFRS). The EU has issued Directives and Regulations. The importance of American stock markets and US-based MNEs has meant that US generally accepted accounting principles (GAAP) have greatly influenced rule-making worldwide. All this has certainly led to a lessening of international differences but, as this book will show, many still remain.

An example of the accounting differences is provided by looking at the reports of GlaxoSmithKline (GSK), a large UK-based pharmaceutical company. GSK reported under UK GAAP until 2004, and then using IFRS from 2005. GSK is listed on the New York Stock Exchange as well as in London, and in accordance with requirements of the US Securities and Exchange Commission (SEC) it had to provide, up to 2006, numerical reconciliations to US GAAP from the earnings and shareholders' equity numbers as published in the statutory financial statements. These are summarised in Tables 1.1 and 1.2.

Table 1.1 GlaxoSmithKline reconciliations of earnings to US GAAP

	UK £m	IFRS £m	US £m	Difference (% change)
1995	717		296	−59
1996	1,997		979	−51
1997	1,850		952	−49
1998	1,836		1,010	−45
1999	1,811		913	−50
2000	4,106		(5,228)	−227
2001	3,053		(143)	−105
2002	3,915		503	−87
2003	4,484		2,420	−46
2004	4,302		2,732	−36
2005		4,816	3,336	−31
2006		5,498	4,465	−19

Table 1.2 GlaxoSmithKline reconciliations of shareholders' equity to US GAAP

	UK £m	IFRS £m	US £m	Difference (% change)
1995	91		8,168	+8,876
1996	1,225		8,153	+566
1997	1,843		7,882	+328
1998	2,702		8,007	+196
1999	3,142		7,230	+130
2000	7,517		44,995	+499
2001	7,390		40,107	+443
2002	6,581		34,992	+432
2003	5,059		34,116	+574
2004	5,925		34,042	+475
2005		7,570	34,282	+353
2006		9,648	34,653	+259

The differences are startling, as may be seen (in percentage terms) in the far right-hand column of each table. The largest cause of these differences is the treatment of goodwill (see Chapter 8).

Unfortunately, this supply of useful information about accounting differences is no longer available from 2007 because the SEC accepts IFRS information from foreign companies. However, data from other reconciliations (particularly when a company moves from national accounting to IFRS) are given later in this book. So far, it is clear that the accounting differences can be very large. No easy adjustment procedure can be used, partly because the differences in the accounting numbers depend not only on the differences between two or more sets of rules, but also on the choices allowed to companies within those rules. The adoption of IFRS by many listed companies, and greater convergence between IFRS and US GAAP, has reduced, but not removed, these differences.

So far, this book has been written in terms of financial reporting by profit-oriented companies, and that is indeed the context of most of the book. However, public sector entities (such as governments or universities) also produce financial reports for outside users. This type of reporting also differs internationally, as is discussed at the end of Chapter 4.

One of the main themes of comparative international accounting is trying to understand why there have been differences in financial reporting in the past, why they continue in the present, and why they will not fully disappear in the future. In the next two sections of this chapter, we look at the global environment of financial reporting, and in particular at the nature and growth of multinational enterprises. We then explore in more depth the reasons for studying comparative international accounting. In the last section, we explain the structure of the book.

1.2 The global environment of accounting

1.2.1 Overview

Accounting is a technology which is practised within varying political, economic, and social contexts. These have always been international as well as national. Certainly, since the last quarter of the twentieth century, the globalisation of accounting rules and practices has become so important that narrowly national views of financial reporting can no longer be sustained.

Particularly important parts of the context have been:

- major political issues, such as the dominance of the United States and the expansion of the EU;
- economic globalisation, including the liberalisation of, and dramatic increases in, international trade and foreign direct investment (FDI);
- the emergence of global financial markets;
- patterns of share ownership, including the influence of privatisation;
- changes in the international financial system; and
- the growth of MNEs.

These developments are interrelated. They have all affected the transfer of accounting technology from one country to another and have therefore affected financial reporting. They are now examined in turn.

1.2.2 Accounting and world politics

Important political events since the end of the Second World War in 1945 have included: the emergence of the United States and the Soviet Union as the world's two superpowers, followed by the collapse of Soviet power at the end of the 1980s; the break-up of the British and continental European overseas empires; and the creation of the EU, which expanded from its original core of six countries to include most of Western Europe and then many former communist countries. More detail on the consequences that these events have had for accounting is given in later chapters. The following illustrations may suffice for the moment:

- US ideas on accounting and financial reporting were for many decades the most influential in the world. The collapse of the US energy trading company, Enron, in 2001 and the demise of its auditor, Andersen, had repercussions in all major economies.
- The development of international accounting standards (at first of little interest in the US) owes more to accountants from former member countries of the British Empire than to any other source. The International Accounting Standards Committee (IASC) and its successor, the IASB, are based in London; the driving force behind the foundation of the IASC, Lord Benson, was a British accountant born in South Africa.

- Accounting in developing countries is still strongly influenced by the former colonial powers. Former British colonies tend to have Institutes of Chartered Accountants (set up after the independence of these countries, not before), Companies Acts and private sector accounting standard-setting bodies. Former French colonies tend to have detailed governmental instructions, on everything from double entry to published financial statements that are set out in national accounting plans and commercial codes.
- Accounting throughout Europe has been greatly influenced by the harmonisation programme of the EU, especially its Directives on accounting and, more recently, its adoption of IFRS for the consolidated financial statements of listed companies.
- The collapse of communism in Central and Eastern Europe led to a transformation of accounting and auditing in many former communist countries. The reunification of Germany put strains on the economy such that large German companies needed to raise foreign capital and had to change their financial reporting to do so.

1.2.3 Economic globalisation, international trade and foreign direct investment (FDI)

A notable feature of the world economy since the Second World War was the globalisation of economic activity. This meant not just the spread round the world of goods and services, but also of people, technologies and concepts. The number of professionally qualified accountants greatly increased. Member bodies of the International Federation of Accountants (IFAC) currently have well over two million members. Accountants in all major countries have been exposed to rules, practices and ideas previously alien to them.

Much has been written about globalisation and from many different and contrasting points of view. One attractive approach is the 'globalisation index' published annually in the journal *Foreign Policy*. This attempts to quantify the concept by ranking countries in terms of their degree of globalisation. The components of the index are: political engagement (measured, *inter alia*, by memberships of international organisations); technological connectivity (measured by internet use); personal contact (measured, *inter alia*, by travel and tourism and telephone traffic); and economic integration (measured, *inter alia*, by international trade and FDI). The compilers of the index acknowledge that not everything can be quantified; for example, they do not include cultural exchanges. The ranking of countries varies from year to year but the most globalised countries, according to the index, are small open economies such as Singapore, Switzerland and Ireland. Small size is not the only factor, however, and the top 20 typically also include the US, the UK and Germany. A possible inference from the rankings is that measures of globalisation are affected by national boundaries. How different would the list be if the EU were one country and/or the states of the US were treated as separate countries?

From the point of view of financial reporting, the two most important aspects of globalisation are international trade and FDI (i.e. shareholdings in a foreign enterprise with the intention of acquiring control or significant influence). Table 1.3

Table 1.3 Merchandise exports as a percentage of GDP, 1950–98

	1950	1973	1998
France	7.7	15.2	28.7
Germany	6.2	23.8	38.9
Netherlands	12.2	40.7	61.2
United Kingdom	11.3	14.0	25.0
Spain	3.0	5.0	23.5
United States	3.0	4.9	10.1
Mexico	3.0	1.9	10.7
Brazil	3.9	2.5	5.4
China	2.6	1.5	4.9
India	2.9	2.0	2.4
Japan	2.2	7.7	13.4
World	5.5	10.5	17.2

Source: Prepared from Maddison, A. (2001) *The World Economy: A Millennial Perspective*. Organisation for Economic Cooperation and Development (OECD), Paris.

illustrates one measure of the liberalisation and growth of international trade: merchandise exports as a percentage of gross domestic product (GDP). Worldwide, the percentage has more than trebled in the 50 years after the end of the Second World War. The importance of international trade to member states of the EU is particularly apparent; much of this is intra-EU trade. At the regional level, economic integration and freer trade have been encouraged through the EU and through institutions such as the North American Free Trade Area (NAFTA, which involves the US, Canada and Mexico). The liberalisation has also been due to the dismantling of trade barriers through ‘rounds’ of talks under the aegis of the General Agreement on Tariffs and Trade (GATT) and its successor the World Trade Organization (WTO). However, trade was under threat in 2008–9 for two connected reasons: the ‘credit crunch’ and falling demand reduced trade; and rising unemployment led to calls for domestic industries to be protected against foreign imports. Again, politically inspired trade wars broke out in 2018.

Trade in agricultural products is less liberalised, leading to the criticism that liberalisation has benefited developed rather than developing countries. For a discussion of both the positive and negative aspects of international trade, see Finn (1996).

The importance of FDI is illustrated in Table 1.4, which ranks the ten leading MNEs by the size of their foreign assets in 2018. It also shows the percentages of their assets, sales and employees that are foreign, and a simple transnationality index (TNI), calculated as the average of the percentages. The home countries of these MNEs are the UK (three MNEs), the US (three), Japan (two), and France and Germany (one each). The industries represented are oil (five MNEs), motor vehicles (two), electrical equipment (one), tobacco (one) and telecommunications (one). BAT, Total and Shell have the highest transnationality indices. Of course, the very nature of an MNE means that the concept of a ‘home country’ can be ambiguous. For example, in Table 1.4, we show Royal Dutch Shell plc as a UK company, as in the source of the data.

Table 1.4 World's top ten non-financial multinationals ranked by foreign assets, 2018[a]

Company	Country	Industry	Foreign assets US$bn	% that is foreign of: Assets	Sales	Employees	TNI[b]
Royal Dutch Shell	UK	Oil	344	84	67	72	75
Toyota Motor	Japan	Motors	303	64	68	64	66
Total	France	Oil	235	97	78	67	81
BP	UK	Oil	220	80	67	59	68
Volkswagen	Germany	Motors	220	43	81	66	60
Softbank	Japan	Telecoms	215	73	51	73	66
Exxon	US	Oil	204	58	65	58	61
British American Tobacco	UK	Tobacco	189	99	99	86	95
General Electric	US	Electrical	187	49	62	66	59
Chevron	US	Oil	184	72	52	51	60

Notes: (a) For years ending on or first before 31 March 2018. (b) TNI = transnationality index, calculated as an average of the assets, sales and employees percentages.
Source: Compiled by the author from data in United Nations Conference on Trade and Development (UNCTAD) (2018) *World Investment Report 2018*, Table 19.

The company is, indeed, legally incorporated in England and Wales. However, here are some other facts about it:

- the word 'Dutch' (and the 'Royal' which relates to the Netherlands not to the UK) reflect a former merger;
- its head office is in the Netherlands, as is its tax residency;
- it is listed on stock exchanges in Amsterdam, London and New York;
- it presents its financial statements in US dollars;
- it has operations in 90 countries and shareholders all over the world.

Despite this interesting mix, its choice of England as country of incorporation has some major effects, such as:

- the Annual Report is presented under UK law;
- the auditors (PwC, London) are appointed under UK law;
- the calculation of distributable profit is done under UK law;
- the UK Corporate Governance Code is followed.

1.2.4 Globalisation of stock markets

At the same time as international trade and FDI have increased, capital markets have become increasingly globalised. This has been made possible by the deregulation of the leading national financial markets (e.g. the 'Big Bang' on the London Stock Exchange in 1986, and the similar event in Japan in 1998); the speed of financial innovation (involving new trading techniques and new financial instruments of sometimes bewildering complexity); dramatic advances in the electronic technology of