Instructor's Manual

Comparative International Accounting

Thirteenth edition

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Contents

Introduction to the Manual

This instructor's manual is designed to be used for courses for which *Comparative International Accounting* (thirteenth edition, 2016) is a text.

Section I contains some suggestions for outline answers to the end-of-chapter questions that are not answered in the text. Fuller answers would contain more details and references to books and articles. The questions and outline answers relating to a chapter are not provided by the authors of the chapters but by the editors, assisted by Lisa Evans of the University of Stirling.

Section II provides some extra questions that require access to annual reports, available on the internet. Section III provides some outline answers to these questions.

Sections IV and V contain some suggestions for multiple-choice questions (and answers to them) on various aspects of the material covered in the text. Again, Lisa Evans has contributed some of these. Teachers with large classes may find these questions a helpful supplement to the essay and numerical questions. Teachers are asked to take the normal precaution of collecting the multiple-choice question sheets after use by students so that questions do not gain wide currency.

Tables from the text are also available in the form of PowerPoint slides on the website.

Christopher Nobes

Robert Parker

SECTION I

Outline answers to the end-of-chapter questions in the text

PART I

Setting the scene

CHAPTER 1

Introduction

Outline Answers to Questions

1.1 What effects have the major political events in the world since the end of the Second World War had on accounting and financial reporting?

[See Appendix in textbook.]

1.2 Why have the major accounting firms become 'international'? From what countries have they mainly originated? Why?

[See Appendix in textbook.]

1.3 What major contributions to accounting and its terminology have been made historically by the following countries: Italy, the United Kingdom, the United States and Japan?

Italy's main contribution has been double-entry bookkeeping. Practised in Italy from the thirteenth century onwards, double entry spread to other countries of Western Europe from the fifteenth century and later to the rest of the world (e.g. to Japan in the late nineteenth century). English and other languages have borrowed Italian bookkeeping and commercial terms. The examples given in the text are bank, capital, cash, debit, credit, folio and journal.

The United Kingdom's main contribution has been professional accountancy, which first developed in its modern form in Scotland, and in England and Wales in the nineteenth century. The supremacy of the British Empire and the export activities of British capital during this period ensured that English became the business language of the world, a position confirmed and consolidated by the later growth of US influence.

The United States' main contributions have been made since the First World War. Consolidated accounting and standard costing, for example, are US 'inventions'.

Professional accountancy worldwide has become dominated by firms in which the largest offices are American even when they have UK or other European origins. Many accounting terms in other languages have been borrowed or adapted from English usage, for example, 'audit' and 'cash flow' in French and 'accountant' in Dutch. The terms 'chartered accountant' (the United Kingdom) and 'certified public accountant' (the United States) have been adopted by other English-speaking countries.

Japan's contribution is much more recent and results from the export of its management (including management accounting) practices. Accounting terms borrowed and translated from Japanese into English (and other languages, sometimes through English) include 'just-in-time' and 'target costing'.

1.4 Which are the top three countries in respect of each of:

(a) share of the world's top 100 companies;

(b) number of qualified accountants;

(c) market capitalization of stock exchange?

Why is the answer not the same for all three questions?

(a) United States, United Kingdom, Germany

(b) United States, United Kingdom, Brazil

(c) United States, China, Japan

These answers are based on Tables 1.5, 1.10 and 1.11 in the text, the first and last of which can be updated easily from the sources cited. The United States is the only country appearing in all three options. Note the small size of the Japanese accountancy profession and the large number of accountants in Brazil and China (a function of their large populations and their fast-growing economies, but perhaps also of the difficulty of defining a 'qualified accountant'). The United Kingdom is second even after excluding the CIMA, which has nothing to do with audit. On the other hand, many ACCA members work outside of the United Kingdom.

1.5 What factors have made possible the 'internationalization' of the world's stock markets?

The main factors that have made possible the 'internationalization' of the world's stock markets are the deregulation of the leading national markets, the speed of financial innovation, advances in communications technology and growing links between domestic and world markets.

1.6 What factors have led to the establishment of multinational enterprises (MNEs)?

Dunning's 'eclectic paradigm' stresses:

(1) possession, or privileged access to, assets that provide a competitive advantage over local firms;

(2) the extent to which it is appropriate, given the relative transaction costs, to internalize the markets for these assets;

(3) the extent to which there are advantages in locating production overseas rather than meeting the demand by exports.

Note that these are economic explanations of a phenomenon that can be looked at more widely.

1.7 Which countries historically have been the home countries of MNEs? Are they the same countries from which international accounting firms have originated?

In addition to the sort of information in Table 1.10, one could use data on the countries of origin of foreign investment. On that basis, according to Table 1.8 in the text, the top four home countries were (in order of importance) as follows:

1914 United Kingdom, United States, Germany, France

1938 United Kingdom, United States, Netherlands, France

1980 United States, United Kingdom, Germany, Netherlands

1990 United States, United Kingdom, Japan, Germany

2000 United States, United Kingdom, Germany, France

2009 United States, United Kingdom, France, Germany

The United Kingdom has remained an important home country despite dropping behind the United States; Germany has recovered a position lost in two world wars; the Netherlands is an example of a small country whose companies can only grow by expanding overseas; Japanese MNEs emerged strongly, but suffered setbacks in the late 1990s.

These are not exactly the same countries from which international accounting firms have originated. What is also needed is a strong domestic accountancy profession – whose growth may depend on other factors as well, for example, the nature of the corporate financing system. (See, also, the answer to Question 1.2.)

1.8 Why are there more accountants per head of population in New Zealand than in France?

Using the figures in the text (page 19), New Zealand had one professional accountant per 125 persons and France had one per 3,158 persons! However, not all accountants are members of a professional body and the tasks carried out by an 'accountant' in one country (e.g. New Zealand) may be carried out in another country (e.g. France) by an 'engineer' or a 'lawyer'.

In general, Anglo-Saxon countries have more 'accountants' per head than other countries, but the influence of international capital markets has increased the number of accountants in France in recent decades.

1.9 Why are some EU companies listed on non-European (especially North American) stock exchanges?

Companies seek listings on stock exchanges in order to raise capital and/or make their shares more widely available. They may also have a policy of being listed in the major countries in which they operate. For all of these reasons, EU companies have sought to be listed on a US exchange. Partly because of the cost of complying with US regulations (notably the Sarbanes Oxley Act), US listing has become less popular on the New York Stock Exchange. Companies have to weigh up the costs and benefits of a US listing. De-listings exceeded new listings for much of the first decade of the new millennium.

1.10 Why is English the leading language of international corporate financial reporting?

English is the leading language of corporate financial reporting for two main reasons:

(a) For historical reasons, English has been the world's dominant language for the last hundred years or so and

(b) corporate financial reporting to shareholders and the terminology of accounting standards that forms a part of it originated in English-speaking countries, especially the United States and the United Kingdom.

Note that US and UK terminology differ in many respects, as illustrated in Chapter 8.

Continental European and Japanese financial statements are usually translated into US English rather than UK English. International accounting standards use a mixture of US and UK English.

Causes and examples of international differences

Outline Answers to Questions

2.1 'The basic cause of international differences in financial reporting practices is the different degree of interference by governments in accounting.' Discuss.

[See Appendix in textbook.]

2.2 Assess the view that accidents of history are primarily responsible for international differences in corporate financial reporting.

[See Appendix in textbook.]

2.3 If you were trying to predict which financial reporting regulations and practices would be found in various African countries, which non-accounting variables would you measure?

Most African countries were under the control of colonial powers for much of the twentieth century. Therefore, it is likely that the best predictor of accounting regulations or practices is that such countries will have an old version of those of the colonial power. Furthermore, the African country is likely to have inherited its style of legal system and accounting profession, which will reinforce the style of accounting.

For example, one would expect a French influence on an African country to extend to the use of an accounting plan, whereas British influence would lead to the use of 'standards', perhaps based on British or IASB rules. See the paper by Elad (2015), referred to in the chapter.

The size of equity market might not be a good predictor for these countries. Some former British colonies may have had no substantial equity market but might have accounting rules suited
to one.

2.4 Explain how international differences in the ownership and financing of companies could lead to differences in financial reporting.

The basic thesis is as follows:

1. In all countries, the government will be interested in the calculation of profit in order to calculate taxable income and prudently distributable profit.

2. Financial reporting rules in a country tend to be driven by large companies because they exercise the greatest influence over the rule makers.

3. In countries with large numbers of listed companies that have large numbers of non-director shareholders, there will be a demand for large quantities of published, audited financial information used for making financial decisions.

4. In these countries, the government's accounting/tax rules will be unsuitable for financial reporting, so accounting calculations will have to be done twice.

5. In other countries, a few large 'international' companies may volunteer to use non-tax rules for group accounts.

If, for example, the United Kingdom and the United States are countries as described in point 3, whereas Germany and Italy are not, the financial reporting will differ.

2.5 Do international differences in the rules for the calculation of taxable income cause accounting differences, or is the influence the other way round?

Using the answer to Question 2.4 (above), the conclusion would be that a basic split of countries into two groups is not caused by tax differences. The fact that some countries have financial reporting closely linked to tax is not caused by differences in the calculation of taxable income.

However, at the next classification level down, we might be looking at a series of countries in all of which the tax rules and the financial reporting rules are closely linked. In that case, differences in tax rules would be likely to cause differences in financial reporting. For example, if tax rules allow the use of last-in first-out (LIFO) (as in Germany, Japan or Italy), financial reporting in those countries may be affected by companies choosing that practice.

2.6 Why is it difficult to establish a causal relationship between specific external factors and international differences in accounting? Discuss the methodological problems in identifying possible causes.

Although a probable relationship between possible causal factors and their effects can be established, it is not possible to be certain that these factors have caused specific differences, or to what extent they may have done so. This is due to the fact that some variables, for example culture, are not easily measurable. Attempts, such as the one by Hofstede, to quantify such an intangible factor and to measure its impact, could only provide partial explanations (this is accepted by Hofstede). Further, other researchers' different definitions of culture and research designs have come up with somewhat different results. Additionally, cultural data are usually collected for anthropological or sociological research, rather than specifically for research related to accounting; and problems can arise if data are used for purposes other than those for which it was originally collected.

Perhaps the greatest problem in linking causal factors to effects lies in the fact that most variables are not independent of each other. For example, it is difficult to separate the effects of culture and language or of company financing and the influence and size of the profession. Also, many factors can represent both cause and effect. For example, taxation regulations are the cause of some of the differences in accounting measurement regulations, while at the same time the extent of the link between financial reporting and taxation represents one of the major differences between countries. Finally, the influences of the causal factors on accounting are not static, but their relative importance changes with time. Historical, economic or political events can introduce new factors or change their effect.

2.7 How do the causal factors discussed in the chapter affect corporate governance structures in different countries?

There is clearly a link between corporate governance structures and the ownership structures of companies (see also the answer to Question 2.4). According to Zysman's classification, companies in some countries (such as the United Kingdom or the United States) rely on financing through capital markets and individual shareholders, while in other countries they depend on finance from governments (e.g. France and Japan) or from financial institutions (e.g. Germany). The respective corporate governance systems are in place to help with the governance of the companies on behalf of their stakeholders.

In many continental European countries, companies have a two-tier board structure consisting of an executive board of directors and a supervisory board. The (non-executive) directors on this supervisory board represent various groups of stakeholders, most notably the providers of finance (e.g. banks and major shareholders) and employees. This means that there is a reduced requirement for the publication and auditing of objective/fair information, since interested parties will have access to this information in their position as 'insiders'. At the same time, it is in the interest of these stakeholders to emphasize the protection of creditors and the long-term survival of the company (as opposed to short-term profits), in other words, to favour conservative accounting rules. In countries (such as the United Kingdom) where companies have only a single (executive) board of directors and where stakeholders are much more dispersed and external to the company, there is a greater requirement for audited, fair information and disclosure.

Another link exists between legal systems and the degree of government control as opposed to private sector regulation. For example, the two-tier board structure and the functions of each board are specified in detail in German legislation, while the United Kingdom prefers private sector regulation.

Note, however, that the differences described here are becoming less distinct. In the United Kingdom, for example, changes to corporate governance structures led to the appointment of non-executive directors and audit committees for large listed companies, while, in Germany, the desire of large multinational companies to raise finance on international capital markets has led to a move away from credit/insider financing and towards 'fairer' reporting rules.

2.8 Are the international differences in the formats of financial statements a major obstacle to comparing the statements?

In principle, international differences in the shape of balance sheets should not be a major obstacle for international comparisons. Users of balance sheets can easily rearrange them to a preferred format. The most obvious difference is that, in some countries (e.g. the United States), balance sheets start with cash, whereas in other countries (e.g. in Europe), they start with intangible assets and move down in the order of increasing liquidity. Some balance sheets do not contain a current/non-current distinction, although equivalent information can usually be found in the notes. A more subtle difference is that some balance sheets combine all debits together (on the left or at the top), whereas others show the financial position by calculating net current assets and then net assets. This difference might mislead users by focusing attention on different totals.

A more serious problem is that there are two basic styles of profit and loss account: by nature and by function. The 'by nature' format shows total wages, total depreciation and so on. For a manufacturing industry, this means that cost of sales and gross profit are not shown. This format is production oriented and is used in France, Germany, Italy and Spain (although many large German companies use the other style). The 'by function' format combines expenses together by stage of production: manufacturing expenses, administration expenses, distribution expenses and so on. It therefore shows the calculation of gross profit. This is generally used in the United States and the United Kingdom.

There may be enough information in the notes to a 'by function' format to enable the calculation of the 'by nature' figures, but the reverse is seldom the case. This is a problem for analysts in Anglo-Saxon equity markets who are trying to interpret continental European statements.