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International Differences and Harmonization in EU

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1. Independent Researches

Abstract: Different countries have contributed to the development of accounting over the centuries. When archaeologists discover ancient remains in the Middle East, almost all with letters or numbers on them, it is a form of accounting: the costs of war or celebration or construction, lists of taxes due or paid. It is now very well documented that the origin of written numbers and written words is closely related to the need to keep and update accounts. The Romans developed sophisticated forms of single-entry accounting from which, for example, farm profits could be calculated. Later, the growing complexity of business in northern Italy in the late middle Ages led to the emergence of a dual system. And even later, the existence of a wealthy merchant class and the need for large investments in large projects led to the public subscription of share capital in Norway in the 17th century. Next, the growing separation of ownership from management fueled the need for audit in 19th century Britain. Many European countries contributed to the development of accounting: France led the development of legal control over accounting, Scotland brought us the accounting profession, and Germany standardized formats for financial statements.

Keywords: accounting system, countries, harmonization, differences, EU

INTRODUCTION

From the late 19th century onwards, the United States gave us financial statement consolidation, management accounting, lease capitalization and deferred tax accounting). The United Kingdom contributed a "true and fair view" which was rounded off by America's "substance over form". In the late 20th century, Japan made many contributions to management accounting and control.

A common feature of all these international influences on accounting is that commercial developments led to accounting advances. Not surprisingly, the leading commercial nations of any period are the leading innovators in accounting. However, while the international influences and similarities are clear, there are also great differences, especially within Europe. An indication of the size of the international difference can be seen in those cases where companies publish two types of accounting items based on different rules - often national compared to US rules, which are published by foreign companies listed on US exchanges.

This paper attempts to group countries according to accounting similarities and then explore the causes of international accounting differences. After that, the paper provides an overview of efforts in the EU and on the part of the IASB to reduce these differences.

CLASIFFICATION

There are easily no two countries with identical accounting practices, some countries appear to form pairs or larger groups with relatively similar influences on financial reporting, such as legal and tax systems. If so, it is possible to set a classification. Such activity is a basic step in many disciplines, for example, classification is one of the tools of scientists - Mendelian system of elements and Linnaeus system of classification are crucial for chemistry and biology. Classification should sharpen description and analysis. Basic structures should be revealed and it should be possible to predict the characteristics of an element based on its place in the classification.

One group of authors, while classifying legal systems, offered practical criteria for determining whether two systems are in the same group. Systems are said to be in the same group if "someone educated in ... one law can be capable, without much difficulty, of treating [another]" (DAVID and BRIERLEY, 2015). Also, the two systems must not be "based on opposing philosophical, political or economic principles". The second criterion ensures that systems in the same group have not only similar surface characteristics but also similar basic structures and are likely to respond to new circumstances in similar ways. Using these criteria, a legal classification was obtained into four groups: Roman-Germanic, common law, socialist and philosophical-religious.

In accounting, the classification should facilitate the study of the logic and difficulties faced by international harmonization. The classification should also assist in the training of accountants who operate internationally. Furthermore, a developing country will more easily understand the available types of financial reporting, and which would be most appropriate for it, by observing which other countries use certain systems. Also, it should be possible for a country to predict the problems it will face and possible solutions by looking at other countries in its group.

For example, one group of researchers (NAIR and FRANK, 2015) divided the characteristics of financial reporting into those related to measurement and those related to disclosure. There was no hierarchy then, but the overall results seem very feasible and fit well with the analysis in this paper. It is shown that, in a world context, most of continental Europe uses the same system. However, the United Kingdom, Ireland and the Netherlands clearly differ from that system.

Another complication is that, especially since the early 1990s and in certain countries, large companies have chosen to follow internationally recognized rather than domestic practices. For example, until 2000, most of the largest 50 German companies used US or IASB rules for the accounting reports of their groups. In this sense, there were several "systems" in use in Germany. In 1998, Nobles published a revised classification to try to take some of these problems into account. To repeat the fact from before, just because the United Kingdom and the United States are on the left side, does not imply that they are equal. For example, their regulatory systems are clearly different. However, when compared with French or German accounting practices, British and American practices look similar.

The use of two systems within a country is a prime example of the fact that practices vary among companies within a country. This paper did not explore in-country differences in detail. The widespread adoption of IFRS since 2005 for the financial statements of some entities, but in many countries not all, has caused further changes in national norms and attitudes as time passes. It seems likely that different national versions of IFRS practice will emerge. The IAS Board (IASB) issued the Conceptual Framework for Financial Reporting in September 2010. It replaces the framework for the preparation and presentation of financial statements.

INFLUENCES ON DIFFERENCES

It is not possible to be sure that the factors discussed below because differences in financial reporting, but connections can be made and reasonable inferences can be drawn in the direction of cause and effect relationships. Factors considered to have influenced the development of accounting include colonial and other external influences, predominant providers of finance, the nature of the legal system, the influence of taxation, and the strength of the accounting profession.

Researchers pointed to factors such as language, culture or geography on a global scale. To the extent that they also have explanatory power, it seems more reasonable to assume that it results from auto correlation. For example, the fact that Australian accounting bears significant similarity to New Zealand accounting can be "confirmed" by linguistic and geographical factors. However, most of their similarities are probably not caused by these factors, but by their historical connection with the United Kingdom, which brought both accounting and language and colonized most parts of Australia during the same period.

If one wanted to include countries outside the developed Western world, it would be necessary to include factors related to the state of development of their economy and the nature of their political economy. Of course, to some extent the precise definition of the term may preclude the inclusion of some countries. For example, if we are interested in the financial reporting practices of publicly traded corporations, those countries that have no or few such corporations will have to be excluded. Now the four factors mentioned above (funding providers, legal systems, taxation and the accounting profession) are specifically considered, after which the international influences are explored in detail.

This was the predominant method of raising finance for large companies in the United States and the United Kingdom. Although it is increasingly the case that shares in these countries are held by institutional investors rather than individual shareholders, this still contrasts with state, bank or family ownership. Indeed, the increasing importance of institutional investors is an argument in favor of the following hypothesis: "In countries with widespread ownership of companies by shareholders who do not have access to internal information, there will be pressure for disclosure, audit and information useful for decision-making." Institutional investors hold larger blocks of shares and may be better organized than private shareholders, so they should increase this pressure.

In contrast, in France and Italy capital provided by the state or banks is very significant, as are family businesses. In Germany, especially banks are important owners of shares in companies, as well as providers of debt financing. Banks are direct owners, or exercise control through proxy, of the majority of shares in some German public companies. In such countries, banks or states, in many cases, appoint directors and thus be able to obtain prohibited information and influence decisions. If it is the case that many companies in continental countries are dominated by banks, governments or families, the need for published information is much less because of this access to private information. This also applies to the need for an audit, as it exists to check management in cases where the owners are "people outside the business".

A characteristic of "fairness", it is a concept associated with the existence of a large number of outside owners who seek unbiased information about the success of the company and the state of its affairs: Although rational understanding is expected, these shareholders are interested in comparing one year with another and one company with another. This involves assessment, which involves experts. This expertise is also required for the verification of financial statements by auditors. In countries such as the United Kingdom, the United States, Australia and the Netherlands, this can, over many decades, result in a tendency for accountants to come up with their own technical rules. This is acceptable to governments because of the influence and expertise of the private sector, which is usually ahead of government (in its capacity as a shareholder, protector of the public interest or tax collector). Thus "generally accepted accounting principles" control accounting. To the extent that governments intervene, they impose disclosure, reporting or measurement requirements, and they tend to follow best practice rather than create it.

In many continental European countries (such as France, Germany and Italy) the traditional lack of "external" shareholders meant that external financial reporting was mainly invented for the purposes of governments, as tax collectors or controllers of the economy. This retarded the development of flexibility, fairness assessment and experimentation. However, it leads to precision, uniformity and stability. It also seems likely that the greater importance of creditors in these countries leads to wiser (more conservative) accounting. This is because creditors are interested in whether, in the worst case scenario; they are likely to get their money back, while shareholders may be interested in an unbiased assessment of future outcomes.

Nevertheless, even in such countries as Germany, France or Italy, where there are comparatively few listed companies, governments have recognized the responsibility of requiring delisted or listed companies to publish detailed, audited, financial statements. There are laws to enforce this in most such countries, and the governments in France and Italy have also established bodies specifically to control the securities markets: in France the Commission des Operations de Bourse (now Authority des Marches Financiers - AMF), and in Italy the Commissione Nazionale per le Societa e la Borsa (CONSOB). These bodies are modeled to some extent on the Securities and Exchange Commission (SEC) of the United States. They are associated with important developments in financial reporting, especially in the direction of Anglo-American practice. This is not unusual, since these stock exchange bodies have a role normally performed by private and institutional shareholders who, over a much longer period, have helped to shape Anglo-American accounting systems.

TAXATION

Although it is possible to group tax systems in a number of ways, only some of them are important for financial reporting. What is particularly important is the degree to which tax authorities determine accounting measures. For example, in Germany tax accounts (Steuerbilanz) should generally be equal to commercial ones. There is even a word for this idea: Massgeblichkeitsprinzip (principle of conformity or binding together). In Italy, until recently, a similar point of view prevailed, described as ilibinario unico (unique approach).

In contrast, in the United Kingdom, the United States, and the Netherlands, there can be many differences between tax numbers and financial reporting numbers. One obvious example of an area affected by this difference is depreciation. In the United Kingdom, for example, the amount of depreciation used in public financial statements is determined by custom that dates back to the last century and is influenced by prevailing accounting standards. Convention and pragmatism, rather than precise rules or even the spirit of the standard, determine the method of depreciation, residual value estimates, and expected useful lives.

The amount of depreciation for UK tax purposes is very independent of these numbers. It is determined by capital reserves, which are a formalized scheme of tax depreciation reserves created to standardize reserve amounts and act as investment incentives, as envisioned by today's government. Due to the separation of the two schemes, there may be a complete lack of subjectivity in tax reserves, but enough room for evaluation when determining depreciation costs and financial reporting. (BLAKE, J., FORTES, H., GOWTHORPE, C. and PAANANEN, P. 2020)

At the opposite extreme, in countries such as Germany, tax authorities determine the maximum depreciation rates used for a certain type of property. They are usually based on the expected useful lives of the assets. However, in some cases reserves are available for accelerated depreciation: for example, for industries that produce energy-saving or anti-pollution products or for certain regions. Until the reunification of Germany in 1990, large reserves were applied in West Berlin and other areas that bordered East Germany, later they were applied in the new German states in the east. If these reserves are established for tax purposes (which would normally be reasonable), they must also be fully expensed in the financial accounts. Therefore, a British accountant would say that an expense against profit is not "just", even if it would certainly be "correct" or "legal". This influence is felt even in the details of the choice of depreciation method, where a typical German note on a company's balance sheet might be: "Plant and equipment are depreciated over a useful life of ten years on a declining balance basis: straight-line depreciation is adopted as soon as this results in a higher cost" (e.g. BASF Annual Report 2008).

With some variations, the Massgeblichkeitsprinzip is applied in Germany, France, Belgium and Italy and in many other countries. This is probably partly due to the prevailing influence of law codification and partly due to the dominance of taxation as a use of accounting. By contrast, by the late 1980s there were clear shifts away from this in some countries. For example, the Spanish accounting law of 1989 reduced the impact of taxes and increasing disclosure on residual tax effects. Similarly, in the Nordic countries the impact of taxation is decreasing. This was evident from the early 1980s in Denmark and became important in Finland, Norway and Sweden in the 1990s. Tax effects should generally be removed for consolidated statements under IFRS.

THE ACCOUNTING PROFESSION

The power, size and capability of the accounting profession in a country can follow, to a great extent, from the various factors and from the type of financial reporting they have helped to produce. For example, the lack of a significant proportion of private shareholders and public companies in some countries means that the need for auditors is much lower than in the United Kingdom or the United States. But the nature of the profession also builds on the type of accounting that is practiced and could be practiced. For example, the 1975 Proclamation in Italy (not enacted until the 1980s), requiring listed companies to have extensive audits similar to those operating in the United Kingdom and the United States, could only initially take effect because of the significant presence of international audit firms.

In Germany there is a separate, though overlapping, profession of tax professionals (Steuerberter), which is larger than the accountancy body. However, in the UK the number of accountants is excessive by including many who specialize in, or occasionally deal with, tax. Secondly, a German accountant can only be a member of the Institute if he practices as an auditor, while at least half of the British number is represented by members working in companies, government, education, and so on. Third, the training period is much longer in Germany than in the United Kingdom. It usually includes relevant four-year studies, six years of practical experience (four in the profession) and a professional exam consisting of oral and written tests plus a thesis. This usually lasts until the enthusiastic accountant is 30-35 years old. Therefore, many German "students" would be counted as part of the eligible number if they were in the British system. Fourth, in the 1980s, the certified auditor was established, a second-level body whose members are allowed to audit certain private companies.

These four factors help to explain the differences, and some of them are valid in other countries, e.g. there is a second instance body of auditors in Denmark. However, there is still a very significant residual difference, which results from the very large number of companies that need to be audited and the different process of forming the "fair" view assessment. The differences are narrowing as audits are extended to many private EU companies and as the UK introduces audit exemptions for smaller companies.

It is interesting to note a further division along Anglo-American versus Franco-German lines. In Anglo-American countries, governments or government agencies require certain types of companies to be audited and set certain limits on who will be the auditors, with government departments having the final say. However, in general, membership of private professional accountancy bodies is a method of qualifying as an auditor. On the other hand, in France and Germany there is a dual group of accounting bodies.

INTERNATIONAL DIFFERENCES

As noted at the beginning of this paper, many nations have contributed to the development of accounting. In the case of some countries, ideas have been carried around the world. For example:

- Several African member countries of the (British) Commonwealth have accounting systems closely based on those of the British Companies Acts of 1929 or 1948.
- The French plancomptable general was introduced in France in the 1940s, closely based on the German predecessor, later in several former French colonies in Africa.

- Japan's accounting system mainly consists of a commercial code borrowed from Germany in the late 19th century, on which American-style securities laws were added in the late 1940s.

By the end of the 20th century, international influences began to affect accounting in all countries, sometimes too much. Market globalization has led to a growing need for internationally comparable accounting information. When several large multinational companies are located in comparably small countries (e.g. the Netherlands and Sweden), the international impacts are likely to be particularly large.

Many large European companies have responded to internationalization by agreeing to use one of two sets of internationally recognized rules: the generally accepted accounting principles (GAAP) of the United States or the international standards of the IASB. Generally - at least in Europe - this use is limited to consolidated financial statements prepared by groups, led by listed companies. (COLASSE, B.2020)

Another effect is that national regulators tried to reduce the differences between their national rules and the above international norms. In the extreme, certain countries have adopted IFRS as part of their national rules.

HARMONIZATION ON EUROPEAN UNION

So far this paper has made it clear that there are large differences in the financial reporting practices of companies in different countries. This leads to major complications for those who prepare, consolidate, audit and interpret published financial statements. Since the preparation of internal financial information often overlaps with the preparation of published information, the complications spread further. To combat this, several organizations around the world are involved in attempts to harmonize or standardize accounting.

"Harmonization" is the process of increasing the compatibility of accounting practices by setting limits according to the degree of their variation. "Standardization" seems to imply the imposition of a more rigid and narrow set of rules. However, in accounting these two words have become almost technical terms, and it is not possible to rely on a normal difference in their meaning. Harmonization is a word usually associated with national legislation of the European Union, while standardization is a word often associated with the International Accounting Standards Board. In practice, these words are often used as synonyms. Convergence is a new word in this context, and it means the gradual alignment of IFRS and US GAAP, with the result that other jurisdictions are harmonizing as well.

It is necessary to distinguish de iure harmonization (rules, standards, etc.) and de facto harmonization (that of corporate financial reporting practices). It is possible, for any particular topic or group of countries, to have one of the two forms of harmonization without the other. For example, countries or companies can ignore the harmonized rules of regulators or even legislators. In contrast, market forces have convinced many listed companies in France and Switzerland to prepare English-language financial statements that closely follow Anglo-American practice. The EU achieves its harmonized objectives mainly through Directives (which must be incorporated into the laws of member states) and Regulations (which have a direct impact). In the 1970s and 1980s, attention was paid to harmonizing national laws with Directives. During the 1990s, the EU began to take international standards more into account, leading the 2002 Rule requiring IFRS for consolidated statements of listed companies.

IMPORTANT EU GUIDELENESS

The relevant legal body for accounting is company law, and the topic of this part will be the Guidelines on company law the exact effects of any guidelines in a particular country will depend on the laws passed by national legislatures. For example, there are dozens of provisions in the Fourth Directive that begin with such expressions as "member countries may require or allow companies to..."

The Fourth Directive (Directive 34) applies to public and private companies. Its articles include those relating to valuation rules, formats of published financial statements and disclosure requirements. It does not cover consolidation, which is left to the Seventh Directive. The first draft of the Fourth Directive was published in 1971, before the United Kingdom, Ireland and Denmark (not to mention the countries that joined later) joined the EU (or its predecessors). The initial draft was heavily influenced by German company law, especially the Aktiengesetz of 1965. As a consequence, for example, the valuation rules were to be conservative and the formats prescribed in detail. The financial statements had to comply with the provisions of the guideline.

The UK, Ireland and Denmark joined the then "common market" in 1973. The influence of Anglo-Saxon thinking was such that in 1974 a much revised draft of the Fourth Directive was issued. Then the concept of "true and fair view" was introduced. Another change by 1974 was the introduction of greater presentation flexibility. This process continued, and until the conclusion of the final guideline, "true and fair view" was presented as the dominant principle in the preparation of financial statements. In addition, the four main principles (accruals, wisdom, consistency and going concern) were better clarified than in the 1974 draft. 1971, and for more in the final guideline than in the 1974 draft. Another problem for Anglo-Saxon accountants was the impact of taxation on Franco-German clients. Additional required disclosures from the 1974 draft on the effect of taxation are included in the final Guidance.

The fact that member countries allow or require a type of inflation accounting is treated in more detail than in the 1974 draft. As a further concession to the Anglo-Saxon opinion, a "Contact Board" of EU and national officials was organized. This is intended as a response to the criticism that the Guidelines encourage laws that are not flexible to changing circumstances and attitudes.

The fourth guideline has not been significantly changed for more than twenty years. However, in 2001 it was amended to allow the valuation of financial instruments at fair value so that gains and losses are attributed to profit, as required by the international standard (IAS 39). In 2003, further improvements removed other inconsistencies with IFRS.

A characteristic of the Fourth Directive (Directive 34) is allowing member countries to exempt some smaller private companies from auditing and from some other requirements. The EU Commission proposed in 2009 that very small companies ("micro", i.e., those with 10 or fewer employees) could be exempted entirely.

The second guideline deals with a number of issues related to share capital and the differences between public and private companies. For example, the directive requires all member states to have separate legal structures for public and private companies and to have separate names for companies.

The subject of the Seventh Guideline is consolidated accounting. The eighth guideline was watered down from the original draft, which could have greatly influenced the practice patterns and scope of accountants' work. However, its main function now is to decide who may audit financial statements in certain countries.

LANGUAGE

The term "true and fair view" (TFV) has found its way into the laws of EU member states in a number of ways. Research (PARKER and NOBES, 2018) in the United Kingdom showed that financial directors of large companies consider TFV unitary, while their auditors consider it dual: roughly, "truth" is taken to mean that the financial statements are in accordance with the facts, and "fairness" is taken to mean that they do not misrepresent (the two characteristics mentioned above). View of any different state of business profit or loss.

PHILOSPHY

Accountants and lawyers in continental countries have, of course, been aware of the looming need to implement TFV since at least the publication of the draft Guidelines in 1974. It was a topic of discussion at international meetings and even at special European conferences in the 1970s and 1980s.

The idea that the law should be deviated from as a result of the opinion of directors and auditors is difficult to accept even by "English" lawyers, not to mention "Roman" ones. (DAVID, R.and BRIERLEY, JQC 2019)

National attitudes towards the implementation of the Guidelines can also be classified into several types, with British and German as the extremes:

UK: TFV is used by directors/auditors when interpreting laws and standards or when there are no laws or standards, and sometimes in order to pass a law or standards. TFVs can also be used by regulators to make rules that go beyond the details of legislation.

Germany: TFV can be used by directors/auditors to interpret government requirements or in cases where there are no requirements. The law cannot be derogated from in order to provide TFV. Some believe that TFV concerns only notes to financial statements.

CONCLUSION

By the early 1990s it became clear, even to the European Commission, that the Guidelines were too demanding and slow to achieve further useful harmonization. The fourth guideline, agreed in 1978, did not cover several issues and was too complicated to be revised frequently. Furthermore, global harmonization has become more important than regional.

It also became clear that, for large European companies, voluntary harmonization could focus on US rules over which the European Commission and other Europeans have no influence. As a consequence, from the mid-1990s, the European Commission began to support the increasingly important efforts of the International Accounting Standards Committee (later, the IASB). The EU also had in mind the creation of powerful harmonized European financial markets.

In 2000, the Commission proposed the mandatory use of IFRS for consolidated statements of listed companies from 2005 onwards. This was agreed by the European Parliament and the Council of Ministers in 2002, in the form of rules.

This rule also allows member countries to expand the use of IFRS, mandatorily or voluntarily impose listed companies and non-consolidated reports. For all companies covered by the Rule, national accounting laws and standards have been adopted. For other companies, national rules (including national implementation of the Guidelines) are still in force.

When it reached a membership of fifteen countries in 1995, the EU remained at a constant size for almost ten years. In 2004, ten more countries joined: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. Romania and Bulgaria became members on January 1, 2007, and Croatia in 2013. It is important that all the new members except Malta and Cyprus and Croatia, from the former "Eastern Bloc", are countries under Russian control. All that joined in 2004 and after are automatically subject to the 2005 Rule. This penetration inevitably changes power relations and influenced attitudes towards the development of financial reporting. The implications are unclear at this stage, but there will certainly be some.

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