

2 Harmonisation of accounting regulation and practice

International harmonisation of accounting has been defined as “the attempt to bring together different systems. It is the process of blending and combining various practices into an orderly structure, which produces a synergistic result” (Samuels & Piper, 1985, pp 56-7). The harmonisation of financial accounting and reporting standards is seen as a means of facilitating the globalization of capital markets by enhancing investors’ ability to make informed decisions regarding investment alternatives. Any subsequent reduction in information asymmetry between preparers and users should be reflected in a lower cost of capital (Baiman & Verrecchia 1996).

Prior research on accounting harmonisation may be characterised as either qualitative or empirical. Qualitative research has typically focussed on the perceived merits of harmonisation and its implications for standard setters. For example, Vishwanath & Kaufmann (2001) examine the role of increased transparency in promoting financial stability and provide specific recommendations on policy making and enforcement for the effective operation of financial markets. Empirical research addressing international harmonisation follows two major approaches: (1) studies of accounting standards and other regulation, that is, *de jure* harmonisation, and (2) studies analysing the accounting practices of corporations within a given regulatory framework, namely, *de facto* harmonisation.

***De jure* harmonisation.**

Early studies of *de jure* harmonisation relied, at least in part, on Price Waterhouse (PW) accounting surveys as the basis for analysis (Nair & Frank 1981, Doupnik 1987; Doupnik & Taylor, 1985). Nobes (1987) criticised such studies on the grounds that the PW surveys were not sufficiently reliable to support the conclusions drawn. Similarly, a 1988 survey by the International Accounting Standards Committee (IASC) of its members to determine the extent of adoption of IAS has been portrayed as wishful thinking rather than fact (Meek & Saudagaran 1990).

Harmonisation is a “moving target” and more recent surveys by international accounting firms have been used to establish the extent of *de jure* harmonisation. For example, Larson & Kenny (1999) examine harmonisation over the period 1991 to 1995 utilising data from Coopers & Lybrand (1991, 1993) and PW (1995) surveys. They sought to determine whether harmonisation increased during a period of greater acceptance of IAS by global stock exchanges. They report “a discernable trend toward IAS through 1993” (p.9).

The latitude allowed during the early 1990s allowed greater scope for compliance. Hence further examination after major revisions of IAS by the IASC in 1995 found that while, in absolute terms, most countries had lower levels of compliance with IAS after 1995 the relative levels of compliance between countries did not appear to be affected. Countries that had previously reported high levels of compliance continued to report a comparable level under the changed regulatory environment. In terms of empirical regularities, countries with

the highest level of compliance with IAS up to 1993 tended to be those that “have an overall accounting system resembling that of either the US or UK and those with a Common Law legal framework”. In 1995 this relationship was no longer observed.

***De facto* harmonisation**

De facto harmonisation is an investigation of reporting practices. Many such studies have been conducted in the last twenty years. For example, Evans & Taylor (1982) analysed the impact of five IAS on 50 corporate financial reports from five countries for the period 1975 to 1980 and concluded that the IAS had little impact on accounting practices. More recently Nobes (1990) examined the accounts of 200 US companies and reported less than 50% compliance with IAS where US GAAP is silent on any particular issue. Cairns (1996) restricted study to a single accounting issue, goodwill accounting. An examination of the policies of 50 international companies revealed a lack of conformity with IAS.

Aims and objectives of this study

Four of the five countries examined by Rahman (1998) are charter members of the Association of South East Asian Nations (ASEAN). Saudagaran & Diga (1997, 2000) and Craig & Diga (1998) examine accounting developments within ASEAN countries. The adoption by ASEAN countries of a global rather than a regional approach to accounting harmonisation is attributed to resource constraints, political considerations, the standard-setting structure in place and the need to enhance the credibility of financial statements for foreign investors. Thus the impetus to adopt international standards for domestic use has been increasing in the region. Further, the May 2000 recommendations by the International Organization of Securities Commissions that regulators allow multi-national issuers to adopt IAS for cross border offerings and listing (subject to the provision of supplemental data) provides an incentive to adopt IAS. To the extent that IASs reduce information asymmetry relative to domestic standards in use in specific countries, standards setters in East Asian countries could be expected to increase their rate of adoption of IAS. Furthermore, preparers of accounting information may increase the level of voluntary disclosures in line with IAS where domestic regulation does not meet market expectations.

Thus at the national level the actions of both standard setters and preparers are of interest. Standard setters, for example, may differ in the priority given to convergence of domestic and international standards. Commonality of agenda topics and the time taken to review and adopt IASs are important determinants of the current state of regulation in each country. In addition to the development/adoption cycle, attention should be directed to the application of those standards. Convergence on interpretation of standards is central to that process. For countries used to writing accounting regulation as highly detailed rules, the movement to IASs based on principles will either allow more discretion in application or regulators may provide interpretations as specified rules. Furthermore, the reporting environment is affected by the mechanisms for monitoring accounting practices. The concurrent acceptance of IASs and domestic standards may severely challenge the resources of the domestic security regulator.

The study of *de jure* or *de facto* harmonisation is dependent on the research question. A study of both the regulatory framework and accounting practice is considered useful in this study to establish the rate of adoption of IAS in each country as well as the compliance (both mandatory and voluntary) at the micro level of the firm.

This study will examine the extent to which accounting standards of selected East Asian countries are consistent with IASs and the extent to which practices of selected East Asian companies conform to the requirements of IASs. Determination of the level of compliance assists in evaluating the “lessons learned” from the Rahman (1998) study. Similar to Rahman (1998), financial statements form the primary source of information for this study.

Disclosure and the Financial Crisis

The importance of disclosure to the financial community cannot be overstated. Accountability demands information production and communication. Theoretically, when capital markets are efficient, information is impounded rapidly into share prices. The form of the information is irrelevant, that is, capital market participants will be indifferent as to whether a transaction is recognised in the financial statements or disclosed in the notes to the accounts.² Indeed, disclosure may be preferable to recognition where uniform accounting practices do not fully reveal differences of substance. For example, a uniform rule to expense a cost may hide differences across firms in their capacity to generate future benefits from such expenditure. Further, harmonisation of accounting principles may render accounting practices deceptively similar. Additional disclosure may be necessary to improve comparability and/or quality.

² Or, possibly, elsewhere although an audited statement is likely to have more credibility than, say, disclosure in the management discussion and analysis section of an annual report.