

INTERNATIONAL HARMONISATION OF ACCOUNTING „PRINCIPLES”

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It is the oath of responsibility that holds our democracy together (Lycurgus to Leocrates, 331 B.C.).

Introduction

I suggest that for the purpose of this article we assume - perhaps wrongly - that there is general agreement about the meaning of the words „international” and „accounting” in the heading of this article.

My Oxford Dictionary tells me that „harmonisation” means „bringing into harmony” and that „harmony” is „the agreeable effect of apt arrangement of parts” or „a sweet, melodious sound”.

Thus harmony has nothing to do with every participant producing the same uniform note, which would result in a terribly annoying concert anyway. Among musicians just as among accountants there are of course people handling and sometimes (at least to my ears) even mishandling the drums, just as there are people who want to play the first violin whereas their capabilities do not reach beyond the second.

When it takes so much time and effort to prepare an orchestra for a concert, how much more difficult will it be to make people of so many different historical, cultural and ethnic backgrounds behave in a harmonized way when faced with financial disclosure problems.

The members of an orchestra who participate in the same piece of music will not all use one type of instrument only, they will not all play at the same time and they will not all play equally loud. Nevertheless no one is less important than the other, and it is the combination of all participants in all variations that hopefully produces „the agreeable effect of a sweet, melodious sound”. Will it ever be possible to attain that same world-wide „agreeable effect” when accounting policies are concerned? One would expect so since the world is becoming a smaller economic field every day. At least that is the current popular saying.

What exactly are „accounting principles”?

Standard nr. 1 of the International Accounting Standards Committee prefers the designation „accounting policies” where it states in par. 8: „Accounting policies encompass the principles, bases, conventions, rules and procedures adopted by managements in preparing and presenting financial statements. There are many different accounting policies in use even in relation to the same subject; judgement is required in selecting and applying those which, in the circumstances of the enterprise, are best suited to present properly its financial position and the results of its operations”. I suggest that again for the purpose of this article we consider the concepts „accounting principles” and „accounting policies” to be identical with a personal preference for „policies”. The concept „principles” is often used too loosely.

Who needs international harmonisation of accounting policies?

A clear distinction should be made between the need for international harmonisation or perhaps even strict uniformity within one internationally operating enterprise and the desirability of a certain degree of harmonisation as between enterprises and countries. Contrary to popular opinion, the fact that an enterprise is operating internationally does not create in itself any urgent need for international harmonisation of accounting policies since the parent company will be in a position to set uniform rules for all inter-company reporting. This does not mean that a company operating internationally will not be affected by different accounting policies in the host country, since in many cases the local subsidiary must also publish its accounts on the basis of local policies and/or legal requirements and even more so if - as is the case in many countries - the tax-bill is assessed on the basis of accounts drawn up in accordance with those policies and requirements. The inherent problems become evident also in the case of the parent company acquiring a minority shareholding in such a company. The parent company will then have to „translate” - often on the basis of inadequate information - the figures from such company in order to maintain uniformity with its own accounting bases.

International differences in accounting policies also create additional problems when a take-over of a local company is being considered. The potential investor will have to convert the „local” figures of the potential acquisition on the basis of his own accounting policies.

Although it may be concluded that international accounting harmonisation would have the effect of facilitating some of the practical reporting difficulties and of reducing the accounting costs of the enterprise operating internationally, the parent company still may and will set internal accounting and reporting rules. For that reason the international enterprise has no urgent need for international harmonisation and even less for international uniformity if such a thing were possible.

The problem is different for the other users of the financial reports viz. bankers, suppliers, investors, trade-unions, analysts and journalists, etc.

This has become more imminent through the growing internationalisation of the capital-markets, the increasing internationalisation of shareholdings and the growing international employee-participation.

Harmonisation of what?

What matters more: the theoretical comparability of different businesses internationally or even nationally, or the true and fair view of each particular enterprise?

The environment in which the businessman and the auditor operate is almost infinitely complex and varying. In my opinion there is neither need nor room for uniformity, neither nationally nor internationally, in the continuously changing circumstances. I believe that most attempts to attain comparability of financial statements by means of rules and regulations have failed because of a false belief that uniformity of methods produces com-

parability of results. Internationally and even nationally there will always exist what the French call „une situation théorique” and „une situation réelle”.

What the informed user of financial statements in fact needs are certain ground-rules for financial reporting, an adequate disclosure by management of all accounting policies which govern the financial statements and of any significant accounting features which called for specific treatment of a special transaction or economic event. But let there be no false illusions: *no user of financial statements will ever obtain an adequate understanding unless he understands the process by which the economic events are converted into monetary terms.* Informed users of financial statements are quite willing to agree that absolute comparability let alone uniformity can never be attained.

It is also quite natural that managements prefer flexibility because it is their duty to assess the probable impact of their financial and other reports on the capital-markets, on the taxable results, on the public at large and on labour relations. The evaluation of these expected impacts naturally influences their preferred choice of accounting alternatives, however managements are also willing to acknowledge the need for some ground-rules especially relating to consistency as opposed to complete flexibility and to agree that not all differences in accounting alternatives can be justified on the basis of economic differences. Examples are diverse depreciation policies by leasing and rental companies. Managements and auditors however rightly argue that real economic differences do exist from country to country, also between companies and sometimes from transaction to transaction that warrant different accounting alternatives.

All over the world efforts are being made to tighten the straitjacket both for business and for the auditor with an ever increasing web of rules, regulations and requirements in respect of accounting practices. As a result businessmen and auditors operating in an international environment are increasingly finding themselves complying with one standard and at the same time falling short of another. Just one example: In the U.S.A. goodwill is commonly written off over a 40-year period. According to the Draft Fourth Directive of the E.E.C. goodwill may be written off over anything between 1 and 5 years. And the English I.C.A.'s Technical Advisory Committee is proposing a fixed 5-year period. What makes it worse is that in a number of countries certain tax allowances are dependent on the adoption of a particular accounting treatment.

Many national standards and local legal requirements stipulate that an enterprise may deviate from any such requirement provided it gives an explanation and quantifies the effect. If not, then the auditor must supply that information in his report. Is this a realistic requirement?

Managements and auditors are constantly facing situations where judgement and discretion must be exercised in determining the appropriate method. Imagine that in all those cases there would be a requirement to make comparisons with the results which would have been achieved had inappropriate methods been used. Nevertheless that is what most committees

drafting accounting standards are inclined to require. In my opinion however the selection of the most appropriate practice should always be dependent upon the particular case.

The London Stock Exchange recently stated that no listed company will be compelled to comply with any accounting standard, but that it should disclose *where* but neither to what extent nor the reason why it has departed from a standard.

As regards the auditor, I do not see how the business-world will or even could allow any auditor to give information in his report regarding the importance of the deviation from the standard when both the management and the auditor in all honesty believe that the accounting treatment applied in that particular case produces a true and fair view whereas the treatment required by the standard would have given a wrong view. The disclosure of the purely theoretical but meaningless extent of a well-considered and sound deviation would only confuse the less well informed user of financial statements and even cause confusing comments, particularly in the popular press.

„Harmonisation” to my mind does not mean that detailed rules and regulations would have to be adopted but rather that *basic* accounting standards and *general guidelines* for disclosure-requirements be developed with provision for circumstances in which deviations from those standards and guidelines are permitted or even mandatory. Finding an acceptable balance between flexibility, consistency, interfirm harmony and international harmonisation should be a singular aim. The primary purpose of *any accounting standard* should be to produce a true and fair view of each particular business, and not a purely theoretical and impracticable uniformity, to make life easier for accountants and auditors.

Is international harmonisation a realistic aim?

On the one hand we see an increasing international activity, but at the same time increasing nationalism in practically all countries calling for local rules and regulations causing more and more obstacles to international harmonisation. What are the reasons for these contradictory developments?

- The economic, political, social and cultural environments in the various countries differ so widely that many doubt whether world-wide accounting standards whatever they would contain can ever be developed except „at a nebulous level of generalization”.
- The legal requirements in the various countries show a confusing variety.
- In many countries tax regulations dictate the determination of income and value (e.g. depreciation methods, stock valuations).
- Accounting and reporting policies which are relevant to the needs of users of financial information in one country are often irrelevant in another.
- Chauvinism often prevents us from objectively seeing the merits of ideas and practices in other countries.
- Every national accounting organization believes that the level of competence of its members and their training is unique. The training and examination procedures in Latin countries not to speak of the Middle and

Far Eastern countries differ widely from the Anglo-Saxon countries and there again - though perhaps less - from countries like Germany, Holland and Scandinavia.

Because of basic differences in our historical and cultural backgrounds, many of these differences will probably persist and make *real* harmonisation impossible at least for many years to come. And who is to say that in its own cultural and behavioural environment one is better than the other? I am thinking for example of the tremendous differences in labour relations, in rates of inflation and of the varying degrees of „flexibility” of interpretation and application of rules and regulations and even of the law. Any search for the „best” international or even national accounting policies is thus exposed to the danger of imposing a theoretical uniformity in a non-uniform environment. I conclude that quite apart from the fact that I do not consider uniformity in accounting a realistic or even desirable aim, even on a national level, I feel that at least for the time being the only realistic aim can be an international agreement on certain *basic* standards and on a requirement to fully *disclose* the important accounting policies governing the financial statements.

The International Accounting Standards Committee (I.A.S.C.)

Neither I.A.S.C.’s Statute nor its Standard nr. 1 gave rise to any expectation that in its subsequent activities I.A.S.C. would propose detailed requirements as to the accounting treatment of specific events but would rather limit itself to the development of certain *basic* standards for financial reporting and the *promotion of adequate disclosure* requirements.

Article 1 of its Statute reads as follows:

The professional accountancy bodies which are signatories hereto, hereby collectively agree:

a. to establish and maintain an International Accounting Standards Committee, with the membership and powers set out below, whose function will be to formulate and publish in the public interest, *basic standards* to be observed in the presentation of audited accounts and financial statements and to promote their world-wide acceptance and observance;

b. to support the standards promulgated by the Committee;

c. to use their best endeavours:

(i) to ensure that published accounts comply with these standards or that there is disclosure of the extent to which they do not and to persuade governments, the authorities controlling securities markets and the industrial and business community that published accounts should comply with these standards;

(ii) to ensure that the auditors satisfy themselves that the accounts comply with these standards. If the accounts do not comply with these standards the audit report should either refer to the disclosure of non-compliance in the accounts, or should state the extent to which they do not comply;

(iii) to ensure that, *as soon as practicable*, appropriate action is taken in respect of auditors whose audit reports do not meet the requirements of (ii) above.

d. to seek to secure similar general acceptance and observance of these standards internationally.

Par. 18 of Standard nr. 1 states „Financial statements should include clear and concise *disclosure* of all significant accounting policies which have been used” and in par. 19 „The disclosure of the significant accounting policies used should be an integral part of the financial statements”.

However, I am afraid that I.A.S.C. now is not only endeavouring to develop *basic* accounting standards and certain *minimum* guidelines for disclosure-policies - which would be in conformity with its Statute - but that there is also a tendency to lay down hard and fast rules and this on the basis of what is considered to be good practice in some countries but not necessarily in others.

In my opinion all members of I.A.S.C. should bear in mind the wise words of E. Kenneth Wright, the then President of the English Institute of Chartered Accountants, under the heading „Towards World Accounting Standards” in the Times of July 1st, 1973:

„The initial objectives of I.A.S.C. were clear and modest - to establish *basic* standards which would command world-wide acceptance. Many countries already work on standards which are far more complex and sophisticated than those with which I.A.S.C. intended to be concerned. But in a large number of territories the accounting professions are young and developing and even in others with a longer experience there are surprising differences in approach. The first step, therefore will be to establish a common ABC. The debate over the coming months will not be whether it is right that this attempt be made but on whether the approach is correct; should the standards be established by the accounting bodies themselves or by their governments, and on whether the standards, once agreed will carry sufficient authority to be accepted by the business community.”

I.A.S.C. is publishing exposure-drafts at astonishing speed, but personally I believe that all users of financial statements would be better off if only one *basic* standard or *disclosure-guideline* were completed each year which would meet general support.

International agreement on a meaningful set of *basic* standards and *guidelines* for disclosure, remains a desirable aim but can only be accomplished when fully understanding the nature and reason for the differences between countries. I am afraid that any attempt to achieve speedy accord must fail because such accord will always be „un accord théorique” and not „un accord réel”. In our enthusiasm we should also not lose sight of the fact that I.A.S.C. is not in a position to lay down the law. I am certainly not suggesting that I.A.S.C. should abandon its efforts to support strongly the development of accounting. Intensive and objective research throughout the world into business practices and the underlying economic facts, the methods of financial measurement, analysis and reporting in order to com-

municate pertinent and reliable information to all interested parties is all to be welcomed, but I am firmly convinced that I.A.S.C. should stick to its original intention and limit itself to fundamentals.

I.A.S.C. has recently issued an exposure-draft on the valuation of stocks and work in progress „in the context of the historical cost-price”. This must have made a remarkable impression on the financial community, now that there is a growing body of criticism all over the world of the adherence of accountants to historical data. More and more people are aware that the information based on historical prices is not relevant for any of the decisions which any user of financial statements must make. The confusion in this respect is nearly complete: the British Accounting bodies and the American F.A.S.B. have recently published exposure-drafts on certain general price-level adjustments whereas both the official British Scandilands-Committee in its September 1975 report and the American S.E.C. in its Release no. 5608 dated August 21st, 1975 propose disclosure on the basis of replacement value accounting. The Australian and South-African professional bodies also favour replacement value accounting. It could rightly be argued that I.A.S.C. here missed a chance by not issuing some guidelines for coping with the world-wide accounting problems resulting from inflation before every individual country started issuing its own standards and guidelines which will again make harmonisation more difficult than ever before.

I.A.S.C. is trying to reach agreement on an essentially pragmatic basis, but unfortunately the essence of much of the criticism of I.A.S.C.'s publications is that the function of financial statements and their contents is not clearly stated and that some basic concepts such as valuation and income-determination have not been defined and explained. Whether the publications of I.A.S.C. are good or bad, they emanate from a small group of accountants. Therefore they should be persuasive and convincing, but they normally contain hardly any persuasion that they are based on fundamental considerations. Would such explanation be given, then they would have a better chance of acceptance and survival. Accounting standards which fall short in explaining their fundamental considerations may survive for a while but not for long.

Sir Henry Benson, the energetic Chairman of I.A.S.C., recently stated in Paris that „all company reports issued in the founder or associate member countries of I.A.S.C. from January 1st, 1976 should carry statements by the auditors that they are satisfied that the accounts comply with the issued international standards. Any non-compliance with these standards should also be reported on by the auditors”. However, the founder and associate members of I.A.S.C. have only undertaken „to support” I.A.S.C.-standards.

Now what does „support” mean? If „support” would mean that founder and associate member bodies would have to see to it that national standards conform to those of I.A.S.C. then a conflict is unavoidable if I.A.S.C.-standards are not in agreement with national concepts. The A.I.C.P.A. e.g. recently decided that no action should be taken to enforce I.A.S.C.-standards at this time. Rather disquieting for the general acceptance of I.A.S.C.-standards is that some people (U.S.A., Canada) believe that dis-

crepancies between national and international standards would only be a matter of concern to companies and auditors reporting in an international environment and they maintain that I.A.S.C.-standards have nothing to do with purely domestic companies. This attitude is not in line with the opinion of the members of I.A.S.C. nor with the views expressed by its Chairman in Paris. It would also lead to a discrimination of and therefore be unacceptable to the business in the smaller countries since these are - however small they are - practically all operating in an „international environment” and so are their auditors.

It is my considered opinion that international standards going beyond whatever must be understood to be „basic” or which are more than a „guideline” will never be accepted unless they have been established with the active participation of all parties concerned (governments, business, stock-exchanges, trade-unions, auditors, lawyers, etc.).

It is too soon to say whether I.A.S.C. will succeed in meeting the challenge which it is facing. The enthusiasm and effort of its participants certainly deserve a positive result.