Financial Reporting Demands in a Globalised World: The Harmonisation of Accounting Rules

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**Abstract:** OECD accounting regimes have significantly changed over the last three decades. Financial reporting rules for (public) companies have become more similar, and the ways in which accounting rules are set and enforced have converged. This paper explores to which extent (financial) globalisation drives convergence of financial reporting systems. We analyse globalisation developments and changes in accounting regulation in six large OECD countries: Canada, France, Germany, Great Britain, Japan and the USA. We identify changes in the demand and supply patterns of accounting regulation, and we present empirical evidence for the concurrence of financial globalisation and accounting harmonisation. A newly developed financial globalisation index and changes in accounting regulation are jointly analysed. We find that the analysed countries have experienced distinct waves of globalisation since the beginning of the 1970s and that these waves coincide with a delayed accounting harmonisation.

**JEL classification:** M 41, G 15, G 38

**Key Words:** Accounting harmonisation, financial globalisation, accounting regulation
1 Introduction

OECD accounting regimes have experienced significant changes over the last three decades. Financial reporting rules for (public) companies have become more similar, and the ways in which rules are set have converged. Accounting scandals, business crises, network effects, cultural reasons or the process of Europeanisation have been advanced as explanations for this development (Zimmermann 2007; van Zandt 2005; Zarzeski 1996; Schipper 2005; Perry and Nöelke 2005). Moreover, scholars often argue that general globalisation developments have an influence on accounting regulation (Chua and Taylor 2008; Nöelke 2005). However, empirical evidence for a link between the developments is to our knowledge still missing. This paper particularly looks at the (financial) globalisation as a driver and explanation for the convergence of financial reporting systems. The changes in laws and regulation are an incremental development. As we will show in this paper, the financial globalisation is an incremental process as well. Recent scholarly work assumes that the financial system of a country is most important for the development of its financial reporting system (Nobes 1998; Ball 2001). Leuz and Wüstemann (2004) even see the accounting system as a subsystem of the financial system. Connecting these theoretical assumptions with our empirical findings we argue that the accounting system and the financial system develop in a coevolutionary process. We measure the globalisation of the financial system with an index calculated out of various macro-economical data like foreign capital markets usage, foreign direct investments or cross-border M&A. A high growth period of globalisation should be followed by changes in accounting regulation. Moreover, the accounting systems should show
the tendency to converge due to the integration of financial systems, which leads to a more homogeneous demand structure of stakeholders.

Globalisation has changed the corporate environment in many ways. Corporations are now not only physically operating around the world in widely extended networks, they also raise money on foreign markets and shares are traded across borders. Increased demand for financial resources, the liberalisation of capital flows and the ensuing financial globalisation have in general led to a stronger role of outside finance. Globalising firms were simply unable to generate the necessary funds for expansion from internal sources or existing owners.

The accounting systems originally developed in response to the legal, financial and cultural systems of nation states, and highly diverse country specific accounting systems ensued (Soderstrom and Sun 2007). In recent years, the country specific solutions have come under pressure. One important reason is (financial) globalisation: multi- or transnational companies have share- and stakeholders in many countries. Corporate financial reporting needs to respond to these developments as investors require information about the performance of their investments and about further investment opportunities. Companies have economic incentives to meet these demands, e.g. the cost of capital can be lowered by reducing information asymmetries between worldwide investors and the company (Hail and Leuz 2006). At a global level, comparable information accounting rules sets\textsuperscript{i} can thus lead to a more efficient allocation of the world’s supply of funds with lower cost of
capital and a higher overall welfare (Ruder et al. 2005). The demand for high quality standards is not only articulated by investors but additionally by stock exchanges who want to increase their liquidity by attracting stock trade. Therefore, large stock exchanges also ask for reports prepared under comparable information accounting rules. So do national regulatory authorities, which are interested in the competitiveness and stability of capital markets. The latest developments indicate that the convergence of financial reporting systems does not only lead to a system that is modelled on an Anglo-American informational style but to one single set of rules, which is likely to be the now pre-eminent set of International Financial Reporting Standards (IFRS): even the SEC plans to mandate the use of IFRS for listed companies in the US beginning in the year 2014.

The paper will discuss reasons and present evidence for changing reporting demands in a globalised world. We show that a higher demand for and supply of comparable, high quality annual reports has led to a harmonisation of accounting regimes. We argue that larger companies experience pressures to use standardised, information accounting rule sets and that they accommodate this demand by supplying share- and other stakeholders with financial reports on the basis of IFRS or US GAAP. These accounting standards focus on providing useful information for investors and are characterised by scholars as favourable for shareholders, standard setters and politicians (La Porta et al. 1998; Barth et al. 2001).
We analyse globalisation developments and changes in accounting regulation in six large OECD countries: the USA, Great Britain, Canada, Germany, France and Japan. These countries allow a rich contrast due to their institutional setups, which appear in two types: insider systems, normally coinciding with a legal system based on code law (Germany, France and Japan), and outsider systems, typically having a common law tradition (USA, Great Britain and Canada). In the second section of this paper we will present evidence of the coalescence of the corporate world by presenting data on globalisation in general and data on the financial globalisation. The third section deals with the question how globalisation pressures the convergence of accounting systems and in the fourth section we present evidence for the concurrence of globalisation and accounting harmonisation. Section five concludes.

2 The coalescence of the corporate world

The most apparent reason for accounting harmonisation is the evolvement of multinational entities (MNEs) that do business across the borders of their country of incorporation. Globalisation promotes the development of MNEs and is itself amplified by MNEs. Technical innovations such as advanced communication, the possibility of mass production and global trade along with decreasing costs of transports around the world changed the environment of companies (Levitt 1983; Chandler 1992). This increases the opportunities for MNEs, and their number and size are growing further.
For a long time in human history, economic activity was limited to the regional level. There was little manufacturing for export and no competition for global market shares. However, this has changed radically during the last 200 years. Especially developments since the 1980s have reshaped the corporate world. Radical shifts in communication and transport technologies as well as the politically achieved possibility of free trade of goods, services and capital started an internationalisation process in an unprecedented dimension. Simultaneously, the reasons for companies to internationalise became more complex than just seeking economies of scale, and its organisation became more challenging. The global expansion in trade and production led to increased capital needs which could neither be satisfied through capital markets in companies’ home countries nor through debt or internal financing. Hence, companies started to raise capital on foreign markets and thus supplemented their internationalisation in operations by trade and FDI through international financial activities. To give empirical evidence for the rapid globalisation developments since the 1980s, we look at worldwide investment and organisational restructuring activity (Exhibit 1, 2) and at global financing activity (Exhibit 3-6).

One of the most common indicator to quantify globalisation is the flow of FDI. Exhibit 1 shows that the FDI flows inside the OECD countries have increased since the beginning of the 1970s. The growth was especially pronounced in three periods: at end of the 1970s, from 1985 to 1989 and from 1995 to 2000. This shows that there are certain periods in which the globalisation of the economy is especially progressing. Globalisation comes in stages, it is not a continuous process and one can
even find negative growth rates in some time windows: after a peak in 2000 the FDI was lower in the following three years but since 2004 the FDI flows have been increasing every year. Since the late 1970s FDI have increased from about 35 billion US Dollar to now over 1,200 billion US Dollars in 2007. The FDI stock in OECD countries relative to the GDP of all OECD members rose from about five percent in 1980 to over 25 percent in 2007.

![Exhibit 1: OECD FDI flow (1970-2007) and FDI stock relative to GDP (1980-2007)](data:image/png;base64,iVBORw0KGgoAAAANSUhEUgAAAAEAAABQAQMAAABAgP5BAAAABGdBTUEAALGPC/xhBQAAAABlBMVEX///8AAAgAElEQVR42u3M8AIAwFwA6OGYdYQoAAAAASUVORK5CYII=

Data Source: UNCTAD, database.

While the previous indicator measures the investment activity across the globe, global M&A can show how corporate networks evolve. Exhibit 2 shows the increase of global cross-border M&A from 1988 to 2006. Again there has been a significant increase since the 1990s interrupted by a drop from 2000 until 2003. Overall, the amount of global cross-border M&A in 2006 was over four times the amount of 1995. Today, MNE have subsidiary enterprises in various countries. The rising worldwide
investment activity in link with the increasing interconnection of companies points to a grown together corporate world.

Exhibit 2: Global cross-border mergers and acquisitions, 1988-2006

What is even more important in the context of the harmonisation of accounting regulation, than the internationalisation of firm’s investment activity, is the integration of capital markets; investors are the most important group demanding financial reports. Hence, we now look at the global financing activity of companies. First of all, the general importance of capital markets will be displayed: Exhibit 3 depicts the market capitalisation relative to the GDP of the three large outsider- and insider-economies that we consider in greater detail and points to a growing use of capital markets. While the importance of capital markets in each system differs, the exhibit illustrates the general growth of equity markets. Exhibit 3 also demonstrates the strong interconnection between capital market performance and merger
activities: the collapse of the New Economy followed by a depression of world stock markets, amplified by the terrorist attacks on the US in late 2001 dented the growth pattern. As a general tendency the importance of capital markets has, however, increased significantly over the last 20 years.

Exhibit 3: Share of market capitalisation relative to GDP
Data Sources: World Bank (World Development Indicators Online, 2009)

A growing use of capital markets does not necessarily mean that they are integrated. This can be measured by the share of foreign investors, the share of foreign stock turnover or the equity issues on foreign markets. This data allows analysing the internationalisation of markets from the perspective of capital providers, which eventually supply financial information, and from investors, which demand that data. Let us first look at the demand side.

Exhibit 4 shows the share of foreign equity investors in Germany, Great Britain, Japan and the US. It illustrates that capital markets were only slightly
internationalised at in the beginning of the 1990s. Since then, the share of foreign investors on international markets has increased significantly. More and more investors are using foreign equity markets. The US stands out: its international share is relatively small. However, the total amount of foreign investments in the US in the year 2000 was about three times higher than in Great Britain. The high percentage of foreign equity investments in Great Britain can be traced to the success of the Alternative Investment Market (AIM), a sub-market of the LSE launched in 1995. In general, the use of foreign markets has been facilitated by the emergence of electronic trading systems.iii The automation of the trading processes facilitates security trading around the world at high speed and low cost.

Exhibit 4: Share of foreign equity investors


Exhibit 5 shows the turnover of foreign shares on the major stock exchanges of the selected countries. This is the turnover of shares at a stock exchange from companies that are not incorporated in the country of the stock exchange. The ratio also reveals
a growing integration of markets: Germany had just two percent of the total share turn-over coming from foreign shares in 1990 (10,709 US dollar). A decade later, 15 percent of share turnover in Germany can be assigned to foreign shares (321,323 US dollar). In August 2007 the ratio was 13 percent (344,170 US dollar). The LSE already had a very high turnover of foreign shares in the 1990s. About 45 percent (262,064 US dollar) of LSE total turnover came from trades with foreign shares in 1990. However, the ratio also increased to about 60 percent (2,669,122 US dollar) in 2000 but went back down to 41 percent (4,277,166 US dollar) in 2007. NYSE’s turnover ratio of foreign shares increased from about five percent (80,600 US dollar) in 1990 to about nine percent in 2007 (4,277,166 US dollar). The relative values for France stay rather constant around three percent. So do the relative values for Japan. However, the absolute trading volume of foreign shares increased considerably at the OECD’s largest stock exchanges.

<table>
<thead>
<tr>
<th>Year</th>
<th>Germany</th>
<th>France (Euronext)</th>
<th>Great Britain</th>
<th>United States</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>10,709</td>
<td>4,598</td>
<td>262,064</td>
<td>80,600</td>
<td>1,232</td>
</tr>
<tr>
<td>1995</td>
<td>13,802</td>
<td>3,616</td>
<td>626,863</td>
<td>341,996</td>
<td>1,039</td>
</tr>
<tr>
<td>2000</td>
<td>321,323</td>
<td>10,390</td>
<td>2,669,122</td>
<td>1,986,296</td>
<td>627</td>
</tr>
<tr>
<td>2007</td>
<td>344,170</td>
<td>27,136</td>
<td>4,277,166</td>
<td>4,072,594</td>
<td>2,769</td>
</tr>
</tbody>
</table>

**Exhibit 5: Turnover of foreign shares in million US dollar**

*Data Sources: DAI Factbook 2009; data for Canada not available*

Let us finally look at the company level data. The growing use of foreign markets by companies can be shown by looking at the primary market comparing the equity issues of companies outside their country of incorporation. Exhibit 6 shows the total amount of equity issues and the percentage of equity issues relative to GDP from French, US American, German, British, Canadian and Japanese companies on foreign marketsiv from 1975 to 2007.
This data also points to an increasing usage of foreign markets: in the mid-1970s, companies only took limited advantage of foreign capital markets. Significant equity issues do not exist until the middle of the 1980s. The total amount of equity issued from companies out of the six countries on other markets than their home markets was 1,781 million US dollar in 1980. Japanese companies had the highest share of the sample’s foreign equity issues during the 1980s (with about 30 percent), indicating that the Japanese capital market could not satisfy the capital demands already during the 1980s. US companies had the second highest share with about 20 percent. In 1990, the total amount issued was 23,592 million US dollar and in 2008 the companies from the six sample countries raised 167,462 million US dollar outside their country of
incorporation. In most years, US companies have the highest share of equity issues on foreign markets since 1990.

The presented data reveals that financial markets have experienced an internationalisation process during the last two decades. Companies increasingly use international markets to raise capital. Moreover, investors have started to hold shares from companies all over the world. Share- and stakeholders interested in financial data are distributed all around the world – the financing and investment business today is global for many firms. The more the markets are globalised, the higher is the demand for globally comparable rules (Tweedie and Seidenstein 2005). This development is an important trigger for the convergence of accounting rules and will be discussed in the next section.

3 Comparable accounting rules: Supply, demand and regulation in globalised financial markets

The increasing use of international capital markets changed the demand for and the supply of financial reports. Investors demand comparable financial reports, with a focus on providing useful information for making financial decisions and companies face the challenge to participate in several institutional settings with the aim to have a competitive, cost-effective and reliable reporting system in a cross-border trading environment (Ruder et al. 2005). Information accounting rule sets, historically prevailing in Anglo-American countries, supposed to lower the information asymmetries more efficient than the Continental-European model. Hence, MNE supply investors with financial reports on the basis of international accepted
reporting rules, even if this is costly and time consuming, particularly if they have to prepare local GAAP accounts as well. These developments lead as well to a pressure on national regulators (Flower 2004; van Zandt 2005). Especially, the institutional arrangements in insider countries do no longer match with the new demand from companies and investors for information accounting rule sets. This leads to an inefficiency of the regulatory environment and puts pressure on national governments. At least for listed companies group accounts, a similar demand for and supply of financial information evolves worldwide.\textsuperscript{v} In the following we will look closer at the economics that govern the behaviour of the mentioned actors in a globalised world: investors, companies and regulatory actors.

3.1 The viewpoint from investors and companies

MNEs have several economic incentives to apply international accepted accounting standards. The pressure arrives mainly from the markets supplying financial resources. The competition on global capital markets increased the demand for comparable, high quality, investor orientated accounting standards. Companies have to take the claims of investors into account if they want to be successful in raising capital (Shleifer and Vishny 1986; Sikka 2001).

An important point for companies to demand uniform accounting standards is the reduction in the cost of capital due to the appliance of the same accounting standards. The costs of equity capital are composed of several factors, e.g. agency costs and the cost of adverse selection (Jensen and Meckling 1976; Healy and Palepu 2001).
One important component is the return assumption of investors, which includes a risk premium resulting from agency, adverse selection and monitoring costs (Perridon and Steiner 2009). If this risk premium can be reduced, the cost of capital can be lowered. This can be achieved by lowering information asymmetries between the company and worldwide investors, e.g. by international comparable financial reports. Another factor reducing the premium is extending the basis of potential investors and therewith higher the liquidity of capital markets. Higher market liquidity reduces the transaction costs investors expect when selling their shares (Engel et al. 2007).

Especially, institutional investors demand transparency in financial reports to lower analysing-costs. This is achieved through an enhanced comparability of available investments, lower cost for investors to collect information and a higher reliance on the presented financial data. Again the demand for a company’s share increases, inducing a higher share price and a lower cost of equity capital for the listed entity. A crucial point is that companies gain legitimacy on regional and global markets with the appliance of international accepted accounting standards (Chua and Taylor 2008). Moreover, worldwide investors better understand the financial reports and are aware of possibilities for companies to brighten the data. Hence, all investors are able to discount the reported figures in a proper way and to identify the expected return of their investment. This is different for reports on the basis of local GAAP. National investors know better if the discounting is appropriate. Foreign investors might have difficulties to understand the prospectus of a company and thus insist on a higher
risk premium or do not invest at all in these markets (Nicolaisen 2005). Local investors are favoured if companies only use local GAAP. Furthermore, financial numbers that very significantly just because of the usage of different accounting sets make investors doubt in the quality of the financial reports. This lowers the worldwide attractiveness of company’s shares and hence the deepness of the whole capital market.

Additionally, higher transaction costs for companies which have to prepare two sets of consolidated accounts induce a demand for one single set of accounting standards. MNE have a high interest in applying only one set of accounting rules to access markets worldwide without being obliged to create different financial reports. The desirable attributes for accounting standards are mostly associated with standards from Anglo-American economies (La Porta et al. 1998; Volmer et al. 2007). Hence, especially international listed companies from Continental-European countries often prepared two sets of consolidated financial reports due to requirements form capital markets outside their jurisdiction. But not only cross-listed companies apply international standards. In fact, even before member states of the EU allowed or demanded financial reports on the basis of international accepted accounting standards, larger companies voluntarily prepared IFRS and US GAAP accounts. For example, the French industrial enterprise Saint-Gobain switched from local GAAP to US GAAP already in 1970. As a consequence, such companies had to prepare two sets of consolidated accounts: one meeting the regulatory demands of their country of incorporation, one to meet the demands of investors. Entities who
prepared two sets of consolidated accounts suffered higher disclosure costs. These include costs for accounting personnel and auditors. Moreover, MNE have to consolidate financial reports from subsidiary companies located in various countries each underlying different national jurisdictions (Tweedie and Seidenstein 2005). This is of course a time consuming and costly procedure. Furthermore, the internal comparability and the connection of financial and management accounting is less problematic when all subsidiaries prepare accounts on the basis of the same standards (Kahle 2003). In consequence, MNEs have a reasonable interest in demanding the acceptance of IFRS or US GAAP in their home countries.

Looking from an organisational viewpoint scholars argue, that firms are in a way forced to model their accounting system on the accounting system of other companies being (more) successful in raising capital (Coffee 2002). To gain legitimacy companies can also cross-list and therewith adapt another regulatory regime. The adoption of a foreign institutional setting can be explained with the neo-institutional concept of coercive isomorphism (DiMaggio and Powell 1983): organisations absorb the structures of other organisations being in a leading position. In our context the role models are listed companies with high market capitalisation and international activity. Companies experience the coercive pressure from “other organisations on which they depend and [from] the society in which the company works” (DiMaggio and Powell 1983). The “society” in which companies “work” has changed during the last two decades. This induces a changing institutional surrounding for companies with the necessity of adaption.
Overall, listed companies as competitors for funds use (and request) international accepted (information) accounting standards mainly for two reasons: to reduce their cost of capital and to reduce transaction costs (Jayaraman et al. 1993; Hail and Leuz 2006). From the perspective of a MNE, there is a clear pressure to use investor orientated accounting standards and to demand one set of financial reporting standards. Larger companies are commonly active on global markets and hence they want to or have to adopt the leading rule set. This is due to market pressure, mainly to reduce the cost of capital and the transaction costs.

3.2 Responses of national regulators

The pressure to accept or use accounting standards with a focus on decision usefulness (information accounting) does not only extend to companies but also to regulatory authorities. Especially in Continental-European countries, a pressure on national regulators to accept international accounting standards has emerged during the last decades. Moreover, not only the rules but the institutional setting of accounting systems is affected. Investors and companies have more confidence in rules set by private, professional bodies; giving these bodies the highest legitimacy (Rodrigues and Craig 2007). Private standard setters, like the International Accounting Standards Board (IASB), suppose to set the most efficient, high quality accounting rules. Here we see a second dimension of the harmonisation process. Not only the rule sets but as well the organisation, meaning the institutional set-up, of accounting systems experience a pressure to harmonise.
We can differentiate between two triggers for governments to change the accounting regulation: (1) Lobbing from firms, investors and stock exchanges and (2) the self interest from the nation states to change the regulatory setup and therewith strengthen the national capital market and firms in the international competition to increase countries’ welfare. The first point is quite obvious considering the described demands of firms and investors. Since the flow of capital has been liberalised these actors put pressure on national regulators to accept or enact information accounting rule sets.

However, the second trigger for national governments to adjust accounting regulation is, that not only companies look for cheap capital but states and stock exchanges compete for companies and (international) investors as customers and tax payers. Efficient, strong and liquid capital markets are the fuel for economic growth (Nicolaisen 2005; Healy and Palepu 2001). Nation states in the OECD experience the force to keep up with the prevailing developments in accounting practice. National politicians and regulatory authorities, especially from countries with a former underdeveloped capital market, undergo a pressure to enhance the comparability of financial reports. This supposed to increase investor protection and improve the allocation of capital on global markets (Zarzeski 1996). Thus, accounting harmonisation has a general welfare aspect for national regulators.
Other important actors, considering regulatory authorities, in the process of demanding financial reports on the basis of international reporting standards are national stock exchanges. They compete for market shares and investors. Investors tend to invest where the best products and the lowest transaction costs are offered (Domowitz et al. 1998). The more companies list at an exchange the higher economies of scale can be achieved. To stay in a leading position the world largest exchanges permanently set up innovative financial products to satisfy investors and companies needs (Zimmermann et al. 2008). Furthermore, stock exchanges demand investor oriented accounting standards and high disclosure requirements and are thus important actors in the process of accounting harmonisation. The Deutsche Börse AG for example demanded financial reporting according to international accepted accounting standards for the segment Neuer Markt already in 1997. The London Stock Exchange allowed the issue of annual reports on the basis of IFRS for the Alternative Investment Market (AIM) already in 1995 (Fisher and Bewsey 2003). As well in 1995 International Organisation of Securities Commissions (IOSCO) and the International Accounting Standards Committee (IASC, precursor of the IASB) envisaged that the IASC standards would be accepted by the stock exchanges for accounts of foreign companies. Today this is the case for all major stock exchanges in our six sample countries.

Nation states follow different paths in the convergence process, but they basically have two options to adjust local accounting laws: (1) to adjust local GAAP or (2) to adapt international reporting standards. Germany is a good example using both
possibilities. With the enactment of the Kapitalaufnahmeerleichterungsgesetz (KapAEG), the German government decided to accept consolidated accounts on the basis of international accepted reporting standards in 1998. Moreover, a private standard setter, the Accounting Standard Committee of Germany (ASCG), was established. The foundation can be seen as a move towards information accounting standard setting model. The adaption of the local GAAP (Handelsgesetzbuch, HGB) is observable in the current enactment of the Bilanzrechtsmodernisierungsgesetz (BilMoG) in May 2009. The BilMoG modifies the HGB and approaches the law to the IFRS, e.g. by allowing the recognition of own produced intangible assets. The German government stresses that the law strengthens local GAAP in the competition with international reporting standards and that it enhances the comparability of financial reports prepared on the basis of HGB with IFRS reports (Bundesjustizministerium 2009).

Similar developments can be observed in other countries. In Japan the private standard setter Accounting Standards Board of Japan (ASBJ) was set up in 2001 with the aim to create high quality accounting standards comparable to IFRS and US GAAP. A convergence project between the ASBJ and the IASB was set up in 2005. In France the state created the public standard setting body with private influence, the Comité de la Réglementation Comptable (CRC), and enacted a law to accept financial reports on the basis of international accounting standards in 1998. However, the application was subject to strict conditions, to be set by the CRC, like the translation of standards into French and the conformity of standards with EU law. This decree
was never published by the CRC. Therefore, French companies were not allowed to prepare consolidated accounts on the basis of international accounting standards instead of national law until Regulation 1606/2002 came in force in 2005 (Delvaille et al. 2005). In the UK even single accounts can be prepared on the basis of IFRS and UK GAAP is not mandatory for any British firm since 2005. The Canadian standard setter, Accounting Standards Board (AcSB), decided in 2006 to require IFRS for all publicly accountable profit-oriented enterprises beginning in 2011. Even the US Security and Exchange Commission (SEC) recently proposed a roadmap towards using IFRS for US issuers beginning in 2014. This shows that national regulators react to the global developments but that not all governments react with the same speed, intensity and commitment.

In the environment of the globalised world nation states are concerned about losing competitiveness of their local markets. MNE and investors demand information accounting rule sets. Moreover, not only the rule sets underlie a pressure to become similar. As well the institutional set-up of accounting systems comes under pressure. Investors seem to have more confidence in rules set by private bodies. To strengthen the position of the national financial centre, states gave away their responsibility to private bodies. We observe a trend towards transnationalisation of the standard setting process. In this process, the role of the state diminishes as national (public) regulators fail in providing necessary resources and technical expertise for creating accounting standards appropriate to meet global reporting demands. Hence, nation states gave away their influence on accounting rules (at least) for listed companies.
As recent developments show a transformation of statehood in accounting regulation can be observed (Zimmermann et al. 2008). Private bodies, like the IASB, are today accountable for setting accounting standards.

4 Concurrence of globalisation and accounting harmonisation

The coalescence of the corporate world was argued to result in a pressure to harmonise accounting systems. We will now present some empirical evidence for a correlation of globalisation and accounting harmonisation. After looking at institutional changes in the accounting systems we will show the rising usage of IFRS and US GAAP in the OECD since the beginning of the 1990s, by depicting the ratio of total assets from users of IFRS and US GAAP relative to total assets of local GAAP users from listed companies in the OECD countries.

To show that the development of financial system and the accounting system are connected, we measure globalisation with an index calculated out of the data presented in section two and extract changes in accounting regulation from laws and regulation along with secondary literature. We will not describe the country cases here in greater detail. For a detailed description of the changes in laws an organisational structures see Zimmermann et al. (2010) and Gadinis and Jackson (2007). The changes in laws and regulation are an incremental development (Zimmermann et al. 2010). As the index will show, the financial globalisation is an incremental process as well. Recent scholarly work assumes that the financial system of a country is most important for the development of its financial reporting system
(Nobes 1998; Ball 2001). Leuz and Wüstemann (2004) even see the accounting system as a subsystem of the financial system. Hence, we hypothesise that the accounting system and the financial system develop in a coevolutionary process. A high growth period of globalisation should be followed by changes in accounting regulation. Moreover, the accounting systems should show the tendency to converge due to the coalescence of financial systems, which leads to a more homogeneous demand structure of stakeholders.

The influence of globalisation on the organisation of accounting regimes started already during the 1970s, when first changes in the organisation of accounting regimes were observable. To inquire into the concurrence of globalisation and accounting harmonisation we use the following approach: We first calculate annual globalisation growth values for each of the six sample countries (Canada, Great Britain, US, France, Germany, and Japan) and for the six countries in total from 1970 to 2007. The globalisation growth value is determined by calculating the unweighted average of the annual percentaged changes in the FDI flows and -when available-, the value of cross-border M&A, the share of market capitalisation to GDP, the stock market value traded to GDP and the share of foreign equity investors. We then calculate the geometric means of the growth rates (GR) for periods of five years (the last period comprises only three years from 2005 to 2007). The resulting average growth value for five year periods allows identifying periods in which the globalisation progressed with different speed. We generated four different growth clusters for the five year time periods: no or negative growth ($GR \leq 1$), moderate
growth ($1<GR\leq1.1$), high growth ($1.1<GR\leq1.25$) and very high growth ($GR>1.25$).

Exhibit 7 shows the calculation of the US globalisation growth rate exemplarily for the period 1995 to 1999.

<table>
<thead>
<tr>
<th>Annual Growth Rates (1.00 = no Change in Growth)</th>
<th>1995</th>
<th>1996</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
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<tr>
<td>FDI Flow</td>
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<td>1.20</td>
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<td>Market Capitalisation relative to GDP</td>
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<td>1.21</td>
<td>1.19</td>
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<tr>
<td>Share of Foreign Equity Investors</td>
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<td>n.a.</td>
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<tr>
<td>Stock Market total Value Traded relative to GDP</td>
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<td>1.32</td>
<td>1.35</td>
<td>1.22</td>
<td>1.33</td>
</tr>
<tr>
<td>Globalisation Growth (unweighted average)</td>
<td>1.25</td>
<td>1.31</td>
<td>1.25</td>
<td>1.56</td>
<td>1.27</td>
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<tr>
<td>Geometric Mean of the Growth Rates from 1995 to 1999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>1.32</strong></td>
</tr>
</tbody>
</table>

**Exhibit 7: Globalisation Index calculation for the US (1995-1999)**

*Source:* Authors Own, Data see Section 2

We observe the highest growth rates for the periods 1985-1989, 1995-1999 and 2005-2007, whereby the highest average annual growth rate is 39 percent in the period 1985-1989. The mean growth rate for the six sample countries from 1970 to 2007 was about 13 percent. The variance is relatively high with 8.4 percent. This shows that there are years with low or negative growth and years with high growth rates. However, we assume that changes in the standard setting process and increasing disclosure requirements, ones they are initiated, will not be revised if growth rates fall for several periods. Comparing the countries, the US has the highest average growth rate with 16 percent while Germany has the lowest with nine percent.

To show the correlation between the globalisation and accounting harmonisation we illustrate the growth speeds and milestones in accounting harmonisation for the defined time windows in Exhibit 8. Developments at the international level are named in the first column together with the aggregated growth rates from all six sample countries. Major events in the development of accounting harmonisation are
displayed in bold letters (concerning the importance of reforms see Zimmermann et al. 2010). We identified 40 events in total from 1970 to 2007, whereby 12 events are at the international or transnational level. Moreover, 16 events are classified as of particular importance. First of all it should be noted that countries with an accounting system which can be classified as investor orientated (Canada, Great Britain and USA) had fewer changes in their standard setting processes, disclosure laws and organisational structures during the last 40 years. Especially, the US accounting system has been relatively stable during the last decades.

We see a time lag in the connection of the coalescence of the corporate world and the harmonisation of accounting systems. Changes in (or the enactment of new) laws, however, seem to follow globalisation developments with a delay. Moreover, the absolute level of globalisation seems to be important. In the 1970s and 1980s, developments were fewer and mostly not so incisive for the systems. However, these changes have been the basis for the developments since the middle of the 1990s. The effect of globalisation on accounting harmonisation becomes evident on the international level. Major developments took place after periods of high growth rates. In the periods between 1990 and 1994 and between 2000 and 2004, respectively, important events can be observed for the development of today’s leading role of IFRS. Looking at the 16 events classified as major events, we also see a concurrence of globalisation and accounting harmonisation. Eight events are observed after periods of high and very high growth, respectively. Moreover, four events are observed at the end of very high growth rate periods. At the national level, legislators in
Germany and France issued laws or degrees for the acceptance of IFRS at the end of the high growth period from 1995 to 1999. Moreover, all three insider economies set up a private standard setting body at the end or after the high globalisation phase at the end of the 1990s: Germany established the *Deutsche Rechnungslegungs Standards Committee* (DRSC) in 1998, France the CRC in 1998, as well, and Japan founded the ASBJ in 2001. Also, the latest phase of high globalisation growth from 2005 to 2007 has initiated harmonisation developments. Canada decided in 2006 to use IFRS from 2011 on, the USA allowed to use IFRS for foreign private issuers from 2007 on and discussed in 2008 to prescribe usage of IFRS by all SEC registered companies beginning in 2014 (SEC, 2008). Germany enacted the BilMoG in 2009, introducing elements of decision usefulness into the HGB, thereby approximating German law to IFRS (Fülbier and Gassen 2007). Japan launched a project to adjust local GAAP to IFRS until 2011.
<table>
<thead>
<tr>
<th>Periods</th>
<th>Aggregate of sample</th>
<th>United States</th>
<th>Canada</th>
<th>United Kingdom</th>
<th>Germany</th>
<th>France</th>
<th>Japan</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>o</td>
<td>- Foundation IASC (1973)</td>
<td>+</td>
<td>- Canadian Business Corporations Act (1975)</td>
<td>o</td>
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<td>o</td>
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<tr>
<td></td>
<td></td>
<td>- Advisory Council (1994)</td>
<td>+</td>
<td>- MJDS (1991)</td>
<td>o</td>
<td></td>
<td>o</td>
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<td></td>
<td>o</td>
<td></td>
<td>o</td>
<td></td>
<td>o</td>
<td></td>
<td>+</td>
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<tr>
<td></td>
<td></td>
<td>- EC 1606/2002</td>
<td>o</td>
<td></td>
<td>o</td>
<td></td>
<td>o</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Norwalk A. (2002)</td>
<td>o</td>
<td></td>
<td>o</td>
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<td>o</td>
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<td></td>
<td>o</td>
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<td>o</td>
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<td>o</td>
</tr>
</tbody>
</table>

Exhibit 8: Concurrence of globalisation and accounting harmonisation
Major events in bold; o GR≤1; + 1<GR≤1.1; ++ 1.1<GR≤1.25; +++ GR>1.25.
Source: Authors Own
The rising usage of IFRS and US GAAP in the OECD since the beginning of the 1990s will be considered next. We capture this phenomenon by comparing total assets of listed firms that use international reporting standards with total assets of firms that use local GAAP. Companies outside the USA started to prepare financial reports on the basis of international accepted reporting standards in the beginning of the 1970s. Daimler-Benz from Germany (1996), Saint-Gobain from France (already 1970) or Glaxo Wellcome (1995) from Great Britain can be named as pioneers in this process. All of them presented additional consolidated accounts on the basis of US GAAP. However, a significant increase of published financial statements prepared in accordance with IFRS or US GAAP can only be observed since the 1990s. Exhibit 9 depicts the ratio of total assets from users of IFRS and US GAAP relative to total assets of local GAAP users from listed companies in the OECD countries (US firms are excluded because the usage of US GAAP is mandatory for all public listed companies in the USA).

Exhibit 9: Total assets of US GAAP and IFRS users relative to total assets of non users from listed companies in the OECD; US firms excluded.
Data Source: Bureau van Dijk Osiris Database
Before 1990, voluntarily issued financial reports on the basis of US GAAP or IFRS cannot be measured; the above mentioned companies had not set a trend. It can also be argued that the globalisation had only little influence on the usage until then. The importance of international accepted accounting standards, however, constantly rose until 2003. Due to the legal prescription for listed companies in the EU to prepare consolidated accounts on the basis of IFRS from 2005 on the ratio substantially increased since 2004. The implementation of the IAS Regulation had various political and economical reasons (see Zimmermann et al. 2008), but one of the most important triggers surely was financial globalisation. It is noteworthy that already after the issuance of Regulation 1606/2002 many firms did no longer hesitate to switch to IFRS. The switching costs were no longer avoidable and could thus be seen as decision-irrelevant. Hence, these costs no longer hinder firms to convert their accounting system to international reporting standards.

Over 7,000 companies in the EU were required to use IFRS in 2005. However, more and more firms from outside the EU switched voluntarily to international reporting standards in recent years. The ratio increased even further from 2006 until 2008. In 2006 the ratio value for the whole OECD was 2.39 and in 2008 the value was 7.68. Today the vast majority of listed firms throughout the OECD prepare their financial reports on the basis of international reporting standards.

5 Conclusion

Canada, France, Germany, Great Britain, Japan and the USA have experienced different waves of globalisation since the beginning of the 1970s. Due to these
developments, companies increasingly got active on international (capital) markets and have subsidiaries around the globe. These developments are also crucial for accounting systems: Indeed, we showed that there is a concurrence of globalisation and accounting harmonisation in the six sample countries. Financial globalisation thus seems to be an important driver for the convergence of accounting systems.

Globalisation put pressure on MNEs to adopt the accounting rules used by leading organisations in the process of raising equity capital. This pressure arises because markets are fully integrated and companies need not only to attract local but worldwide investors. They search for the most liquid markets to lower their cost of capital. Investors demand comparable, information accounting rule sets to be able to discount financial numbers to calculate their expected returns. Local GAAP privileges national investors and is thus not able to minimize information asymmetries. Foreign investors might have difficulties to understand the prospectus of a company and thus insist on a higher risk premium or do not invest at all in these markets. Hence, companies who want to attract international investors, have to prepare financial reports on the basis of international accepted accounting standards. If companies have to use more than one rule set transaction costs (reporting costs) will rise. Therefore, they demand national regulators to accept international accounting standards. The pressure on national regulators does not only arise from the lobbying by companies directly. Moreover, the liberalisation of capital flow and the financial globalisation started a severe competition between capital markets to attract companies and investors. Nation states are required to adjust the regulatory system to ensure the competitiveness of the domestic market. Otherwise domestic
companies might migrate to foreign markets and foreign investors avoid domestic markets. An efficient and liquid capital market is important to increase countries welfare.

The globalisation does not only put the rule sets under pressure but as well the institutional setting of accounting systems. Accounting standards set by private, professional standard setting bodies have a higher legitimacy than rules set by state law. Therefore, we observed a self-transformation process, in particular in Continental-European countries. Nation states gave away competencies in the standard setting process and assigned this task to private or transnational bodies. This does not only hold for Germany and France, part of the European Union, but is with a little time delay as well observable in Japan. As we have shown in Exhibit 8 the pressure on the institutional setting is especially large at the end and after periods with high globalisation growth rates, respectively.

Overall, the globalisation induces market forces that strongly promote the harmonisation of accounting systems. We find that the sample countries have experienced different waves of globalisation since the beginning of the 1970s and that there is indeed a concurrence of globalisation and accounting harmonisation. We showed that financial globalisation is an important driver for the convergence of accounting systems and that the accounting system and the financial system develop in a coevolutionary process. However, we see a time lag in the connection of the coalescence of the corporate world and the harmonisation of accounting systems.
Changes in (or the enactment of new) laws seem to follow globalisation developments with a delay.

As the latest developments show, there is a clear trend towards further diffusion of IFRS in the area of group accounts. Japan decided to adjust local GAAP towards IFRS until 2011. Canada proposed in 2006 to use IFRS beginning in 2011. With the SEC release no. 33-8879 from 2007 and release 2008-184 from 2008 even the USA proposed a roadmap towards using IFRS for US issuers beginning in 2014. If the SEC sticks to this decision the convergence towards the usage of a single set of accounting standards issued by a transnational body, the IASB, would be possible. Regardless the current financial crisis, the expected further integration of capital markets will certainly support the convergence of accounting regulation.
Notes

i The focus of information accounting rule sets is on presenting relevant rather than reliable information, i.e. the aspect of decision usefulness is more pronounced than the general principle of prudence. The national General Accepted Accounting Principles (GAAP) of France, Germany and Japan had historically a focus on reliable accounts whereas US GAAP and the IFRS have a clear focus on decision usefulness and will thus be named information accounting rules sets in the following.

ii Concerning their financial systems, states can be subdivided into two major categories, the (more market-based) outsider-control-systems and the (more bank-based) insider-control-systems (Franks and Mayer 1994). Other classifications lead to nearly the same cluster of countries. La Porta et al. (1997) classified countries regarding their legal systems and Hall and Soskice’s (2001) approach of the “Varieties of Capitalism” differentiate between liberal market economies and coordinated market economies.

iii The first electronic stock market was the NASDAQ, already set up in 1971.

iv Example: A company incorporated in France issues equity on the US market. Main and parallel markets are included.

v Due to country specific institutional setups (inducing path-dependencies) there is persistence in nation-specific regulation for individual financial statements observable, see e.g. Heine and Kerber (2002). This can be traced back to deviant demands of private and public firms and different economic functions of single and group accounts (Goncharov et al. 2009).

vi Transaction costs arise in economic exchanges between different actors and contain bargaining, policing and enforcement costs.

vii This paper relies on observing concurrent phases of increasing transnational economic activities and accounting change. It would also be possible to give quantitative evidence on globalisation as driver for harmonising financial reporting. However, we refrained from the latter approach due to modelling considerations (e.g. level effects of globalisation, differential time lags of driver).

viii Due to data limitation not all proxies are available in every year. For the years 1970 to 1977 the growth value only consists of FDI growth rates.
References


